

**Tulsian's**  
**BUSINESS LAWS**  
**[SECTION A]**  
*for*  
**CA Foundation Course**  
**Third Edition**



# **Tulsian's**

# **BUSINESS LAWS**

## **[SECTION A]**

### *for*

## **CA Foundation Course**

### **Third Edition**

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**McGraw Hill Education (India) Private Limited**

Published by McGraw Hill Education (India) Private Limited  
444/1, Sri Ekambara Naicker Industrial Estate, Alapakkam, Porur, Chennai 600 116

**Tulsian's Business Laws for CA Foundation Course, 3e**

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This edition can be exported from India only by the publishers,  
McGraw Hill Education (India) Private Limited.

1 2 3 4 5 6 7 8 9 D103074 22 21 20 19 18

Printed and bound in India.

**Print-Book Edition**

ISBN (13): 978-93-5316-315-0

ISBN (10): 93-5316-315-3

**E-Book Edition**

ISBN (13): 978-93-5316-316-7

ISBN (10): 93-5316-316-1

Director—Science & Engineering Portfolio: *Vibha Mahajan*

Senior Portfolio Manager: *Suman Sen*

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Typeset at APS Compugraphics, 4G, PKT 2, Mayur Vihar Phase-III, Delhi 96, and printed at

Cover Designer: Creative Designer

Cover Image Source: Thinkstock

Cover Printer:

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CIN: U22200TN1970PTC111531

Toll Free Number: 1800 103 5875

# Preface

We are thankful to the Readers and Teachers for their response and encouragement given to the Previous Editions. This edition is thoroughly revised and substantially expanded; all chapters have been updated and expanded.

## Salient Features

The book adopts a fresh and novel approach to the study of Accountancy for the students of CA Foundation Course. It has been written in a teach yourself style strictly following a student-friendly approach, and is essentially meant to serve as a tutor at home. Among the important features of this book include:

### COVERAGE OF THE BOOK

Broadly the coverage would enable the reader in understanding the basics of: (1) The Indian Contract Act, 1872 (2) The Sale of Goods Act, 1930 (3) The Indian Partnership Act, 1932 (4) The Limited Liability Partnership Act, 2008 (5) The Companies Act, 2013

### PEDAGOGICAL FEATURES

<b>Simple Language</b>	The Text is presented in the simplest language "meant to serve beginners".
<b>Heading for each Paragraph</b>	Each paragraph has been arranged under a suitable heading for easy retention of concepts.
<b>Tabular form</b>	Wherever possible the text matter relating to a particular topic/sub-topic has been presented in a Tabular Form.
<b>Eye-catching Screens</b>	All important equations, formulae, figures and practical steps have been presented in screen format to catch the eye.
<b>Uniform Format of Chapter</b>	Each chapter has been uniformly organised under suitable headings, viz., Text Supported by Suitable Illustrations, Practical Problems.

### DISTINCTIVE FEATURES

<b>Important Distinctions</b>	Over 50 distinctions have been provided for a better comparative study.
<b>Exhibits</b>	Over 75 exhibits to acquaint students with various accounting treatment and formats.
<b>Illustrations</b>	Over 500 Illustrations have been provided for a better understanding of the text.
<b>Practical Problems</b>	Over 500 solved problems.
<b>Appendix 1</b>	<b>Tulsian's Revision One Day before Examination</b>
<b>Appendix 2</b>	<b>Tulsian's Correct or Incorrect Questions</b>
<b>Appendix 3</b>	<b>Tulsian's Practical Problems</b>
<b>Appendix 4</b>	<b>Tulsian's Model Test Papers</b>
<b>Appendix 5</b>	<b>CA Foundation Examination Papers</b>



# Acknowledgements

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We wish to express our sincere thanks to several individuals who have been a source of inspiration and support personally and professionally including Dr. R. P. Tulsian, Dr. M. M. Goyal, Dr. Rajeev Goyal, Dr. V. K. Aggarwal, Dr. V. P. Bansal, Dr. Vibha Jain, Dr. S.C. Gupta, Dr. Naresh Gupta, Dr. Amit Singhal, Dr. J.B. Gupta, Dr. Madhu Gupta, Dr. Sushma Aggarwal, Dr. Renu Gupta, Dr. Manju Gupta, Dr. C.P. Gupta Dr. S. Z. H. Zaidi. CA M.K. Aggarwal, CA S.K. Aggarwal, CA N D Gupta, CA Naveen Gupta, CA Anil Jindal, CA Madhu Sudan Goyal, CA Vinod Aggarwal, CA Sunil Gupta, CA Arun Jain, CA Virender Aggarwal, CA. S.K. Gupta, CA Ishwar Khemka, CA Prem Bansal, CA Ashish Gupta, CA M.K. Sharda, CA Rajeev Rastogi. CA Atul Gupta, CA Kuldeep Bhardwaj, CA Neeraj Chabra, CA Kishore Paul, CA Pradeep Narang, CA S.K. Gupta, CA R. Devarajan, CA Tapas Dutta, CA Arnav Chakrabarty, CA Seema Gupta, CA Shilpa Aggarwal, CA Vishal Pandey, Prof. J.P. Sharma, CA Pallavi, CA Antima Jain, CA Piyush Tulsian, CA Swati Tulsian, CA Piyush and CA Prarthana Mittal, CA Aman Mittal, CA Piyush Sharma, CA Mohit Gupta, Sheena Tulsian

Special word of thanks is also due to our favourite students **Pranav and Arushi** who provided incisive comment and useful feedback.

We must conclude that this book would never has been written without the support, encouragement and prodding of our family members. Many thanks to them.

Any criticisms or suggestions for further improvement of the book will be gratefully acknowledged and appreciated. Please feel free to write to us at [\*\*queryfortulsian@gmail.com\*\*](mailto:queryfortulsian@gmail.com)

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# Syllabus

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## CA FOUNDATION COURSE SYLLABUS PAPER – 2 : BUSINESS LAWS [Section A]

Time 3 Hours

Marks-100

**Objective:**

To develop an understanding of significant provisions of select business laws and acquire the ability to address basic application-oriented issues.

S. No.	Contents	Relevant Chapter of the Book
1.	<b>The Indian Contract Act, 1872:</b>	1-11
	An overview of Sections 1 to 75 covering the general nature of contract, consideration, other essential elements of a valid contract, performance of contract, breach of contract, Contingent and Quasi Contract.	
2.	<b>The Sale of Goods Act, 1930:</b>	12
	Formation of the contract of sale, Conditions and Warranties, Transfer of ownership and delivery of goods, Unpaid seller and his rights.	
3.	<b>The Indian Partnership Act, 1932:</b>	13
	General Nature of Partnership, Rights and duties of partners, Reconstitution of firms, Registration and dissolution of a firm.	
4.	<b>The Limited Liability Partnership Act, 2008:</b>	14
	Introduction- covering nature and scope, Essential features, characteristics of LLP, Incorporation and differences with other forms of organizations.	
5.	<b>The Companies Act, 2013:</b>	
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# Meaning and Essentials of Contract

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## 1.0 WHAT IS LAW?

1. Law means a 'set of rules'.
2. Broadly Speaking, Law may be defined as the rules of conduct recognised and enforced by the state to control and regulate the conduct of people, to protect their property and contractual rights with a view to securing justice, peaceful living and social security.
3. Since the value system of society keeps on changing, the law also keeps on changing according to the changing requirements of the society.
4. There are several branches of law such as International law, Constitutional law, Criminal law, Civil law etc. Every branch of law regulates and controls a particular field of activity.

## 2.0 WHY SHOULD ONE KNOW LAW ?

1. One should know the law to which he is subject because **ignorance of law is no excuse**.
2. **Examples:** (i) *If X is caught travelling in a train without ticket, he cannot plead that he was not aware of the rule regarding the purchase of ticket and therefore, he may be excused.* (ii) *if Y is caught driving scooter without driving license, he cannot plead that he was not aware of the traffic rule regarding the obtaining of a driving license and therefore, he may be excused.*

## 3.0 WHAT IS MERCANTILE LAW (OR COMMERCIAL LAW)?

1. Mercantile law is not a separate branch of law.
2. Basically, it is a part of civil law which deals with the rights and obligations of mercantile persons arising out of mercantile transactions in respect of mercantile property.
3. It includes laws relating to various contracts, partnership, companies, negotiable instruments, insurance, carriage of goods, arbitration etc.

## 4.0 WHAT ARE THE SOURCES OF MERCANTILE LAW?

1. In India, mercantile law is basically an adaptation of the English Law with some modifications and reservations which are necessitated by the peculiar conditions prevailing in India.

2. The main sources of the Indian mercantile law are as follows.
  - (a) **English Mercantile Law** English laws are the primary sources of Indian Mercantile Law. English laws are based on customs and usages of merchants in England.
  - (b) **Indian Statute Law** The various Acts passed by the Indian Legislature are the main sources of mercantile law in India, e.g. Indian Contract Act, 1872, The Sale of Goods Act, 1930, The Indian Partnership Act, 1932, The Negotiable Instruments Act 1881, The Companies Act, 1956.
  - (c) **Judicial Decisions** The past judicial decisions of English courts and Indian courts are also one of the sources of law. Wherever the law is silent on a point, the judge has to decide the case according to the principle of equity, justice and good conscience. The past judicial decisions are followed by the courts while deciding similar cases before them.
  - (d) **Customs and Usages** The customs and usages of a trade are also one of the sources of mercantile law in India. These customs and usages govern the merchants of a trade in their dealings with each other. Some Acts passed by the Indian Legislature recognises the importance of such customs and usages. For example, Section 1 of the Indian Contract Act, 1872 provides "nothing contained therein shall affect any usage of custom of trade . . ." Similarly, Section 1 of The Negotiable Instruments Act, 1881 provides "nothing contained therein shall affect any local usage relating to instrument in an oriental language."

### 5.0 WHAT IS THE LAW OF CONTRACT?

1. The law of contract is contained in the Indian Contract Act, 1872 which-
  - (a) deals with the general principles of law governing all contracts, and
  - (b) covers the special provisions relating to special contracts like Bailment, Pledge, Indemnity, Guarantee and Agency.
2. The law of Contract is applicable not only to business but also to all day-to-day personal dealings. In fact, each one of us enters into a number of contracts from sunrise to sunset.

#### EXAMPLES OF CONTRACT

1. *When you purchase a newspaper, you enter into a contract with the vendor of newspaper.*
2. *When you purchase milk, you enter into a contract with the milkman.*
3. *When you purchase bread and butter, you enter into a contract with the vendor of bread and butter.*
4. *When you ride a bus, you enter into a contract with the transport company.*

**Note:** The general law of contract relates to the essentials of a valid contract, the rules for performance and discharge of a contract and the remedies available to the aggrieved party in case of breach of contract.

## 6.0 WHAT IS CONTRACT ?

1. According to Section 2(h) of the Indian Contract Act, 1872, "An agreement enforceable by law is a contract." In other words, an agreement which can be enforced in a court of law is known as a contract.
2. On analyzing this definition of contract, it appears that a contract must have the following two elements:
  - (a) An agreement, and
  - (b) Enforceability of an agreement.
3. In the form of an equation, it can be shown as under:

**Contract = An Agreement + Enforceability of an agreement**

Now the question arises, 'What is an Agreement?' and What is Enforceability of an agreement?

### WHAT IS AN AGREEMENT?

According to Section 2(h) of the Indian Contract Act, 1872, "**An agreement enforceable by law is a contract.**" In other words, an agreement which can be enforced in a court of law is known as a contract.

According to Section 2(e) of the Indian Contract Act, 1872, "**Every promise and every set of promises forming the consideration for each other is an agreement.**" Now the question arises, 'What is promise?' According to Section 2(b) of the Indian Contract Act, 1872, "**A proposal when accepted, becomes a promise.**"

**Example:** *X offers to sell his car for ₹ 1,00,000 to Y. Y accepts this offer. This offer after acceptance becomes promise and this promise is treated as an agreement between X and Y.*

In other words, an agreement consists of an offer by one party and its acceptance by the other. In the form of an equation, it can be shown as under:

**Agreement = Offer (or Proposal) + Acceptance of Offer (or Proposal)**

### WHAT IS AN ENFORCEABILITY OF AGREEMENT?

1. An agreement is said to be enforceable by law if it creates some legal obligation. In other words, the parties to an agreement must be bound to perform their promises and in case of default by either of them, must intend to sue.
2. In commercial or business agreements the usual presumption is that the parties intend to create legal relations.

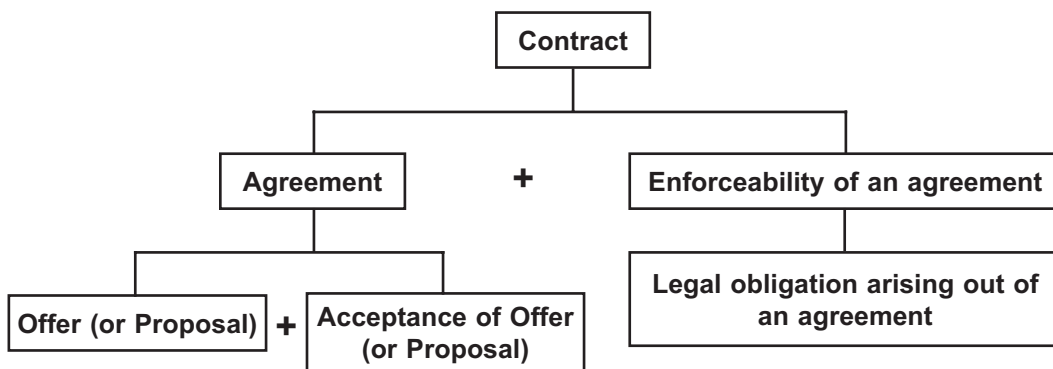
**Example:** *X offers to sell his car to Y for ₹ 1,00,000. Y accepts this offer. Such an agreement between X and Y is a contract because it creates legal obligation. In this agreement, if X refuses to sell or Y refuses to buy, the other party can file a suit in the court of law for the breach of the contract.*

3. In case of social or domestic agreements, the usual presumption is that the parties do not intend to create legal relations.

**Example:** *X invites his friend Y to a dinner and Y accepts the invitation. If Y fails to turn up for dinner, X cannot go to the court to claim his loss.*

Similarly, in case of domestic arrangements, parties to agreement do not intend to sue each other so as to make such agreements unenforceable by law, e.g. in **Balfour v. Balfour** (1919) 2 K.B. 571, a promise by the husband to pay his wife £ 30 every month was held unenforceable as the parties never intended it to be attended by legal obligations.

Thus, in the form of a graphic representation, the contract can be expressed as under:



## 7.0 THE LAW OF CONTRACT IS NOT THE WHOLE LAW OF AGREEMENTS NOR IS IT THE WHOLE LAW OF OBLIGATIONS

### "THE LAW OF CONTRACTS IS NOT THE WHOLE LAW OF AGREEMENTS."

- (a) The law of contracts is the law of only those agreements which create legal obligations (i.e. an obligation which is enforceable by law). An obligation is the duty to do or not to do certain act. In other words, the law of contract is concerned with only those agreements where the parties have the intention to create legal obligations (i.e. the parties are bound to do or not to do certain act). In business or commercial agreements, the usual presumption is that the parties intend to create legal obligations.

**Example:** *X offers to sell his car to Y for ₹ 1,00,000. Y accepts this offer. In this agreement if there is default by either party, an action for breach of contract can be enforced through a court of law provided all the essential elements of a valid contract are present in this agreement.*

- (b) The law of contract is not the law of those agreements which do not create legal obligations. In other words, the law of contract is not concerned with those agreements where the parties do not have the intention to create legal obligations. In social, domestic, moral or religious agreements, the usual presumption is that the parties do not intend to create legal obligations.



**Example:** *X invites Y to dinner. Y accepts the invitation but fails to turn up. Here, X cannot sue Y for damages because the parties to this agreement do not intend to create legal obligations.*

Thus, the whole position may be summarised as under:

Type of Agreement	Whether the law of contract covers such agreements
1. Agreements where the parties intend to create legal obligations, e.g. business agreements	Yes
2. Agreements where the parties do not intend to create any legal obligation, e.g. social agreements	No

Thus, the law of contracts is not the whole law of agreements.

### "THE LAW OF CONTRACTS IS NOT WHOLE LAW OF OBLIGATIONS."

The law of contracts is the law of only those obligations which arise out of agreements. The law of contracts is not concerned with those obligations which do not arise out of agreements. For example, obligation to maintain wife and children, obligation arising from judgment of courts, obligations arising from torts or civil wrong.

Thus, the whole position may be summarised as under:

Type of Obligation	Whether the law of contract covers such obligations
1. Obligations which arise out of agreements	Yes
2. Obligations which do not arise out of contract	No

Thus, the law of contracts is not the whole law of obligations.

## 8.0 DISTINCTION BETWEEN AN AGREEMENT AND A CONTRACT

An agreement differs from a contract in the following respects:

Basis of distinction	An Agreement	A Contract
1. What constitute?	Agreement = Offer + Acceptance	Contract = Agreement + its enforceability.
2. Creation of legal obligation	An agreement may or may not create a legal obligation.	A contract necessarily create a legal obligation.
3. One in other	Every agreement need not necessarily be a contract.	All contracts are necessarily agreements.
4. Binding	Agreement is not concluded or a binding contract.	Contract is concluded and binding on the concerned parties.

## 9.0 WHAT ARE THE DIFFERENT TYPES OF CONTRACTS?

The various bases on which the contracts can be classified are discussed below:

### CONTRACTS ON THE BASIS OF CREATION

<b>(a) Express Contract</b>	<p>Express contract is one which is made by words spoken or written.</p> <p><b>Example I:</b> <i>X says to Y "Will you buy my car for ₹ 1,00,000?" Y says to X "I am ready to buy your car for ₹ 1,00,000." It is an express contract made orally.</i></p> <p><b>Example II:</b> <i>X writes a letter to Y, "I offer to sell my car for ₹ 1,00,000 to you." Y sends a letter to X, "I am ready to buy your car for ₹ 1,00,000." It is an express contract made in writing.</i></p>
<b>(b) Implied Contract</b>	<p>An implied contract is one which is made otherwise than by words spoken or written. It is inferred from the conduct of a person or the circumstances of the particular case.</p> <p><b>Example I:</b> <i>A transport company runs buses on different routes to carry passengers. This is an implied offer by transport company. X boards a bus. This is an implied acceptance by X. Now, there is an implied contract and X is bound to pay the prescribed fare.</i></p> <p><b>Example II:</b> <i>X, a coolie in uniform picks up the baggage of Y to carry it from railway platform to the taxi without being asked by Y to do so and Y allows it. In this case there is an implied offer by the coolie and an implied acceptance by the passenger. Now, there is an implied contract between the coolie and the passenger and the passenger is bound to pay for the services of the coolie.</i></p>
<b>(c) Tacit Contract</b>	<p>A tacit contract is one which is inferred from the conduct of parties.</p> <p><b>Example I:</b> <i>Withdrawing cash through ATM</i></p> <p><b>Example II:</b> <i>Sale by fall of hammer at an auction sale</i></p>

### CONTRACTS ON THE BASIS OF EXECUTION

<b>(a) Executed Contract</b>	<p>It is a contract in which both the parties to the contract have <b>performed</b> their respective obligations under the contract.</p> <p><b>Example:</b> <i>X offers to sell his car to Y for ₹ 1,00,000. Y accepts X's offer. X delivers the car to Y and Y pays ₹ 1,00,000 to X. It is an executed contract.</i></p>
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<b>(b) Executory Contract</b>	<p>It is a contract in which both the parties to the contract have <b>still to perform</b> their respective obligations.</p> <p><b>Example:</b> <i>X offers to sell his car to Y for ₹ 1,00,000. Y accepts X's offer. If the car has not yet been delivered by X and the price has not yet been paid by Y, it is an executory contract.</i></p>
<b>(c) Partly Executed and Partly Executory Contract</b>	<p>It is a contract in which <b>one of the parties</b> to the contract has B his obligation and the <b>other party</b> has <b>still to perform</b> his obligation.</p> <p><b>Example:</b> <i>X offers to sell his car to Y for ₹ 1,00,000 on a credit of one month. Y accepts X's offer. X delivers the car to Y. Here, the contract is executed as to X and executory as to Y.</i></p>
<b>(d) Unilateral Contract</b>	<p>An Unilateral contract is one sided contract in which only <b>one party has to perform</b> his promise or obligation to do or forebear.</p>
<b>(e) Bilateral Contract</b>	<p>A bilateral contract is one in which <b>both the parties have to perform</b> their respective promises or obligations to do or forebear.</p>

### CONTRACTS ON THE BASIS ON ENFORCEABILITY

<b>(a) Valid Contract</b>	<p>A contract which satisfies all the conditions prescribed by law is a valid contract.</p> <p><b>Example:</b> <i>X offers to marry Y. Y accepts X's offer. This is a valid contract.</i></p>
<b>(b) Void Contract</b>	<p>The term 'Void Contract' is a contradiction in terms. But according to Section 2(j) of the Indian Contract Act, 1872, <b>"A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable."</b> In other words, a void contract is a contract which was valid when entered into but which subsequently became void due to impossibility of performance, change of law or some other reason.</p> <p><b>Example:</b> <i>X offers to marry Y. Y accepts X's offer. Later on Y dies. This contract was valid at the time of its formation but became void on the death of Y.</i></p>
<b>(c) Void Agreement</b>	<p>According to Section 2(g), <b>"An agreement not enforceable by law is said to be void."</b> Such agreements are <i>void-ab-initio</i> which means that they are unenforceable right from the time they are made.</p> <p><b>Example:</b> <i>An agreement with a minor or a person of unsound mind is void-ab-initio because a minor or a person of unsound mind is incompetent to contract.</i></p> <p>Thus, a void agreement never matures into a contract.</p>

<p><b>(d) Voidable Contract</b></p>	<p>According to Section 2(i) of the Indian Contract Act, 1872, "<b>an agreement which is enforceable by law at the option of one or more of the parties thereon but not at the option of the other or others</b>", is a voidable contract. In other words, "A voidable contract is one which can be set aside or repudiated or avoided at the option of the aggrieved party." Until the contract is set aside or repudiated by the aggrieved party, it remains a valid contract. For example, a contract is treated as voidable at the option of the party whose consent has been obtained by coercion or undue influence or fraud or misrepresentation.</p> <p><b>Example:</b> <i>X threatens to kill Y if he does not sell his house for ₹ 1,00,000 to X. Y sells his house to X and receives payment. Here, Y's consent has been obtained by coercion and hence this contract is voidable at the option of Y, the aggrieved party. If Y decides to avoid the contract, he will have to return ₹ 1,00,000 which he had received from X. If Y does not exercise his option to repudiate the contract within a reasonable time and in the meantime, Z purchases that house from X for ₹ 1,00,000 in good faith, Y cannot repudiate the contract.</i></p> <p><b>Note:</b> In case of voidable contract, if the aggrieved party decides to repudiate the contract, the party rescinding the contract must restore the benefit received by him under the contract to the person from whom the benefit was received and the other party is freed from his obligation to perform the contract. [Section 64]</p>
<p><b>(e) Illegal Agreement</b></p>	<p>An illegal agreement is one the object of which is unlawful. Such an agreement cannot be enforced by law. Thus, illegal agreements are always void <i>ab-initio</i> (i.e. void from the very beginning).</p> <p><b>Example:</b> <i>X agrees to pay Y ₹ 1,00,000 if Y kills Z. Y kills Z and claims ₹ 1,00,000. Y cannot recover from X because the agreement between X and Y is illegal as its object is unlawful.</i></p> <p><b>Effect on collateral agreements</b> In case of illegal agreements, even the collateral agreements become void.</p> <p><b>Example:</b> <i>If in the above example, X borrows ₹ 1,00,000 from W who is aware of the purpose of the loan, the main agreement between X and Y is illegal and the agreement between X and W which is collateral to the main agreement is also void. Hence, W cannot recover the money from X.</i></p>
<p><b>(f) Unenforceable Contract</b></p>	<p>It is a contract which is actually valid but cannot be enforced because of some technical defect (such as not in writing, under stamped). Such contracts can be enforced if the technical defect involved is removed.</p>

**Example:** *An oral agreement for arbitration is unenforceable because the law requires that an arbitration agreement must be in writing. If the oral agreement for arbitration is reduced to writing, it will become enforceable.*

### **DISTINCTION BETWEEN VOID AGREEMENT AND VOIDABLE CONTRACT**

Void agreement differs from voidable contract in the following respects:

<b>Basis of Distinction</b>	<b>Void Agreement</b>	<b>Voidable Contract</b>
<b>1. Void ab-initio</b>	It is void from the very beginning.	It is valid when made and continues to remain valid till it is repudiated by the aggrieved party.
<b>2. Which essential element of contract is missing</b>	Enforceability by law is missing.	Free consent of a party is missing.
<b>3. Enforceability</b>	It cannot be enforced by any party.	It continues to be enforceable if the aggrieved party does not repudiate the contract.
<b>4. Right of third party</b>	Third party does not acquire any rights.	A third party who purchases goods in good faith and for consideration before the contract is repudiated, acquires good title to those goods.
<b>5. Effect of lapse of reasonable time</b>	Even on the expiry of a reasonable time, it can never become a valid contract.	On the expiry of a reasonable time, it may become a valid contract if the aggrieved party does not repudiate the contract within reasonable time.
<b>6. Damages</b>	The question of damages does not arise.	The aggrieved party can claim damages.

### **DISTINCTION BETWEEN VOID AGREEMENT AND ILLEGAL AGREEMENT**

Void agreements differ from the Illegal Agreements in the following respects:

<b>Basis of Distinction</b>	<b>Void Agreement</b>	<b>Illegal Agreement</b>
<b>1. Void/illegal</b>	All void agreements need not necessarily be illegal.	All illegal agreements are always void.

<b>2. Effect on collateral agreements</b>	The collateral agreements do not become void.	The collateral agreements also become void.
<b>3. Restoration of benefit received</b>	If a contract becomes void subsequently, the benefit received must be restored to the other party.	The money advanced or thing given can not be claimed back.

## 10.0 ESSENTIALS OF A VALID CONTRACT

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

The analysis of the provisions of Section 10 shows that a valid contract must have the following essential elements:

- 1. Proper Offer and Acceptance** There must be at least two parties-one making the offer and the other accepting it. Such offer and acceptance must be valid. An offer to be valid must fulfil certain conditions, such as it must intend to create legal relations, its terms must be certain and unambiguous, it must be communicated to the person to whom it is made, etc. An acceptance to be valid must fulfil certain conditions, such as it must be absolute and unqualified, it must be made in the prescribed manner, it must be communicated by an authorised person before the offer lapses.
- 2. Intention to Create Legal Relationship** There must be an intention among the parties to create a legal relationship. In case of social or domestic agreements, the usual presumption is that the parties do not intend to create legal relationship but in commercial or business agreements, the usual presumption is that the parties intend to create legal relationship unless otherwise agreed upon.

**Example:** *X invited Y to a dinner. Y accepted the invitation. It is a social agreement. If X fails to serve dinner to Y, Y cannot go to the courts of law for enforcing the agreement. Similarly, if Y fails to attend the dinner, X cannot go to the courts of law for enforcing the agreement.*

But even a business agreement may not be enforceable by law where the agreement so provides e.g. in **Rose & Frank Co. v. Crompton Bros. (1925) A.C. 445**, the agreement entered into stated that it will not be subject to legal jurisdiction in the law courts, the agreement was not enforceable by law as the parties never agreed to create legal obligations despite being a business agreement.

- 3. Capacity of Parties** The parties to an agreement must be competent to contract. In other words, they must be capable of entering into a contract. According to Section 11 of Indian Contract Act, 1872, **"every person is competent to contract who is of the age of majority according to the law to which he is subject and who is of sound mind and is not disqualified from contracting by any law to which he is subject."** In other words, the person must be major, must be of **sound mind**

and must **not be declared disqualified** from contracting by any law to which he is subject. If the parties to agreement are not competent to contract, then no valid contract comes into existence.

**Example:** *X, a minor borrowed ₹ 8,000 from Y and executed mortgage of his property in favour of the lender. This was not a valid contract because X is not competent to contract. Therefore, the mortgage was not valid and the money advanced to minor could not be recovered.*

4. **Lawful Consideration** An agreement must be supported by lawful consideration. Consideration means something in return. According to Section 23 of the Indian Contract Act, 1872, **"the consideration is considered lawful unless it is forbidden by law or is fraudulent or involves or implies injury to the person or property of another or is immoral or is opposed to public policy."**

**Example I:** *X agrees to sell his car to Y for ₹ 1,00,000. Here, Y's promise to pay ₹ 1,00,000 is the consideration for X's promise to sell the car and X's promise to sell the car is the consideration for Y's promise to pay ₹ 1,00,000.*

**Example II:** *X promises to drop prosecution which he has initiated against Y for robbery and Y promises to restore the value of things taken. The agreement is void because the consideration is unlawful.*

5. **Free Consent** There must be free consent of the parties to the contract. According to Section 14, **"Consent is said to be free when it is not caused by (i) coercion, (ii) undue influence, (iii) fraud, (iv) misrepresentation, or (v) mistake"**. If the consent of the parties is not free, then no valid contract comes into existence.

**Example:** *X threatens to kill Y if he does not sell his house to X. Y agrees to sell his house to X. In this case, Y's consent has been obtained by coercion and therefore, it cannot be regarded as free.*

6. **Lawful Object** The object of the agreement must be lawful. According to Section 23 of the Indian Contract Act, 1872, **"the object is considered lawful unless it is forbidden by law or is fraudulent or involves or implies injury to the person or property of another or is immoral or is opposed to public policy."**

**Example I:** *X, Y and Z enter into an agreement for the division among them of gains acquired or to be acquired by them by fraud. The agreement is void because its object is unlawful.*

**Example II:** *X lets a flat on hire to Y, a prostitute, knowing that it would be used for immoral purposes. The agreement is void because its object is for immoral purposes.*

7. **Agreement not Expressly Declared Void** The agreement must not have been expressly declared void under the provisions of Sections 24 to 30 of the Indian Contract Act, 1872. Under these provisions, agreement in restraint of marriage, agreement in restraint of legal proceedings, agreement in restraint of trade and agreement by way of wager have been expressly declared void.

**Example I:** *X promised to marry none else except Y and in default pay her ₹ 1,00,000. X married to Z and Y sued X for the recovery of ₹ 1,00,000. It was held*



*that Y was not entitled to recover anything because this agreement was in restraint of marriage and as such void.*

**Example II:** *X and Y carried on business in Chandni Chowk area of Delhi. X promised to stop business in that locality if Y paid ₹ 1,00,000. X stopped his business but Y did not pay him the promised money. It was held that X was not entitled to recover anything because the agreement was in restraint of trade and as such void.*

8. **Certainty of Meaning** The terms of the agreement must be certain and unambiguous. According to Section 29 of the Indian Contract Act, 1872, **"agreements the meaning of which is not certain or capable of being made certain are void."**

**Example :** *X a dealer in different types of oils agreed to sell 100 tonnes of oil to Y. This agreement is void on the ground of uncertainty because it is not clear what kind of oil is intended to be sold.*

If, however, the meaning of the agreement could be made certain from the circumstances of the case, it will be treated as a valid contract.

**Example:** *X who is a dealer in mustard oil, agreed to sell 100 tonnes of oil to Y. This agreement is valid because the meaning of the agreement could be easily ascertained from the circumstances of the case.*

9. **Possibility of Performance** The terms of the agreement must be such as are capable of performance. According to Section 56, **"an agreement to do an impossible act is void."**

**Example I:** *X agrees with Y to discover treasure by magic and Y agrees to pay ₹ 1,000 to X. This agreement is void because it is an agreement to do an impossible act.*

**Example II:** *X agrees with Y to enclose some area between two parallel lines and Y agrees to pay ₹ 1,000 to X. This agreement is void because it is an agreement to do an impossible act.*

10. **Legal Formalities** The agreement must comply with the necessary formalities as to writing, registration, stamping etc. if any required in order to make it enforceable by law.

**Example I:** *An oral agreement for arbitration is unenforceable because the law requires that arbitration agreement must be in writing.*

**Example II:** *An oral agreement for sale of immovable property is unenforceable because the law requires that such agreement must be in writing and registered.*

**Conclusion** All the aforesaid elements must be present in an agreement in order to create a valid contract. If any one of them is missing or absent, the agreement will not be enforceable by law.



## PRACTICAL PROBLEMS

### PROBLEM 1

X invites Y to dinner. Y accepts the invitation but fails to turn up. Can X sue Y for the damage?

**Solution:** X cannot claim any damages from Y because the agreement between X and Y is not enforceable by law. It is a social agreement and the usual presumption in such agreement is that the parties do not intend to create legal relationship.

### PROBLEM 2

X makes a promise to his wife Y to give her pocket money of ₹ 1,000 per month. After 6 months, he stops making the payment. Can Y claim damages from X.

**Solution:** Y cannot claim any damages from X because the agreement between X and Y is not enforceable by law. It is a social agreement and the usual presumption in such agreement is that the parties do not intend to create legal relationship.

### PROBLEM 3

X promises Y to give a diamond ring at the time of his marriage. X fails to give the ring. Can Y claim the ring?

**Solution:** Y cannot claim the diamond ring because there is no consideration from Y.

### PROBLEM 4

X polished Y 's shoes without being asked by Y to do so. Y does not make any attempt to stop X from polishing the shoes. Is Y bound to make payment to X?

**Solution:** Y is bound to pay because he has accepted X's implied offer by conduct (i.e. by not stopping X from polishing the shoes).

### PROBLEM 5

X agrees to marry Y. Y dies before the marriage takes place. Is it a void agreement?

**Solution:** It is not a void agreement. It is a void contract because it was valid when it was entered into but subsequently became void on the death of Y.

### PROBLEM 6

X agreed to sell a particular horse to Y. Later on, it was discovered that the horse was dead at the time of making the contract. Advise the parties.

**Solution:** The agreement is void because both the parties were under a mistake of fact regarding existence of the subject matter.

### PROBLEM 7

X agrees to let his flat to Y for use as a gambling den on a monthly rent of ₹ 10,000. After 3 months, Y stops making the payment of rent. Advise X.

**Solution:** X cannot recover anything. The agreement between X and Y is void because the object of the agreement is unlawful.

### PROBLEM 8

X agrees to pay ₹ 1,00,000 to Y if Y does not marry throughout his life. Y promises not to marry at all but later on X refuses to pay ₹ 1,00,000. Advise Y.

**Solution:** Y cannot recover anything. The agreement between X and Y is in restraint of marriage which has been expressly declared void under Section 26.

### PROBLEM 9

X threatens to kill Y if he (Y) does not sell his house to X for ₹ 1,00,000. Y agrees. X borrows ₹ 1,00,000 from Z who is also aware of the purpose of the loan. What is the nature of the agreement between X and Y, and X and Z?

**Solution:** The contract between X and Y is a contract which is voidable at the option of Y because Y's consent is not free as it has been obtained by coercion. The contract between X and Z is a valid contract because the object of contract (i.e. borrowing for the purchase of a house) is lawful.

### PROBLEM 10

X agrees to pay Y ₹ 1,00,000 if Y kills Z. To pay Y, X borrows ₹ 1,00,000 from W who is also aware of the purpose of the loan. Y kills Z but X refuses to pay. X also refuses to repay the loan to W. Advise Y and W.

**Solution:** The agreement between X and Y is an illegal agreement because its object is unlawful. Hence, Y cannot recover anything from X. Since the main agreement between X and Y is illegal, the agreement between X and W which is collateral to the main agreement is also void and hence W cannot recover anything from X.

## IMPORTANT POINTS TO REMEMBER

### 1.0 Meaning of Contract

<b>Contract</b>	= An Agreement + Enforceability of an Agreement
<b>Agreement</b>	= Offer (or Proposal) + Acceptance of Offer (or proposal) <b>Note:</b> 1. A proposal when accepted becomes a promise. 2. Every promise and every set of promise forming consideration for each other is an agreement.

<b>Enforceability</b>	An agreement is said to be enforceable by law if it creates some legal obligation.
<b>Usual Presumption</b>	<p><b>In Social or Domestic Agreements</b> – That the parties do not intend to create legal relations.</p> <p><b>In Commercial or Business Agreements</b> – That the parties intend to create legal relations.</p>

## 2.0 Scope of Law of Contract

<b>Not Whole Law of Agreements</b>	The law of contracts is not the whole law of agreements because it is concerned with only those agreements (e.g. Business or Commercial Agreements) where parties have the intention to create legal obligations and is not concerned with those agreements (e.g. Social or Domestic Agreements) where parties do not have the intention to create legal obligations.
<b>Not Whole Law of Contracts</b>	The law of contracts is not the whole law of obligations because it is concerned with only those obligations which arise out of agreements and is not concerned with those obligations (e.g. obligation to maintain wife & children) which do not arise out of agreements.

## 3.0 Classification of Contracts

<b>Type of Contract</b>	<b>Meaning</b>
<b>1. On the Basis of Creation</b>	
(a) <b>Express Contract</b>	One which is made by words spoken or written
(b) <b>Implied Contract</b>	One which is made otherwise than by words spoken or written.
(c) <b>Tacit Contract</b>	One which is inferred from the conduct of parties or circumstances of the case
<b>2. On the Basis of Execution</b>	
(a) <b>Executed Contract</b>	Where both the parties to the contract have performed their respective obligations.
(b) <b>Executory Contract</b>	Where both the parties to the contract have still to perform their respective obligations.
(c) <b>Partly Executed, Partly Executory</b>	Where one of the parties to the contract has performed his obligation and the other party has still to perform his obligation.
(d) <b>Unilateral Contract</b>	One in which only one party has to perform his Promise or obligation to do forebear.

<b>(e) Bilateral Contract</b>	One in which both parties have to perform their respective obligations.
<b>3. On the Basis of Enforceability</b>	
<b>(a) Valid Contract</b>	Which satisfies all the conditions prescribed by law.
<b>(b) Void Contract</b>	A contract which was valid when entered into but which subsequently becomes void due to impossibility of performance due to change of law or any other reason
<b>(c) Void Agreement</b>	An agreement not enforceable by law <b>Note:</b> <i>Collateral Agreements do not become void.</i>
<b>(d) Voidable Contract</b>	An agreement which is enforceable by law at the option of one or more of the parties but not at the option of the other or others.
<b>(e) Illegal Agreement</b>	One the object or consideration of which is unlawful. <b>Note:</b> <i>Collateral Agreements also become void.</i>
<b>(f) Unenforceable Contract</b>	A contract which is actually valid but cannot be enforced because of some technical defect. Such contract can be enforced if the technical defect is removed.

#### 4.0 Essential Elements of a Valid Contract

<b>Provisions of Sec. 10</b>	"All agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void."
<b>Essential Elements of a Valid Contract</b>	<ol style="list-style-type: none"> <li>1. Proper Offer and its Proper Acceptance</li> <li>2. Intention to create legal relationship</li> <li>3. Free Consent</li> <li>4. Capacity to Contract</li> <li>5. Lawful Consideration</li> <li>6. Lawful Object</li> <li>7. Agreement not expressly declared void</li> <li>8. Certainty of Meaning</li> <li>9. Possibility of Performance</li> <li>10. Legal Formalities</li> </ol>

## TRUE OR FALSE QUESTIONS

**State with reasons whether the following statements are True or False:**

1. Law is the body of principles enforced by judiciary.
2. Indian mercantile law is primarily an adaptation of the English law.
3. Mercantile law is applicable to business community only.
4. Customs and usages are an important source of mercantile law.
5. Law of contract is the whole law of agreements.
6. Law of contract is the whole law of obligations.
7. All contracts are agreements.
8. All agreements are contracts.
9. In social agreements, the usual presumption is that the parties intend to create legal obligations.
10. In business agreements, the usual presumption is that the parties do not intend to create legal obligations.
11. Express contract is made by words in writing only.
12. Implied contract is made by words spoken only.
13. A contract where both the parties have fulfilled their respective obligations is called an 'Executory contract'.
14. A contract is not void from its inception.
15. A contract can be void ab-initio.
16. A contract is usually treated as voidable when the consent of a party has not been free.
17. A voidable contract also remains enforceable by law.
18. Collateral transactions to a void agreement also become void.
19. Collateral transactions to an illegal agreements do not become void.
20. An unenforceable contract can be enforced if the technical defect involved is removed.
21. A valid contract may be voidable at the option of aggrieved party.
22. A valid agreement may be voidable at the option of aggrieved party.

### ANSWERS

1. True 2. True 3. False 4. True 5. False 6. False 7. True 8. False 9. False  
 10. False 11. False 12. False 13. False 14. True 15. False 16. True  
 17. True if the aggrieved party does not repudiate the contract; false if the aggrieved party repudiates the contract.  
 18. False 19. False 20. True 21. True 22. False

### **VERY SHORT ANSWER TYPE QUESTIONS**

1. Define Agreement.
2. Define Contract.
3. What is enforceability of an agreement?
4. What is the usual presumption in social or domestic agreements?
5. What is the usual presumption in commercial or business agreements?
6. What is an 'Express Contract'?
7. What is an 'Implied Contract'?
8. Define 'Executed Contract'.
9. Define 'Executory Contract'.
10. What is meant by 'Partly Executed and Partly Executory Contract'?
11. What is meant by a Valid Contract?
12. Define 'Void Contract'.
13. Define 'Void Agreements'.
14. What is 'Voidable Contract'?
15. What is Illegal Agreement?
16. What is 'Unenforceable Contract'?

### **SHORT ANSWER TYPE QUESTIONS**

17. Enumerate the essentials of a valid contract.
18. Distinguish between the following:
  - (a) Implied Contract and Express Contract
  - (b) Executory Contract and Executed Contract
  - (c) Void Contract and Voidable Contract
  - (d) Void Contract and Void Agreement
  - (e) Void Agreement and Illegal Agreement
19. Comment on the following statements:
  - (a) All contracts are agreements but all agreements are not contracts.
  - (b) The law of contract is not the whole law of agreements nor is it the whole law of obligations.
  - (c) In commercial and business agreements the presumption is that the parties intend to create legal relations.

### **LONG ANSWER TYPE QUESTIONS**

20. (a) Define Contract.  
(b) Explain the essentials of a valid contract.



# Offer and Acceptance

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## 1.0 OFFER

### MEANING OF OFFER

An offer is the starting point in the making of an agreement. An offer is also called 'proposal'. According to Section 2(a) of The Indian Contract Act, 1872, **"A person is said to have made the proposal when he signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that offer to such act or abstinence."**

### ESSENTIAL ELEMENTS OF OFFER

An offer involves the following essential elements:

- (a) It must be made by one person to another person. In other words, there can be no proposal by a person to himself.

**Example:** *X says to Y that he wants to sell his car to himself for ₹ 1 lakh. There is no proposal because there can be no proposal by a person to himself.*

- (b) It must be an expression of readiness or willingness to do (i.e. a positive act) or to abstain from doing something (i.e. a negative act).

**Example I:** *X offers to sell his car to Y for ₹ 1 lakh. It is a positive act on the part of X.*

**Example II:** *X offers not to file a suit against Y if Y pays X the outstanding amount of ₹ 1,00,000. It is a negative act on the part of X.*

- (c) It must be made with a view to obtain the consent of that other person to proposed act or abstinence.

**Example:** *X jokingly says to Y "I am ready to sell my car for ₹ 1,000." Y, knowingly that X is not serious in making the offer, says "I accept your offer." In this case, X's offer was not the real offer as he did not make it with a view to obtain the consent of Y.*

## 2.0 OFFERER (OR 'PROMISOR') AND OFFEREE (OR PROMISEE)

### MEANING OF OFFERER

The person making the proposal is called the 'offerer' or 'proposer'.

### MEANING OF OFFEREE

The person to whom the proposal is made is called the 'offeree' or 'proposee'.

**Example:** *X says to Y, "I want to sell my car to you for ₹ 1 lakh." Here, 'to sell car' is an offer or proposal. X who has made the offer is called offeror or promisor. Y to whom the offer has been made is called the offeree or proposee.*

### 3.0 HOW TO MAKE AN OFFER?

An offer can be made by any act which has the effect of communicating it to another person. An offer may, either be an 'express offer' or 'implied offer'.

1. **Express Offer** An express offer is one which is made by words spoken or written.

**Example I** *X says to Y, "Will you purchase my car for ₹ 1,00,000?"*

**Example II** *X writes to Y in a letter, "I want to sell my house for ₹ 2,00,000."*

**Example III** *X advertises in a newspaper, "I will pay ₹ 1,000 to anyone who traces my missing nephew".*

2. **Implied Offer** An implied offer is one which is made otherwise than in words. In other words, it is inferred from the conduct of the person or the circumstances of the particular case.

**Example I** *A transport company runs buses on different routes to carry passengers. This is an implied offer by the transport company to carry passengers for a certain fare.*

**Example II** *A bid at an auction is an implied offer to buy.*

### 4.0 TO WHOM IS AN OFFER MADE ?

An offer may be 'specific' or 'general'.

#### SPECIFIC OFFER

A specific offer is one which is made to a definite person or particular group of persons. A specific offer can be accepted only by that definite person or that particular group of persons to whom it has been made.

**Example** *X offers to buy car from Y for ₹ 1.0 lakh. This offer is a specific offer which has been made to a definite person Y. No person other than Y can accept this offer. [Boulton v. Jones]*

Similarly an offer made to a company is an offer to a group of persons and hence a specific offer.

#### GENERAL OFFER

A general offer is one which is made to the world at large or public in general. A general offer can be accepted by any person by fulfilling the terms of the offer. In case of general offer, the contract is made with person who having the knowledge of the offer comes forward and acts according to the conditions of the offer.



**Example I** X advertised in the newspaper that he would pay ₹ 5,000 to anyone who traces his missing boy. Y, who knew about the reward traced that boy and sent a telegram to X that he had found his son. It was held that X was entitled to receive the amount of reward. [Harbhajan Lal v. Harcharan Lal (AIR All 539)]

**Example II** Carbollic Smoke Ball Co. advertised in the newspaper that it would pay ₹ 1,000 to anyone who contracts influenza after using the smoke ball of the company according to the printed instructions. Mrs Carlil uses the smoke ball according to the printed directions but subsequently contracted influenza. On a suit for the reward she was held entitled to recover the same because she had accepted the offer by fulfilling the terms of the offer. [Carlil v. Carbollic Smoke Ball Co.]

## 5.0 WHAT ARE THE LEGAL RULES FOR A VALID OFFER ?

An offer to be valid must fulfil the conditions discussed below:

1. **Intention to Create Legal Relationship:** An offer must intend to create legal relations. An offer must be such that when accepted, it will create legal relationship among the parties.

The question whether or not the parties have intention to create legal relationship can be answered with reference to type and terms of agreement and the circumstances under which the agreement is made. (As discussed in the last chapter.)

2. **Certain and Unambiguous Terms:** The terms of the offer must be certain and unambiguous and not vague. If the terms of the offer are vague, no contract can be entered into because it is not clear as to what exactly the parties intended to do.

**Example I** X offers to sell to Y "a 100 tons of oil." If X is a dealer in coconut oil and mustard oil, his offer is not certain because it is not clear whether he wants to sell coconut oil or mustard oil. But if X is a dealer in coconut oil only, it is clear that he wants to sell coconut oil. Hence, the offer is certain.

**Example II** X offers to sell to Y his car for ₹ 1,00,000 or ₹ 1,50,000. Here X's offer is not certain because it is not clear which of the two prices was to be given by Y.

**Note:** If the terms of the offer are capable of being made certain, the offer is not regarded as vague. For example, X offers to sell to Y "a 100 tons of coconut oil." Here, the offer cannot be said to be uncertain on the ground that it is not clear what price is to be given for oil because in such a case if such an offer is accepted by Y, Y has to give only a reasonable price.

3. **Different from a Mere Declaration of Intention:** The offer must be distinguished from a mere declaration of intention. Such statement or declaration merely indicates that an offer may be made or invited in future.

**Example I** X tells Y "I want to sell my car for ₹ 1 lakh." It is a mere statement of intention and not an offer.

**Example II** A father wrote to his would be son-in-law that his daughter would have a share of what he left after the death of his wife. It was held that the letter was a mere statement of intention and not an offer. [Farine v. Fickar]

**Example III** X, a broker of Mumbai wrote to Y a merchant of Ghaziabad stating the

*terms on which he is willing to do business. It was held that the letter was a mere statement of intention and not an offer. [Devidatt v. Shriram]*

**Example IV** *A notice that the goods stated in the notice will be sold by tender does not amount to an offer to sell. [Spencer v. Harding]*

**Example V** *An auctioneer advertised in a newspaper that a sale of office furniture will be held on a particular day. Mr X with the intention to buy furniture came from a distant place for the auction but the auction was cancelled. It was held that Mr X cannot file a suit against the auctioneer for his loss of time and expenses because the advertisement was merely a declaration of intention to hold auction and not an offer to sell. [Harris v. N. Nickerson]*

4. **Different from an Invitation to Offer:** An offer must be distinguished from an invitation to offer. In case of an invitation to offer, the person making an invitation invites others to make an offer to him. It is prelude to an offer inviting negotiations or preliminary discussions.

**Example I** *X asks Y "At what price will you buy my car?" Y replied "I agree to buy your car for ₹ 1 lakh. X's statement is merely an Invitation to offer, Y's reply is merely an offer to buy.*

**Example II** *Goods were displayed in the shop for sale with price tags attached on each article and self service system was there. One customer selected the goods but the owner refused to sell. It was held that the display of goods was only an invitation to offer and the selection of the goods was an offer by the customer to buy and refusal by owner was rejection of the offer and hence there was no contract and customer had no right to sue the owner. [Pharmaceutical Society of Great Britain v. Boots Cash Chemists Ltd.]*

**Example III** *A prospectus issued by a company for subscription of its shares and debentures is only an invitation to general public to make an offer to buy the shares/debentures which may or may not be accepted by the company.*

Similarly, an advertisement inviting quotations of lowest price in response to an enquiry amounts to invitation to offer but not an offer capable of acceptance, e.g. in *Harvey v. Facey* (1893), X sent a telegram to Y asking "Will you sell us Bumper Hall Penn? Telegraph Lowest Cash Price." Y replied through a telegram "Lowest Price for Bumper Hall Penn £900." X replied telegraphically stating "We agree to buy Bumper Hall Penn for £900 asked by you." Held, the quotation of price by Y was a mere invitation to offer. Consent of X to purchase the estate for £900 was an offer.

### DISTINCTION BETWEEN OFFER AND INVITATION TO OFFER

<b>Basis of Distinction</b>	<b>Offer</b>	<b>Invitation to Offer</b>
<b>1. Meaning</b>	Where a person shows his willingness to enter into a contract, it is called as an offer.	Where a person invites others to make an offer to him, it is called as an invitation to offer.

<b>2. Purpose</b>	An offer is made by a person with the purpose of entering into a contract.	The purpose of making an invitation to offer is to receive the offers or to negotiate the terms on which the person making the invitation is willing to contract.
<b>3. Legal effect</b>	An offer, if acted upon (i.e., accepted), results in a contract.	An invitation to offer, if acted upon, only results in making of an offer.

5. **Communication:** An offer must be communicated to the person to whom it is made. An offer is complete only when it is communicated to the offeree. One can accept the offer only when he knows about it. Thus, an offer accepted without its knowledge does not confer any legal rights on the acceptor.

**Example I** *G sent his servant L to trace his lost nephew. When the servant had left, G announced a reward of ₹ 500 to anyone who traces the missing boy. L found the boy and brought him home. When L cagreement + its enforced a suit against G to recover the reward. It was held that L was not entitled the reward because he did not know about the reward when he found the missing boy. [Lalman Shukla v. Gauri Dutt]*

**Example II** *S offered a reward to anyone who traces his lost dog. F brought the dog without any knowledge of the offer of reward. It was held that F was not entitled to the reward because F cannot be said to have accepted the offer which he did not know. [Fitch v. Snedakar]*

6. **No Term the Non-compliance of which Amounts to Acceptance:** The offer must not contain a term the non-compliance of which would amount to acceptance. It means that while making the offer, the offerer can not say that if offer is not accepted before a certain date, it will be presumed to have been accepted.

An offer cannot impose the burden on the offeree to reply. Acceptance can not be presumed merely by silence.

**Example** *X writes a letter to Y. I offer to sell my horse for ₹ 1,00,000. If I do not receive your reply by Friday next, I shall assume that you have accepted the offer Y does not reply. There is no contract since acceptance was not communicated by Y to X [Felthouse v. Bindley]*

7. **Communication of Special Terms or Standard Form Contracts:** The special terms of the offer must also be communicated along with the offer. If the special terms of the offer are not communicated, the offeree will not be bound by those terms. The question of special terms arises generally in case of standard form of contracts. Standard contracts are made with big companies such as insurance companies, railways, shipping companies, banking companies, hotel companies, dry cleaning companies. Since such companies are in position to exploit the weakness of general public by including certain terms in the contract which may limit their

liabilities, it is provided that the special terms of the offer must be brought to the notice of general public.

**Example I** *X purchased a steamer ticket for travelling from Dublin to White Haven and on the back of the ticket, certain conditions were printed one of which excluded the liability of the company for loss, injury or delay to the passengers or his luggage. X never looked at the back of the ticket and there was nothing to draw his attention to the conditions printed on the back side. His luggage was lost due to the negligence of the servants of the shipping company. It was held that X was entitled to claim compensation for the loss of his luggage in spite of the exemption clause because there was no indication on the face of the ticket to draw his attention to the special terms printed on the back of the ticket. [Handerson v. Stevenson]*

**Example II** *P deposited his bags in the cloakroom at a railway station. On the face of the receipt the words 'see back' were printed. One of the conditions printed on the back was 'the liability of the railway company shall be limited for any package to \$10'. P's bag was lost and P claimed the actual value of bag amounting to \$24. P admitted knowledge of the condition printed on the back but denied having read it. It was held that P could recover only \$10 because the railways had given reasonable sufficient notice on the face of the ticket as to the existence of conditions. [Parker v. S.E. Rail Co.]*

### Notes:

- (i) In case the special conditions are printed in a language which the offeree does not understand, it is the offeree's duty to ask for the translation of the condition before accepting the offer and if he does not ask, it shall be presumed that he knows them and he will be bound by them.
- (ii) The special terms and conditions must be brought to the knowledge of the offeree before the contract is concluded and not afterwards. A subsequent communication will not bind the acceptor unless he himself agrees thereto. For example, Mr X and Mrs X hired a room in hotel for a week. When they entered the room, they found a notice on the wall disclaiming the owner's liability for damages, loss or theft of articles. Some of their items were stolen. It was held that owner was liable because the notice was not a part of the contract as it came to the knowledge of the customer after the contract was entered into. **[Olley v. Marlborough Court Ltd.]**
- (iii) The special terms and conditions must be reasonable. What is reasonable is a question of facts. If terms and conditions are unreasonable, the other party will not be bound by them. For example, if a dry cleaner limits his liability to 25% of the market price of the article in case of loss, the customer will not be bound by this condition because it means that the dry cleaner can purchase garments at 25% of the market price. In **Lily White Drycleaners v. Munnuswamy** AIR 1966 (Mad.), the receipt issued by the drycleaner stated that the drycleaner would be liable only to the extent of 10 times the drycleaning charges in the event of any damage to the clothes. Held, such a clause was unreasonable and opposed to public policy, and therefore, couldn't bind the parties.

## 6.0 CROSS OFFERS

### MEANING OF OFFERS

Two offers which are similar in all respects made by two parties to each other, in ignorance of each other's offer are known as 'cross offers'.

### EFFECT OF OFFERS

Cross offers do not amount to acceptance of one's offer by the other. Hence, no contract is entered into on cross offers.

**Example** *X of Agra sends a letter by post to Y of Delhi offering to sell his car for ₹ 1 lakh. The letter is posted on 1st January and the same day, Y of Delhi sends a letter by post to X of Agra offering to buy X's car for ₹ 1 lakh. These two letters cross each other. Y's letter is merely an offer and not the acceptance of X's letter. Here, both the parties are making offer and no party has accepted the offer. Therefore, no contract has been entered into. If they want to enter into a contract, at least one of them must send his acceptance to the offer made by the other.*

## 7.0 STANDING OFFER/OPEN OFFER/CONTINUING OFFER

### MEANING OF OFFERS

An offer of a continuous nature is known as 'standing offer'.

### NATURE OF OFFERS

A standing offer is in the nature of a tender.

### CONTRACT OF OFFERS

A contract is said to have been entered into only when an order is placed on the basis of the tender.

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

## 8.0 MEANING OF ACCEPTANCE

1. Acceptance means giving consent to the offer. It is an expression by the offeree of his willingness to be bound by the terms of the offer. According to Section 2(b) of the Indian Contract Act, 1872, **"A proposal is said to be accepted when the person to whom the proposal is made signifies his assent thereto. A proposal when accepted becomes a promise."** In other words, an acceptance is the consent given to offer.

**Example** *X offers to sell his car to Y for ₹ 1,00,000. Y agrees to buy the car for ₹ 1,00,000. Y's act is an acceptance of X's offer.*

## 9.0 WHO CAN ACCEPT AN OFFER ?

In general, an offer can be accepted only by the person or persons to whom it is made. The specific answer to this question can be given with reference to type of offer as under:

### WHO CAN IN CASE OF SPECIFIC OFFER

An offer made to a definite person or particular group of persons (called specific offer) can be accepted only by that definite person or that particular group of persons to whom it has been made and none else.

**Example** *X sold his business to Y but this fact was not known to an old customer Z. Z placed an order for certain goods to X by name. Y supplied those goods to Z. It was held that there was no contract between Y and Z because Z never made any offer to Y. [Boulton v. Jones]*

### WHO CAN IN CASE OF GENERAL OFFER

An offer made to the world at large or public in general (called general offer) can be accepted by any person having knowledge of the offer by fulfilling the terms of the offer.

**Example** *A company advertised that it would pay \$100 to anyone who contracts influenza after using the smoke balls of the company according to the printed directions. Mrs Carlil used the smoke balls according to the printed directions but subsequently she contracted influenza. She filed a suit for the reward. It was held that she was entitled to recover the reward because she had accepted the offer by complying with the terms of the offer. [Carlil v. Carbolic Smoke Ball Company]*

## 10.0 HOW TO MAKE AN ACCEPTANCE ?

Like an offer, an acceptance may also be either an 'implied acceptance' or 'express acceptance'.

### EXPRESS ACCEPTANCE

An express acceptance is one which is made by words spoken or written.

**Example** *X says to Y, "Will you purchase my car for ₹ 1,00,000?" Then Y says, "I am ready to purchase your car for ₹ 1,00,000."*

### IMPLIED ACCEPTANCE

An implied acceptance is one which is made otherwise than in words. In other words, it is inferred from the conduct of the person or the circumstances of the particular case.

**Example** *A transport company runs buses on different routes to carry passengers. X, a passenger boards the bus. X's act is an implied acceptance by X and he is bound to pay the fare.*

## 11.0 WHAT ARE THE LEGAL RULES FOR A VALID ACCEPTANCE ?

An acceptance to be valid must fulfil certain conditions which are discussed below.

1. **Absolute and Unqualified** According to Section 7(1) of the Indian Contract Act, 1872, "In order to convert a proposal into a promise, the acceptance must be absolute and unqualified." It means, that an offer must be accepted as it is without any reservation, variation or condition. A qualified and conditional acceptance amounts to making of a counter offer which puts an end to the original offer and it cannot be revived by subsequent acceptance.

**Example I** *X offered to sell his car for ₹ 1,00,000 to Y. Y agreed to buy it for ₹ 90,000. Y's act is a counter offer and not an acceptance of X's offer. Now, if Y accepts the original offer to buy the car for ₹ 1,00,000, X will not be bound to sell the car because Y's counter offer has put an end to the original offer. [Nihal Chand v. Amar Nath]*

**Example II** *X offered to sell two plots of land to Y at a certain price. Y accepted the offer for one plot. It was held that the acceptance was not valid because it was not for the whole of the offer. [Bhawan v. Sadula]*

**Example III** At an auction sale, X's bid was provisionally accepted at an auction sale. The acceptance was subject to confirmation. X withdrew his bid before confirmation. It was held that X could withdraw his bid before confirmation because the acceptance was not absolute but subject to confirmation.

2. **Manner** According to Section 7(2) of the Indian Contract Act, 1872, the acceptance of an offer must be given in the following manner.

(a) If the proposal does not prescribe the manner in which it is to be accepted.	The offer must be accepted in some usual and reasonable manner.
(b) If the proposal prescribes the manner in which it is to be accepted	The offer must be accepted in the prescribed manner.

**Consequences of not accepting the offer in the prescribed manner:** If the offer is not accepted in the prescribed manner, the offerer may approve or reject such acceptance. If the offerer wants to reject it, he must inform the acceptor within a reasonable time that he is not bound by acceptance because it is not in the prescribed manner. If he does not do so within a reasonable time the presumption will be that he doesn't mind the offer being accepted in a different mode and will be bound by such acceptance.

**Example** *X of Agra sends a letter by post to Y of Delhi offering to sell his car for ₹ 1,00,000 and also writes "send your acceptance by telegram." Y sends his acceptance by an ordinary letter. X can reject such acceptance on the ground that it was not accepted in the prescribed manner. But if he does not inform Y within the reasonable time, he shall be deemed to have accepted such acceptance and a valid contract will be formed between X and Y.*

3. **Communication** The acceptance must be signified (i.e. indicated or declared). In other words, the acceptance is complete only when it has been communicated to the offerer. A mere mental determination to accept is no acceptance in the eyes of



law unless there is some external manifestation of that determination by words or conduct.

**Example** *X offered to supply coal to a Railway Company. The manager of the company accepted the offer and put it in the drawer of his table and forgot all about it. It was held that no contract was made because acceptance was not communicated. (Brogden v. Metropolitan Railway Co.)*

**Note:** In case of acceptance made by post, the proposer becomes bound by the acceptance as soon as the properly addressed and stamped letter of acceptance is duly posted even if such letter of acceptance is lost or delayed in post.

4. **By Whom** Acceptance must be communicated by the offeree himself or by a person who has the authority to accept. In other words, if acceptance is communicated by an unauthorised person, it will not give rise to legal relations.

**Example** *P applied for the post of a headmaster in a school. The managing committee passed a resolution approving P to the post but this decision was not communicated to P. But one member of the managing committee in his individual capacity and without any authority informed P about the decision. Subsequently, the managing committee cancelled its resolution and appointed someone else. P filed a suit for breach of contract. It was held that P's suit was not maintainable because there was no communication of acceptance as he was not informed about his appointment by some authorised person. [Powell v. Lee]*

**Note:** The communication of acceptance is not necessary in case of unilateral contracts where the offerer prescribed a particular mode of acceptance. In such cases, it is sufficient if that prescribed mode is followed as in case of Carlil v. Smoke Ball Co. and Har Bhajan Lal v. Harcharn Lal.

5. **To Whom** Acceptance must be communicated to the offerer himself. In other words, if acceptance is communicated to an unauthorised person, it will not give rise to legal relations.

**Example** *F offered by a letter to buy his nephew's horse for \$30 saying "If I hear no more about him, I shall consider the horse mine." The nephew sent no reply at all but told B his auctioneer, not to sell that particular horse as he intended to sell that horse to F. B sold the horse by mistake. It was held that F will not succeed because his nephew had not communicated acceptance to him. [Feltthouse v. Bindley]*

6. **Time Limit** The acceptance must be given within the time prescribed (if any) or within a reasonable time (if no time is prescribed). What is reasonable time depends upon the facts and circumstances of the case.

**Example** *An offer to buy shares of a company was made in June but the acceptance was communicated in November, it was held that the offerer was not bound by the acceptance because the acceptance was not given within a reasonable time. [Ramsgate Victoria Hotel Co. v. Montefiore]*

7. **Before Lapse of Offer** The acceptance must be given before the offer lapses or is withdrawn. In other words, if an acceptance is made after the lapse or withdrawal of the offer, it will not give rise to legal relations.



**Example** *X offered by a letter to sell his car for ₹ 1,00,000. Subsequently, X withdrew his offer by a telegram which was duly received by Y. After the receipt of telegram, Y sent his acceptance to X. In this case, the acceptance is invalid because it was made after the effective withdrawal of the offer.*

- 8. Mode of Acceptance**—Acceptance may be given by performance of condition or acceptance of consideration.

## 12.0 PROVISIONS RELATING TO COMMUNICATION OF OFFER AND ACCEPTANCE

The communication of offer and acceptance must complete so as to bind the concerned parties because as soon as the communication is complete the parties lose the right of withdrawal or revocation. The legal provisions relating to the communication of offer and acceptance are as under:

### WHEN IS COMMUNICATION OF OFFER COMPLETE?

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

**Example** *X of Agra sends a letter by post to Y of Delhi offering to sell his car for ₹ 1,00,000. The letter is posted on 1st January and this letter reaches on 7th January. The communication of the offer is complete on 7th January.*

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

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

### WHEN IS COMMUNICATION OF ACCEPTANCE COMPLETE?

The communication of acceptance is complete at different times for the proposer and acceptor. The rules regarding the communication of acceptance are as under:

The communication of acceptance is complete...	When does the communication of acceptance complete...
(i) As against the proposer	When it is put in a course of transmission to him, so as to be out of the power of the acceptor. In case of acceptance made by post, the proposer becomes bound by the acceptance as soon as the properly addressed and stamped letter of acceptance is duly posted even if such letter of acceptance is lost or delayed in post.
(ii) As against the acceptor	When it comes to the knowledge of the proposer. In case of acceptance made by post, the acceptor becomes bound by the acceptance only when the letter of acceptance is actually received by proposer.

**Note:** The time gap between the date on which the letter of acceptance is posted and the date on which the letter of acceptance is received by the proposer, can be utilized by the acceptor to withdraw his acceptance by a speedier mode of communication so that the revocation notice reaches the proposer before the letter of acceptance.

**Example** *X of Agra sends a letter by post to Y of Delhi offering to sell his car for ₹ 1,00,000. The letter is posted on 1st January and this letter reaches Y on 7th January. Y sends his acceptance by post on 10th January but X receives this letter of acceptance on 15th January. In this case the legal position relating to the communication of offer and acceptance is as under:*

Communication	When does the communication	Reason
(a) Communication of offer	7th January	The letter containing the offer reaches the offeree on 7th January.
(b) Communication of acceptance as against the proposer	10th January	The letter of acceptance is posted on 10th January.
(c) Communication of acceptance as against the acceptor	15th January	The letter of acceptance is received by the proposer on 15th January.

After posting the letter of acceptance on 10th January, Y can withdraw his acceptance by a speedier mode of communication so that the revocation notice reaches the proposer before the letter of acceptance.

### POSITION OF CONTRACTS OVER TELEPHONE/TELEX/FAX

A contract by telephone/telex/fax is treated on the same principle as an oral agreement made between two parties when they are face to face with each other. In such cases, the contract will complete only when the acceptance is received by the proposer and not when it is transmitted by the acceptor. Therefore, the acceptor must ensure that his acceptance is properly received by the proposer.

**Example** *X made an offer to Y over telephone. While Y was conveying his acceptance, the line went dead and X could not hear anything. In this case, there was no contract at that moment.*

**Note:** In case of contracts over telephone, telex or fax, the question of revocation (i.e. withdrawal of acceptance) does not arise because there is instantaneous communication of the offer and its acceptance (i.e. the offer is made and accepted at the same time).

## 13.0 PROVISIONS RELATING TO REVOCATION OF OFFER AND ACCEPTANCE

### MEANING OF REVOCATION

The term 'revocation' means 'taking back' or 'withdrawal'.

### WHAT IS THE TIME LIMIT WITHIN WHICH OFFER CAN BE REVOKED ?

According to Section 5 of the Indian Contract Act, a proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards. We know that communication of acceptance is complete as against the proposer when a properly addressed and stamped letter of acceptance is duly posted by the acceptor. Hence, an offer can be revoked at any time before the letter of acceptance is duly posted by the acceptor. Thus, the proposer may revoke his offer by a speedier mode of communication which will reach before the letter of acceptance is posted by the acceptor.

**Example** *X of Agra offers by a letter dated 1st January sent by post to sell his car to Y of Delhi for ₹. 1,00,000. Y accepts the offer on 7th January at 1 p.m. by letter sent by post. Here, X may revoke his offer at any time before 1 p.m. on 7th January but not afterwards.*

#### Notes:

- (i) Revocation must always be expressed.
- (ii) Revocation must move from the offerer himself or a duly authorised agent.
- (iii) Notice of revocation of a general offer must be given through the same channel by which the original offer was made.
- (iv) Offer cannot be revoked even if the letter of acceptance is lost or delayed in transit.

### WHAT IS THE TIME LIMIT WITHIN WHICH ACCEPTANCE CAN BE REVOKED?

According to Section 5 of the Indian Contract Act, "An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards." We know that communication of acceptance is complete as against the acceptor when the letter of acceptance is actually received by the proposer. Hence, an acceptance can be revoked at any time before the letter of acceptance is actually received by the proposer. Thus an acceptor may revoke his acceptance by a speedier mode of communication which will reach before the letter of acceptance is received by the proposer.

**Example** *X of Agra offers by a letter dated 1st January sent by post to sell his car to Y of Delhi for ₹ 1,00,000. Y accepts the offer on 7th January at 1 p.m. by a letter sent by post. X receives the letter of acceptance on 15th January at 3 p.m. Here, Y may revoke his acceptance at any time before 3 p.m. on 15th January but not afterwards.*

### ACCEPTANCE IS TO OFFER WHAT A LIGHTED MATCH IS TO A TRAIN OF GUNPOWDER?

The position relating to revocation of proposal and acceptance has been described by Anson in the following words, "**Acceptance is to offer what a lighted match is to a train of gunpowder. It produces something which can not be recalled or undone.**"

This statement primarily holds good under English law.

Here, **Gunpowder = Offer and Lighted Match = Acceptance**

When a lighted match is shown to a train of gunpowder, it explodes and something happens which cannot be undone. Similarly, an offer once accepted cannot be revoked. But so long

a lighted match is not shown, the gunpowder remains inert and can be removed, similarly an offer can be revoked before it is accepted.

Similarly, once acceptance is given it cannot be revoked. But under Indian Contract Act, acceptance can be revoked by resorting to quicker means of communication so that the offerer learns about it before acceptance. Thus, the above statement doesn't hold in relation to revocation of acceptance under Indian law.

### **SIMULTANEOUS DELIVERY OF LETTER OF ACCEPTANCE AND THE TELEGRAM CONTAINING REVOCATION OF ACCEPTANCE**

In case the letter of acceptance and the telegram containing revocation of acceptance are delivered to the proposer at the same time, the formation of contract depends upon the fact which one is read first by the offerer. The contract shall be said to have been formed if the letter of acceptance is read first but shall not be said to have been formed if the telegram containing revocation of acceptance is read first. Generally, it is presumed that a man of ordinary prudence will first read the telegram. Hence the revocation will be quite effective.

### **NO REVOCATION IN CASE OF CONTRACT OVER TELEPHONE OR TELEX OR FAX**

In case of contracts over telephone or telex or fax, the question of revocation does not arise because there is instantaneous communication of the offer and its acceptance (i.e. the offer is made and accepted at the same time).

### **WHEN IS COMMUNICATION OF REVOCATION COMPLETE [SECTION 4] ?**

The communication of revocation is complete at different times for person who makes it and the person to whom it is made. The rules regarding the communication of revocation are as under:

<b>The communication of revocation is complete...</b>	<b>When does the communication of revocation complete...</b>
<b>(a) As against the person who makes it</b>	When it is put in a course of transmission to the person to whom it is made so as to be out of the power of the person who makes it.
<b>(b) As against the person to whom it is made</b>	When it comes to his knowledge.

**Example** *X proposes by letter to sell his car to Y for ₹ 1,00,000. Y accepts X's proposal by a letter sent by post. If X revokes his proposal by telegram, the revocation of offer is complete as against X when the telegram is dispatched and it is complete as against Y when Y receives the telegram. If Y revokes his acceptance by telegram, the revocation of acceptance is complete against Y when the telegram is despatched and as against X when it reaches him.*

**Conclusion:**

1. **Revocation of offer binds the offeree only if it comes to his knowledge before the completion of its acceptance against the offeror.**
2. **Revocation of Acceptance binds the offeror only if it comes to his knowledge before the completion of its acceptance against the offeree.**

**14.0 WHEN DOES AN OFFER COME TO AN END ? (LAPSE OF AN OFFER)**

An offer must be accepted before it lapses (i.e. comes to an end). An offer may come to end in any of the following ways:

1. **By Revocation** An offer lapses if the offeror revokes the offer before its acceptance by the offeree. According to Section 5 of the Indian Contract Act, a proposal may be revoked at any time before the communication of acceptance is complete as against the proposer but not afterwards.

**Example I** X of Agra offers by a letter dated 1st January sent by post to sell his car to Y of Delhi for ₹ 1,00,000. Y accepts the offer on 7th January at 1 p.m. by a letter sent by post. Here, X may revoke his offer at any time before 1 p.m. on 7th January but not afterwards.

**Example II** At an auction sale, the highest bidder can revoke his offer to buy before the fall of the hammer.

2. **By Lapse of Time** An offer lapses if it is not accepted within the fixed time (if any prescribed in the offer) or within reasonable time (if no time is prescribed in the offer).

**Example** An offer to buy shares of a company was made in June but the acceptance was communicated in November. It was held that offer to buy shares had lapsed because it was not accepted within a reasonable time. [Ramsgate Victoria Hotel Co. v. Montefiore]

3. **By Death or Insanity of the Offeror or Offeree** An offer lapses if—
  - (a) the fact of death or insanity of offeror comes to the knowledge of the acceptor before he makes his acceptance.
  - (b) the offeree dies or becomes insane before accepting the offer because an offer can be accepted only by the offeree and not by any other person.

**Note:** If the offer is accepted in ignorance of the death or insanity of the offeror, there will be a valid contract. It may be noted that in English law the death of the offeror terminates the offer even if acceptance is made in ignorance of the death.

4. **By Failure to Accept condition Precedent** An offer lapses if it is accepted without fulfilling the conditions of the offer.

**Example** X offered to sell his car to Y for ₹ 1,00,000 subject to the condition that Y should pay an advance of ₹ 20,000 before a certain date. Y accepted the offer but did not send an advance of ₹ 20,000. In this case, the offer has lapsed because the advance was not paid.

5. **By Counter Offer** An offer lapses if the counter offer is made because a counter offer amounts to rejection of the original offer. Counter means making a fresh offer instead of accepting the original offer.

**Example** X offered to sell his car to Y for ₹ 1,00,000. Y said that he would buy it for ₹ 90,000. X refused to sell for ₹ 90,000. Subsequently, Y offered to buy the car for ₹ 1,00,000. Here, Y's offer to buy for ₹ 90,000 is a counter offer which terminates the original offer. Y's second offer to buy for ₹ 1,00,000 is a fresh offer and not an acceptance of the original offer. [Hyde v. Wrench]

6. **By not Accepting in the Prescribed Mode or usual Mode** An offer if it is not accepted in the specific manner (if any, prescribed in the offer) or in some usual and reasonable manner (if no manner has been prescribed in the offer).

**Example** X offered to sell his car to Y for ₹ 1,00,000 and wrote to Y "Send your acceptance by telegram." Y sent acceptance by an ordinary letter. X can reject such acceptance.

7. **By Rejection of Offer by Offeree** An offer lapses if it is rejected by the offeree and offeree communicates his refusal to the offeror. An offer is said to be rejected if the offeree expressly rejects it or accepts it subject to certain conditions. It may be noted that once an offer is rejected, it can not be revived subsequently.

8. **By Subsequent illegality or Destruction of Subject Matter of the Offer** An offer lapses if it becomes illegal or the subject matter is destroyed before its acceptance by offeree.

**Example I** X of Delhi offered supply of 100 tons of sugar to Y at Mumbai on a certain date. Before this offer is accepted by Y, the Central Government issued an order prohibiting the inter-state movement of sugar. Here, X's offer has come to an end.

**Example II** X of Delhi offered to sell his car to Y of Agra for ₹ 1,00,000. Before the offer is accepted by Y, the car is destroyed by fire. Here X's offer has come to an end.

## PRACTICAL PROBLEMS

### PROBLEM 1

X advertises in a newspaper that he would pay ₹ 1,00,000 to anyone who traces his missing son. Y traced that boy and claimed the amount of reward. State whether Y is entitled to receive the amount of reward if (a) he did not know about the reward, (b) if he knew about the reward?

#### Solution:

- (a) Y is not entitled to receive the amount of reward because there can be no valid acceptance without the knowledge of the offer.

[Leading case: Lalman Shukla v. Gauri Dutt]

- (b) Y is entitled to receive the amount of reward because Y has accepted the general offer by tracing the missing son. [Har Bhajan Lal v. Harcharan Lal]

### PROBLEM 2

Mr. X promises to pay ₹ 1,000 per month to Mrs X but fails to pay the promised amount. Mrs X filed a suit against her husband for breach of this agreement. Will she succeed?

**Solution:** She will not succeed because it was a social agreement and the parties never intended to create any legal relations. [Leading case: Balfour v. Balfour]

### PROBLEM 3

X Ltd. was appointed as an agent by Y Ltd. by an agreement. One of the clauses of the agreement provided, "This agreement is not entered into as a formal or legal agreement and shall not be subject to legal jurisdiction in the law courts." Is this agreement a valid contract?

**Solution:** This agreement is not a legally binding contract because there was no intention to create relations. [Leading case: Rose & Frank Company v. Crompton Brothers]

### PROBLEM 4

X wrote to Y, his would be son-in-law, that his daughter would have a share of what he left after the death of his wife. Is the letter a valid offer by X to Y?

**Solution:** The letter was a mere statement of intention and not an offer at all. [Farina v. Fickus]

### PROBLEM 5

X, a broker of Mumbai wrote to Y, a merchant of Ghaziabad stating the terms on which he is willing to do business. Is the letter a valid offer by X to Y?

**Solution:** The letter was a mere statement of intention and not an offer at all. [Devidatt v. Shriram]

### PROBLEM 6

A notice that the goods stated in the notice will be sold by tender. Is the notice a valid offer to sell?

**Solution:** The notice was mere a statement of intention and not an offer to sell. [Spencer v. Harding]

### PROBLEM 7

X, gave an advertisement in a newspaper that a sale of office furniture by auction will be held at 2 p.m. On 9th August 1997 at 'Pragati Maidan, Stall No. 420, New Delhi.' Y from Mumbai reached New Delhi on the appointed date and time but X had cancelled the auction sale. Advise Y.

**Solution:** Y cannot file a suit against X for his loss of time and expenses because the advertisement was merely an invitation to offer and not an offer to sell.

[Leading case: Harris v. Nickerson]

### PROBLEM 8

X delivered a coat to Y, a dry cleaner for dry cleaning and took the receipt. On the back of the receipt, certain conditions were printed in English language. One of the conditions printed on the back was "the liability of the dry cleaner company shall be limited to the 50% of the cost of the goods." X never looked at the back of the receipt. X's coat was lost and X claimed the actual value of the coat. Discuss the legal position in each of the following alternative cases:

**Case:**

- (a) If there was nothing on the face of the receipt to draw the attention to the conditions printed on the back side and X was a graduate in English.
- (b) If on the face of the receipt, the words 'See Back' were printed in English but X did not read it.

**Solution: Case:**

- (a) X was entitled to claim compensation for the loss of his coat because there was no indication on the face of the ticket to draw his attention to the special terms printed on the back of the ticket. [Handerson v. Stevenson]
- (b) X was entitled to claim only 50% of the cost of the coat because there was sufficient notice on the face of the ticket as to the existence of the conditions.

### PROBLEM 9

Mr. X and Mrs X hired a room in a hotel for a week. When they entered the room, they found a notice on the wall disclaiming the owner's liability for damages, loss or theft of articles. Some of their items were stolen. Discuss the legal position.

**Solution:** The owner of the hotel was liable because the special terms (i.e. notice) were communicated after the formation of the contract.

[Leading case: Olley v. Marlborough Court Ltd.]

### PROBLEM 10

X sold his business to Y but this fact was not known to an old customer Z. Z placed an order for certain goods to X by name. Y supplied the goods to Z. Is there a valid contract?

**Solution:** There was no contract at all between Y and Z because Z's offer was a specific offer to X and X alone could accept it.

[Leading case: Boulton v. Jones]

### PROBLEM 11

X offered to sell his car for ₹ 1,00,000 to Y. Y replies "I will pay ₹ 90,000 for it." X refuses to sell at this price. Y then attempts the original offer but X refuses to sell his car. Discuss the legal position.



**Solution:** Y's first reply is a counter offer and not an acceptance of X's offer and has put an end to the original offer. After having made the counter offer, Y cannot accept the original offer which has already come to an end. Hence, X is not bound to sell his car to Y.  
[Leading case: Nihal Chand v. Amar Nath]

### PROBLEM 12

X offered to sell two plots of land to Y at a certain price. Y accepted the offer for one plot. Is there a valid contract?

**Solution:** This is not a contract at all because the acceptance was not valid as it was not for the whole of the offer.  
[Bhawan v. Sadula]

### PROBLEM 13

F offered by a letter to buy his nephew's horse for ₹ 100 saying "If I hear no more about him, I shall consider the horse mine." The nephew sent no reply at all but told B his auctioneer not to sell that particular horse as he intended to sell that horse to F. B sold the horse by mistake. F filed a suit against B. Will he succeed?

**Solution:** F will not succeed because his nephew had not communicated acceptance to him.  
[Felthouse v. Bindley]

### PROBLEM 14

X made an offer to buy shares of Y Ltd. on 10th January 1997 but the allotment was made on 10th July 1997. Is X bound by the acceptance?

**Solution:** X is not bound by the acceptance because the acceptance was not given within a reasonable time.  
[Ramsgate Victoria Hotel Co. v. Montefiore]

### PROBLEM 15

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

- When is the communication of offer complete?
- When is the communication of acceptance complete as against the offerer?
- When is the communication of acceptance complete as against the acceptor?
- If X sends a telegram on 8th January revoking his offer, and this telegram reaches Y before the letter of the acceptance is posted. Is revocation of offer is valid?
- If Y sends a telegram on 14th January revoking his acceptance and this telegram reaches X before the letter of acceptance is received by X. Is revocation of acceptance is valid?

**Solution:**

- The communication of offer is complete on 7th January because the letter containing the offer reaches the offeree on 7th January.

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- (b) The communication of acceptance is complete as against the offerer on 10th Jan. because the letter of acceptance is posted on 10th January.
- (c) The communication of acceptance is complete as against the acceptor, on 15th Jan. because the letter of acceptance is received by the offerer on 15th January.
- (d) X's revocation is valid because X can revoke his offer at any time before the letter of acceptance is posted by the offeree.
- (e) Y's revocation is valid because Y can revoke his acceptance at any time before the letter of acceptance is received by the offerer.

### IMPORTANT POINTS TO REMEMBER

#### 1.0 Meaning, mode and rules for a valid offer

<b>Meaning of Offer</b>	A person is said to have made the proposal when he signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that offer to such act or abstinence.
<b>Meaning of "Offerer"</b>	The person making the proposal is called the offerer or proposer.
<b>Meaning of "Offeree"</b>	The person to whom the proposal is made is called the 'offeree' or 'proposee'.
<b>How to make an offer?</b> (a) Express offer (b) Implied offer	One which is made by words spoken or written. One which is made otherwise than in words. It is inferred from the conduct of the person or the circumstances of the particular case.
<b>To Whom Offer can be Made?</b> (a) Specific Offer  (b) General Offer	A specific offer is one which is made to a definite person or particular group of persons. A specific offer can be accepted only by that definite person or that particular group of persons to whom it has been made.  A general offer is one which is not made to a definite person, but to the world at large or public in general. A general offer can be accepted by any person by fulfilling the terms of the offer.

<b>Legal Rules for a Valid Offer</b>	<ol style="list-style-type: none"> <li>1. Intention to create legal relations</li> <li>2. Certain and unambiguous</li> <li>3. Different from a mere declaration of intention</li> <li>4. Different from an invitation to offer</li> <li>5. Proper communication</li> <li>6. No term the non-compliance of which amount to acceptance</li> <li>7. Communication of special terms</li> </ol>
<b>Meaning of Cross Offers</b>	Two offers which are similar in all respects made by two parties to each other, in ignorance of each other's offer are known as 'cross offers'. Cross offers do not amount to acceptance of one's offer by the other. Hence, no contract is entered into on cross offers.
<b>Meaning of Standing Offer</b>	An offer of a continuous nature is known as 'standing offer'. A standing offer is in the nature of a tender. It is the same thing as an invitation to an offer. A contract is said to have been entered into only when an order is placed on the basis of the tender.

## 2.0 Meaning, mode and rules for a valid acceptance

<b>Meaning of Acceptance</b>	Acceptance means giving consent to the offer. "A proposal is said to be accepted when the person to whom the proposal is made signifies his assent thereto. A proposal when accepted becomes a promise."
<b>Who can Accept Offer?</b>	
<b>(a) In case of Specific Offer</b>	An offer made to a definite person or particular group of persons (called specific offer) can be accepted only by that definite person or that particular group of persons to whom it has been made and none else.
<b>(b) In case of General Offer</b>	An offer made to the world at large or public in general (called general offer) can be accepted by any person having knowledge of the offer by fulfilling the terms of the offer.

<b>How to make an Acceptance</b> <b>(a) Express Acceptance</b> <b>(b) Implied Acceptance</b>	<p>Like an offer, an acceptance may also be <i>either</i> an 'implied acceptance' or 'express acceptance'.</p> <p>An express acceptance is one which is made by words spoken or written.</p> <p>An implied acceptance is one which is made otherwise than in words. In other words, it is inferred from the conduct of the person or the circumstances of the particular case.</p>
<b>Legal Rules for a Valid Acceptance</b> <b>1. Absolute and Unqualified</b> <b>2. Prescribed/Usual Manner</b> <b>3. Communication to Offerer</b> <b>4. Communication by Offeree</b> <b>5. Within Prescribed/ Reasonable Time</b> <b>6. Before Lapse of Offer</b>	<p>It must be absolute &amp; unqualified.</p> <p>The offer must be accepted in the prescribed manner (if any) or in same usual and reasonable manner (if not prescribed)</p> <p>It must be communicated to the offerer.</p> <p>It must be communicated by the offeree or his authorised agent.</p> <p>It must be communicated within the time prescribed (if/any) or within a reasonable time. (if no time in prescribed).</p> <p>It must be made before the offer lapses or is withdrawn.</p>

### 3.0 Communication of Offer and Acceptance

<b>Communication of Offer</b>	The communication of offer is complete when it comes to the knowledge of the person to whom it is made. In case an offer is made by post, its communication will complete when the letter containing the offer reaches the offeree.
<b>(i) Communication of Acceptance as against the proposer Complete....</b>	When it is put in a course of transmission to him, so as to be out of the power of the acceptor. In case of acceptance made by post, the proposer becomes bound by the acceptance as soon as the properly addressed and stamped letter of acceptance is duly posted even if such letter of acceptance is lost or delayed in post.
<b>(ii) Communication of Acceptance as against the acceptor Complete....</b>	When it comes to the knowledge of the proposer. In case of acceptance made by post, the acceptor becomes bound by the acceptance only when the letter of acceptance is actually received by proposer.

**Note:** *The time gap between the date on which the letter of acceptance is posted and the date on which the letter of acceptance is received by the proposer, can be utilized by the acceptor to withdraw his acceptance by a speedier mode of communication so that the revocation notice reaches the proposer before the letter of acceptance.*

#### 4.0 Revocation of Offer and Acceptance

<b>Meaning of Revocation</b>	The term 'revocation' means 'taking back' or 'withdrawal'.
<b>Time Limit within which Offer can be Revoked</b>	<p>A proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards. Hence, an offer can be revoked at any time before the letter of acceptance is duly posted by the acceptor.</p> <p><b>Notes:</b></p> <ol style="list-style-type: none"> <li>1. Revocation must always be expressed.</li> <li>2. Revocation must move from the offerer himself or a duly authorised agent.</li> <li>3. Notice of revocation of a general offer must be given through the same channel by which the original offer was made.</li> <li>4. Offer cannot be revoked even if the letter of acceptance is lost or delayed in transit.</li> </ol>
<b>Time Limit within which Acceptance can be Revoked</b>	"An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards." Hence, an acceptance can be revoked at any time before the letter of acceptance is actually received by the proposer.
<b>No Revocation in Case of Contract over Telephone or Telex or fax</b>	In case of contracts over telephone or telex or fax, the question of revocation does not arise because there is instantaneous communication of the offer and its acceptance (i.e. the offer is made and accepted at the same time).
<b>1. The Communication of Revocation as against the person who makes it is Complete . . .</b>	When it is put in a course of transmission to the person to whom it is made so as to be out of the power of the person who makes it.

<b>2. The Communication of Revocation as against the person to whom it is made is Complete . . .</b>	When it comes to his knowledge.
<b>When does An Offer come to end? (or Lapse of An offer)</b>	<ol style="list-style-type: none"> <li>1. By Revocation</li> <li>2. By Lapse of time</li> <li>3. By Death or insanity of the offerer/offeree</li> <li>4. By Failure to Accept condition Precedent</li> <li>5. By Counter Offer</li> <li>6. By not Accepting in the Prescribed Mode or usual Mode</li> <li>7. By Rejection of Offer by Offeree</li> <li>8. By Subsequent illegality or Destruction of Subject Matter of the Offer</li> </ol>

### TRUE OF FALSE QUESTIONS

**State with reasons whether the following statements are True or False:**

1. An express offer must be in writing.
2. A bid at an auction is an express offer.
3. An advertisement to pay reward to anyone who traces the missing boy of the advertiser is a specific offer.
4. An advertisement to sell goods by auction is an offer.
5. An advertisement offering reward to anyone who finds the lost dog of the advertiser is not an offer.
6. An acceptance of an invitation for dinner does not create any legal obligations.
7. Special terms and conditions of an offer may be communicated later on.
8. If the offeree remains silent, it means that he has accepted the offer.
9. A specific offer can be accepted by anyone.
10. A general offer can be accepted by anyone.
11. In social agreements, the usual presumption is that the parties do not intend to create legal relations.
12. In commercial agreements, the usual presumption is that parties intend to create legal relations.
13. A notice that the goods stated in the notice will be sold by tender amounts to an offer to sell.
14. The offer must not contain any term the non-compliance of which would amount to an acceptance.

15. Two offers which are similar in all respects made by two different parties to one person are known as cross offers.
16. A standing offer is in the nature of a tender.
17. A standing offer is an invitation to offer.
18. A counter offer amounts to rejection of original offer.
19. If counter offer is not accepted, the original offer can be accepted.
20. Acceptance may be communicated by any person.
21. Communication of offer is complete when the properly addressed and stamped letter of offer is duly posted by the offerer.
22. Communication of acceptance is complete when it comes to the knowledge of the offerer.
23. An offer can be revoked at any time before its acceptance is complete as against the offeree.
24. An acceptance can be revoked at any time before the letter of acceptance reaches the offerer.
25. The communication of acceptance is complete as against the acceptor when it is put into a course of transmission.
26. Death or insanity of the proposer automatically revokes the proposal.
27. Crossing of letters of offer in the post for the sale and purchase of the same article constitute a valid agreement.
28. A proposal may be revoked by the proposer before the posting of the letter of acceptance by the acceptor.
29. If an offer is made in the form of a promise in return for any act, the performance of that act even without any communication thereof is to be treated as an acceptance of the offer.
30. Acceptance can be made even without the knowledge of the offer.
31. An agreement with intention to create legal liability is not enforceable by law.
32. A valid contract results from identical cross offers.

### ANSWERS

1. False 2. False 3. False 4. False 5. False 6. True 7. False 8. False 9. False  
 10. True 11. True 12. True 13. False 14. True 15. False 16. True 17. True 18. True  
 19. False 20. False 21. False 22. False 23. False 24. True 25. False 26. False  
 27. False 28. True 29. True 30. False 31. False 32. False

### VERY SHORT ANSWER TYPE QUESTIONS

1. What is an offer?
2. Who is called an offerer?
3. Who is called an offeree?

4. What is meant by an express offer?
5. What is meant by an implied offer?
6. What is meant by specific offer?
7. What is meant by general offer?
8. What are cross offers?
9. What is 'standing offer'?
10. What is acceptance?
11. What is an 'express acceptance'?
12. What is an 'implied acceptance'?
13. What happens if an offer is not accepted in the prescribed mode?
14. What happens if the acceptance is not made according to the mode prescribed?

### SHORT ANSWER TYPE QUESTIONS

1. How can an offer be made?
2. To whom an offer can be made?
3. How can an offer be accepted?
4. Who can accept an offer?
5. When is communication of offer complete?
6. When is communication of acceptance complete as against the offerer?
7. When is communication of acceptance complete as against the acceptor?
8. When is communication of revocation complete?
9. Is there any limit of time after which an offer cannot be revoked?
10. Is there any limit of time after which an acceptance cannot be revoked?
11. When does an offer come to an end?
12. Can the following be regarded as offer?
  - (a) An advertisement to sell goods by auction.
  - (b) An advertisement by a Company for subscribing to its shares.
  - (c) An advertisement offering reward to anyone who finds the lost dog of the advertiser.
  - (d) Display of goods with price tags attached to them in the showcase.
  - (e) A catalogue of goods for sale.
13. Comment on the following statements:
  - (a) An invitation to offer is an offer.
  - (b) Acceptance must be something more than a mere mental assent.
  - (c) There cannot be a contract to make a contract.
  - (d) Acceptance is to offer what a lighted match is to a train of gunpowder.
  - (e) An acceptance to be effective must be communicated to the offerer.



14. Write short notes on the following:
- (a) Counter offer
  - (b) Cross offer
  - (c) Standing offer
  - (d) Lapse of offer
  - (e) General offer
  - (f) Implied offer
  - (g) Implied acceptance
  - (h) Invitation to offer
  - (i) Contracts over telephone
  - (j) Contracts by post
15. Distinguish between the following:
- (a) Offer and invitation to offer
  - (b) Offer and mere statement of intention
  - (c) Counter offer and Cross offers
  - (d) Revocation of offer and lapse of offer

### LONG ANSWER TYPE QUESTIONS

1. (a) What is an offer?  
(b) When does it complete?  
(c) Discuss the legal rules of a valid offer.
2. (a) What is an acceptance?  
(b) How can an offer be accepted?  
(c) Discuss the legal rules of a valid acceptance.
3. Explain briefly the legal provisions relating to the communication of offer.
4. Explain briefly the legal provisions relating to the communication of acceptance.
5. How and on what grounds does an offer stand revoked? Is there any limit of time after which an offer cannot be revoked?
6. How can an acceptance be revoked? Is there any limit of time after which an acceptance cannot be revoked?





# Capacity of Parties

## 1.0 WHO IS COMPETENT TO CONTRACT?

1. According to Section 11 of the Indian Contract Act, 1872, "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject."
2. **Three Tests** All the three tests (viz. age, soundness, disqualification) must be applied to determine whether a person is competent to contract or not. The following table summarises the result of these tests.

Test to check competency	The person is competent to contract	The person is not competent to contract in the following cases						
(a) Whether he is of the age of majority	Yes	Yes	Yes	No	No	No	Yes	No
(b) Whether he is of sound mind	Yes	Yes	No	Yes	No	Yes	No	No
(c) Whether he is not disqualified from contracting	Yes	No	Yes	Yes	Yes	No	No	No

## 2.0 AGREEMENTS WITH A MINOR

### WHO IS MINOR ?

A minor is a person who has not attained majority. According to Section 3 of the Indian Majority Act, 1875, a person is deemed to have attained majority as under:

(a) Where a guardian of a minor's person or property is appointed under the Guardian and Wards Act, 1890	On completion of 18 years
(b) Where minor's property has passed under the superintendence of the court of wards	On completion of 21 years
(c) In other cases	On completion of 21 years

### POSITION OF AGREEMENTS BY A MINOR

The law protects minor's rights because they are not mature and may not possess the capacity to judge what is good and what is bad for them. The position of agreements with or by a minor may be summarised as under:

1. **Void:** An agreement with a minor is void ab-initio  
[Leading case Law **Mohiri Bibee v. Dharmodas Ghosh**]  
Facts D, a minor borrowed a sum from M by executing a mortgage of his property in favour of M. Subsequently, D sued for setting aside the mortgage. The privy council held that Sections 10 and 11 of the Indian Contract Act make the minor's agreement void and therefore the mortgage was not valid. M prayed for refund of the amount by the minor. It was held that the money advanced to minor cannot be recovered because minor's agreement was void.
2. **No Estoppel:** A minor is not estopped from setting up the plea of minority. He may plead infancy to escape from being liable. In *G. Bhimappa Meti v. Balangowda Bhimangowda*; the Bombay High Court held that "Where an infant represents fraudulently or otherwise that he is of age and thereby induces another to enter into a contract with him, he in an action founded on the contract, is not estopped from setting up infancy."
3. **In case of fraudulent representation of age by minor:** According to Sections 30 and 33 of the Specific Relief Act, 1963, in case of a fraudulent misrepresentation of his age by the minor inducing the other party to enter into a contract, the court may award compensation to the other party. The Lahore High Court in *Khan Gul v. Lakha Singh* held that where the contract is set aside, the status quo ante should be restored and the court may direct the minor on equitable grounds to restore the money or property to the other party if the money or property could be traced.
4. **No Ratification on attaining the age of majority:** An agreement with a minor cannot be ratified even after he attains majority. Ratification relates back to the date of the making of the agreement and therefore an agreement which was then void cannot be made valid by subsequent ratification. In *Indran Ramaswamy v. Anthaoppa*, a person on attaining majority, gave a promissory note in satisfaction of one executed by him for money borrowed when he was a minor. It was held that the claim under the promissory note could not be enforced because there was no consideration.
5. **Contract for supply of necessities**
  - (a) A person who has supplied the necessities to a minor or to those who are dependent on him is entitled to be reimbursed from the property of such minor.  
[Section 68]
  - (b) **Meaning of Necessaries:** The term necessities includes articles required to maintain a particular person in the state, degree and station in life in which he is. In India, food, clothing, shelter, education and marriage of a female have been held to be necessities.
  - (c) Section 68 covers the reimbursement for the supply of such items or loans for

the same. Example: In case of *Nash v. Inman*, a minor bought eleven fancy coats from N for his own use. It was held that eleven coats at a time cannot be a necessity. Section 68 also covers the rendering of necessary services to a minor. For example, the lending of a money to a minor for the purpose of defending him in prosecution is deemed to be a service rendered to the minor.

- (d) **'Claim against property and not against person':** A claim for the payment of necessities supplied can be made against the minor's property and not against the minor personally. In other words, a minor cannot be asked to expend labour in exchange.
  - (e) **Liability of minor's guardian:** The parent or guardian of a minor cannot be held liable unless those goods/services are supplied/rendered to a minor as the agent of the parent or guardian.
6. **Contract by minor's guardian:** The contracts entered into on behalf of a minor by his guardian or manager of his estate can be enforced by or against the minor if the contract (a) is within the scope of the authority of guardian or manager, and (b) is for the benefit of the minor. [*Subramanyam v. Subba Rao*]. It may also be noted that his guardian cannot enter into a valid contract for purchase of the immovable property for his/her service.
  7. **Contract for the benefit of a minor:** A minor can be a promisee. In *Raghva Chariar v. Srinivasa*, the Madras High Court held that a mortgage executed in favour of a minor who has advanced the mortgage money is enforceable by him or by any other person on his behalf. Similarly, in case of sale of goods by a minor, he is entitled to recover the price from the buyer. Thus, he may be a promisee but not promisor on a promissory note or a drawer but not drawee on a bill of exchange.
  8. **Minor as a partner:** A minor cannot become a partner in a partnership firm. However, according to Section 30 of Indian Partnership Act 1932, with the consent of all the partners for the time being he is admitted to the benefits of partnership. In other words, he can share the profits without incurring any personal liability.
  9. **Minor as an agent:** A minor can act as an agent and bind his principal by his acts without incurring any personal liability.
  10. **Minor as a shareholder or member of a company:** A minor can become a shareholder or member of a Company if (a) the shares are fully paid up and (b) the articles of association do not prohibit so.
  11. **Minor as an insolvent:** A minor cannot be declared insolvent because he is not competent to contract.
  12. **Minor as an Apprentice:** A minor can be apprentice if he is of at least 14 years of age.
  13. **Minor as an Employee:** A minor can not be an employee because minor's promise to serve is not a consideration for employer's promise to pay salary.  
[*Raj Rani vs. Prem Adib*]
  14. **Minor as guarantor:** A minor can not be a guarantor.
  15. **Validity of minor's agreement jointly with a major person:** The agreements

made by a minor jointly with a major person are void vis-a-vis the minor but can be enforced against the major person who has jointly promised to perform.

- 16. Minor's liability in Tort:** A minor may be held liable in Tort (civil wrong). But if in the course of doing what he is entitled to do under the contract, he is found guilty of negligence, he cannot be made liable on tort if he is not liable on the contract, e.g. in *Burnard v. Huggis*, a minor hired a horse promising not to jump it. He lent the horse to his friend who used the horse against the instructions and this led to the death of the horse. The minor was held liable on Tort. But in another case a horse was hired for riding. The horse was injured due to over-riding. The minor could not be held liable since the injury resulted from negligence in the course of what he was entitled to do under the contract. Since he was not liable on the contract himself, he could not be held liable in tort too. (*Jennings v. Randall*).

## 3.0 POSITION OF PERSONS OF UNSOUND MIND

### WHO IS A PERSON OF UNSOUND MIND?

According to Section 12 of the Indian Contract Act, "A person is said to be of sound mind for the purpose of making a contract, if at the time when he makes it, is capable-

- (a) to understand the terms of the contract,
- (b) to form a rational judgment as to its effect upon his interests."

Thus, if a person is not capable of both, he is said to have suffered from unsoundness of mind. The examples of persons having an unsound mind include idiots, lunatics and drunken persons. A person who is so mentally deficient by birth as to be incapable of ordinary reasoning or rational conduct is said to be an 'idiot'. A person affected by lunacy is said to be 'lunatic'. A person can become lunatic at any stage of his life.

### POSITION OF A PERSON WHO IS USUALLY OF UNSOUND MIND BUT OCCASIONALLY OF SOUND MIND

He may make a contract when he is of sound mind."

**Example.** *A patient in a lunatic asylum who is at intervals of sound mind may contract during those lucid intervals.*

### POSITION OF A PERSON WHO IS USUALLY OF SOUND MIND BUT OCCASIONALLY OF UNSOUND MIND

He may not make a contract when he is of unsound mind."

**Example.** *A sane man who is so drunk that he cannot understand the terms of a contract or form a rational judgment as to its effect on his interest, cannot enter into contract whilst such drunkenness lasts.*

Thus, a person can enter into contract only when he is of sound mind.

### BURDEN OF PROOF

The law presumes that every person is of sound mind.

The rules regarding the burden of proof are summarised as under:

Case	The burden of proof lies on . . .
I. Where a person is usually of sound mind	The burden of proving that he was of unsound mind at the time of contract lies on the person who challenges the validity of contract.
II. Where a person is usually of unsound mind	The burden of proving that he was of sound mind at the time of contract, lies on the person who affirms it.
III. In case of drunkenness or delirium from fever or other causes	The burden of proving that he was delirious from fever or was so drunk at the time of contract, lies on the person who challenges the validity of the contract.

### POSITION OF AGREEMENTS WITH PERSONS OF UNSOUND MIND

The position of agreements of persons of unsound mind is summarised as under:

Persons of unsound mind	Capacity to enter into contract
<b>I. Lunatic (i.e. a person who is mentally deranged due to some mental strain or other personal experience but who has some lucid intervals of sound mind)</b>	
(a) While he is of unsound mind	He cannot enter into any contract. Any agreement entered into by him during this period is altogether void and he cannot be held liable thereon.
(b) While he is of sound mind	He can enter into a valid contract and he is liable for such contracts.
<b>II. Idiots (i.e. a person who is permanently of unsound mind)</b>	He cannot enter into any contract. Any agreement entered into by him is altogether void and he is not liable thereon.
<b>III. Drunken person (i.e. a sane person who is delirious from fever or who is so drunk that he cannot understand the terms of a contract or form a rational judgment as to its effect on his interest)</b>	He cannot contract while such delirium or drunkenness lasts.

**Exceptions** The position of contracts with persons of unsound mind is identical with that of contracts with a minor. Thus, the position of contracts with persons of unsound mind is as under:

- (a) He may enforce a contract for his benefit;
- (b) His properties shall be attachable for realisation of money due against him for the supply of necessities to him or to any of his dependents.

#### 4.0 PERSONS DISQUALIFIED BY LAW

Besides minors and persons of unsound mind, there are others who are disqualified from contracting under the provisions of some other laws. Such persons have been discussed below:

##### ALIEN ENEMY

- (a) An alien is a person who is the citizen of a foreign country. An alien may either an alien friend or an alien enemy.
- (b) An alien whose country is at peace with the Republic of India is called as alien friend. He has usually the full contractual capacity.
- (c) An alien whose country is at war with the Republic of India is called an alien enemy. His contractual capacity can be summarised as under:

<b>I. Position of contracts during the war</b>	An alien enemy can neither enter into any contract nor can be sued in an Indian Court except by licence from the Central Government.
<b>II. Position of contracts entered into before the war</b>  <b>(a) If such contracts are against the public policy or are such that may benefit the enemy</b>  <b>(b) If such contracts are not against public policy</b>	  (a) Such contracts stand dissolved.  (b) Such contracts are merely suspended for the duration of the war and revived after the war is over unless they have already become time barred under the Law of Limitation Act.

**Example X**, an Indian, carries on a business in Pakistan. He enters into a contract with Y who carries on business in India. Immediately after the formation of the contract, a war broke out between India and Pakistan. In this case, X becomes an alien enemy though he is Indian and the contract between X and Y (if not against the public policy) will be suspended for the duration of the war and revived after the war is over.

- 2. **Foreign Sovereigns and Ambassadors** They can enter into contracts and enforce those contracts in our courts but they **cannot be sued** in our courts without the sanction of the Central Government unless they choose to submit themselves



to the jurisdictions of our Courts.

**Notes:**

- (i) An ex-king can be sued in our Courts.
  - (ii) Where a foreign sovereign etc. enter into a contract through an agent residing in India, the agent shall be held liable on the contract.
3. **Convicts** A person is called a convict during his period of sentence. His contractual capacity is summarised as under:

(a) During the period of sentence	He cannot enter into any contract.
(b) After the expiration of the period of sentence or when he is on parole.	He can enter into a contract. He can sue on a contract.

4. **Company under the Companies Act or Statutory Corporation under the Special Act of Parliament** The contractual capacity of the company and the statutory corporation is summarised as under:

(a) In case of a Company	Its contractual capacity is determined by the 'object clause' of its Memorandum of Association.
(b) In case of Statutory Corporation	Its contractual capacity is determined by the statute creating it.

Any act done in excess of the power given is ultra vires (i.e. beyond power) and hence void.

5. **Insolvents** When a person's debts exceed his assets, he is adjudged insolvent and his property stands vested in the Official Receiver or Official Assignee appointed by the Court. Such person—
- (i) cannot enter into contracts relating to his property,
  - (ii) cannot sue,
  - (iii) cannot be sued.

**Note:** When the insolvent is discharged, the aforesaid disqualification is removed.

## PRACTICAL PROBLEMS

### PROBLEM 1

D, a minor, borrowed a sum from M by executing a mortgage of his property in favour of M. Subsequently, D sued for setting aside the mortgage. Is mortgage valid? Can M recover the sum advanced to D?

**Solution:** Section to which the given problem relates: Section 10 and Section 11.

**Decision:** The mortgage was not valid and the money advanced to minor cannot be recovered.

**Reason:** A minor is not competent to contract and hence minor's contract is void.

[**Leading case:** Mohiri Bibee v. Dharmodas Ghosh]

### PROBLEM 2

X, on attaining majority, gave a promissory note in the satisfaction of one executed by him for money borrowed when he was a minor. Is this promissory note valid?

**Solution:** Sections to which the given problem relates: Section 10 and Section 11.

**Decision:** The promissory note is not valid and hence cannot be enforced.

**Reason:** There was no consideration.

[**Leading case:** Ramaswamy v. Anthaoppa]

### PROBLEM 3

X, executed a mortgage in favour of Y, a minor who has advanced the money. Is this mortgage valid?

**Solution:** The mortgage is valid and hence the money advanced to X can be recovered.

**Reason:** A minor can be a promisee.

[**Leading case:** Raghva Charar v. Srinivasa]

### PROBLEM 4

X, a guardian, on behalf of Y, a minor, entered into a contract with Z for the purchase of a movable property for the benefit of the minor. Is the contract valid?

**Solution:** Section to which the given problem relates: Section 10 and Section 11.

**Decision:** This contract is valid provided this contract is within the scope of the authority of guardian.

**Reason:** This contract is for the benefit of minor.

[**Leading case:** Subramanayan v. Subba Rao]

### PROBLEM 5

X, a minor entered into contract with Y to supply food and clothes to his dependents. Y supplied the same but X refused to pay for the same. Can Y recover anything?

**Solution:** Section to which the given problem relates: Section 68.

**Decision:** Y is entitled to be reimbursed from the property of such minor.

**Reason:** A person who has supplied the necessaries to a minor or those who are dependents on him is entitled to be reimbursed from the property of such minor.

### PROBLEM 6

X, a guardian, on behalf of Y, her minor daughter, entered into a contract with Z whereby Z promised to marry her. Later on Z refused to marry. Can Y sue Z for damages?

**Solution:** Sections to which the given problem relates: Sections 10 and 11.

**Decision:** Y can sue Z for damages.

**Reason:** This contract was for the benefit of minor and a minor can be promisee.

[**Leading case:** Mohiri Bibee v. Dharmodas Ghosh]

## PROBLEM 7

X agreed to sell his property worth about ₹ 1,00,000 for ₹ 10,000 only. X's mother proved that X was a congenital idiot, incapable of understanding the transaction. Is this sale valid?

**Solution:** Section to which the given problem relates: Section 12.

**Decision:** This sale is void.

**Reason:** X was incapable of exercising his own judgment as to whether the act he is about to do is in his interest or not.

## IMPORTANT POINTS TO REMEMBER

### 1.0 Who is competent to contract?

<b>Major</b>	Person who is of the age of majority according to the law to which he is subject
<b>Sound Mind</b>	Person who is of sound mind.
<b>Not Disqualified</b>	<p>Person who is not disqualified from contracting by any law to which he is subject</p> <p><b>Note:</b> A minor whose property has passed under superintendence of the court of wards where a guardian has been appointed under the Guardian and Wards Act, 1890, attains majority on completion of 21 years and in other case minor attains majority on completion of 18 years.</p>

### 2.0 Position of Agreements by a Minor

<b>Void-ab-initio</b>	An agreement with a minor is <i>void ab-initio</i> . [ <b>Mohiri Bibee v. Dharmodas Ghose</b> ]
<b>No Estoppel</b>	A minor is not estopped from setting up the plea of minority. He may plead infancy to escape from being liable.
<b>In case of fraudulent representation of age by minor</b>	The Court may award compensation to the other party if the money or property supplied to minor could be traced.

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<b>No Ratification on attaining the Age of Majority</b>	An agreement with a minor cannot be ratified even after he attains majority. <b>Ratification relates back to the date of the making of the agreement</b> and therefore an agreement which was then void cannot be made valid by subsequent ratification.
<b>Validity of Minor's Agreement jointly with a Major Person</b>	The agreements made by a minor jointly with a major person are void vis-a-vis the minor but can be enforced against the major person who has jointly promised to perform.
<b>Minor as a Partner</b>	A minor cannot become a partner in a partnership firm. However, with the consent of all the partners, minor may be admitted to the benefits of partnership.
<b>Minor can be an Agent and not Principal</b>	A minor can act as an agent and bind his principal by his acts without incurring any personal liability.
<b>Minor can be a Shareholder or Member of a company</b>	A minor can become a shareholder or member of a Company if (a) the shares are fully paid up and (b) the articles of association do not prohibit so.
<b>Minor can not be an Insolvent</b>	A minor cannot be declared insolvent because he is not competent to contract.
<b>Contract for Minor's Benefit</b>	A minor can be a promisee.
<b>Contract by Minor's Guardian</b>	The contracts entered into on behalf of a minor by his guardian or manager of his estate can be enforced by or against the minor if the contract (a) is within the scope of the authority of guardian or manager, and (b) is for the benefit of the minor. It may also be noted that his guardian cannot enter into a valid contract for purchase of the immovable property for his/her service.

<b>Contract for Supply of Necessaries</b>	<ol style="list-style-type: none"> <li>1. A person who has supplied the necessities to a minor or to those who are dependent on him is entitled to be reimbursed from the property of such minor.</li> <li>2. <b>Meaning of Necessaries:</b> The term 'necessaries' includes articles required to maintain a particular person in the state, degree and station in life in which he is. In India, food, clothing, shelter, education and marriage of a female have been held to be necessities.</li> <li>3. Section 68 covers the reimbursement for the supply of such items or loans for the same. Section 68 also covers the rendering of necessary services to a minor.</li> <li>4. <b>'Claim against Property and not against Person'</b> A claim for the payment of necessities supplied can be made against the minor's property and not against the minor personally. In other words, a minor cannot be asked to expend labour in exchange.</li> <li>5. <b>Liability of Minor's Guardian</b> The parent or guardian of a minor cannot be held liable unless those goods/ services are supplied/rendered to a minor as the agent of the parent or guardian.</li> </ol>
<b>Minor's Liability in Tort</b>	A minor may be held liable in Tort (civil wrong). But if in the course of doing what he is entitled to do under the contract, he is found guilty of negligence, he cannot be made liable on tort if he is not liable on the contract.

### 3.0 Position of Persons of unsound Mind

<b>Who is a Person of Unsound Mind?</b>	<p>"A person is said to be of sound mind for the purpose of making a contract, if at the time when he makes it, is capable—</p> <ol style="list-style-type: none"> <li>(a) to understand the terms of the contract,</li> <li>(b) to form a rational judgment as to its effect upon his interests."</li> </ol>
<b>When can make Contract?</b>	"A person who is usually of unsound mind but occasionally of sound mind may make a contract when he is of sound mind."

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<b>When can not make Contract?</b>	"A person who is usually of sound mind but occasionally of unsound mind may not make a contract when he is of unsound mind."
<b>Position of Contracts with Person of Unsound Mind</b>	The position of contracts with persons of unsound mind is identical with that of contracts with a minor. Thus, (a) He may enforce a contract for his benefit; (b) His properties shall be attachable for realisation of money due against him for the supply of necessities to him or to any of his dependents.

#### 4.0 Position of Persons Disqualified by Law

<b>Alien Enemy</b>	An alien whose country is at war with the Republic of India is called an alien enemy.	
	<b>I. Position of Contracts during the war</b>	An alien enemy can <i>neither</i> enter into any contract <i>nor</i> can be sued in an Indian Court except by licence from the Central Government.
	<b>II. Position of Contracts entered into before the war</b>  <b>(a) <i>If such contracts are against the public policy or are such that may benefit the enemy</i></b>  <b>(b) <i>If such contracts are not against public policy</i></b>	<b>(a)</b> Such contracts stand dis-solved.  <b>(b)</b> Such contracts are merely suspended for the duration of the war and revived after the war is over unless they have already become time barred under the Law of Limitation Act.

<b>Foreign Sovereigns and Ambassadors</b>	They can enter into contracts and enforce those contracts in our courts but they cannot be sued in our courts without the sanction of the Central Government unless they choose to submit themselves to the jurisdictions of our Courts.
<b>Convicts</b>	A person is called a convict during his period of sentence.
<b>Company</b>	<b>Contractual Capacity</b> is determined by the 'Object Clause' of its Memorandum of Association.
<b>Statutory Corporation</b>	<b>Contractual Capacity</b> is determined by the statute creating it.
<b>Act Ultra vires</b>	Any act done in excess of the power given is <i>ultra vires</i> (i.e. beyond power) and hence <b>void</b> .
<b>Insolvents</b>	When a person's debts exceed his assets, he is adjudged insolvent and his property stands vested in the Official Receiver or Official Assignee appointed by the Court. Such person— (a) cannot enter into contracts relating to his property, (b) cannot sue, (c) cannot be sued.

### TRUE OR FALSE QUESTIONS

**State with reasons whether the following statements are True or False:**

1. A minor who is of sound mind is competent to contract.
2. A major who is of unsound mind is not competent to contract.
3. A contract with a minor is voidable at the option of the minor.
4. The court shall not award any compensation to the other party even in case of a fraudulent misrepresentation of his age by the minor.
5. An agreement with a minor can be ratified after he attains majority.
6. An agreement made by a minor with a major person can neither be enforced against the minor person nor against the major person.
7. A minor together with two major persons can form a partnership.
8. A minor can act as principal.
9. A minor cannot act as an agent.
10. A minor can be shareholder even if the shares are partly paid up.
11. A minor can also be declared as insolvent.
12. A minor can be a payee of a cheque.
13. A minor cannot recover the price of his goods sold on credit to a major person.
14. The contracts entered into on behalf of a minor by his guardian cannot be enforced

against the minor.

15. A contract entered into on behalf of a minor by his guardian for the purchase of immovable property for the benefit of the minor is valid.
16. A minor is personally liable for the necessities supplied to him or his dependents.
17. Guardian of a minor shall not be held liable for necessities supplied to minor or his dependents.
18. A person who is usually of an unsound mind cannot enter into contract even when he is of a sound mind.
19. A person who is usually of a sound mind cannot enter into contract when he is of unsound mind.
20. A person of sound mind can make a valid contract even when he is so drunk that he is incapable of forming a rational judgment.
21. An idiot can never enter into a contract.
22. A lunatic can never enter into a contract.
23. An alien friend can acquire property in India.
24. A convict cannot enter into a contract even when he is on parole.
25. When a person is declared an insolvent, he cannot be sued.

#### **ANSWERS**

1. False 2. True 3. False 4. False 5. False 6. False 7. False 8. False 9. False  
10. False 11. False 12. True 13. False 14. False 15. False 16. False 17. True  
18. False 19. True 20. False 21. True 22. False 23. True 24. False 25. True

#### **VERY SHORT ANSWER TYPE QUESTIONS**

1. Is a minor who is of sound mind competent to contract?
2. What are necessities?
3. Can a minor be promisee?

#### **SHORT ANSWER TYPE QUESTIONS**

1. Who is competent to contract?
2. State the effect on a contract where a minor, a party to the contract is guilty of deliberate misrepresentation with regard to his age.
3. Name the persons who are treated as persons of unsound mind.
4. Name the persons forbidden under other laws for the time being in force, to enter into contracts.

#### **LONG ANSWER TYPE QUESTIONS**

1. (a) Who is competent to contract?  
(b) Discuss briefly the position of a minor with regard to the contracts entered into by him.



2. (a) Who are treated as persons of unsound mind?  
(b) State the legal position of contracts with such persons.
3. (a) Who are treated as persons disqualified by law other than minor and persons of unsound mind?  
(b) State the legal position of contracts with such persons.



# 4

## Consideration

### 1.0 WHAT IS CONSIDERATION?

1. Consideration is one of the essential elements of a valid contract.
2. The term 'consideration' means something in return, i.e. *quid-pro-quo*. What is 'something' has been explained by Justice Lush J. in a leading English case *Currie v. Misa* as under:

"A valuable consideration in the sense of the law, may consist *either* in some right, interest, profit or benefit accruing to the one party or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other."

3. Thus, consideration must result in a benefit to the promisor, and a detriment or loss to the promisee or a detriment to both.
4. Section 2(d) of the Indian Contract Act, 1872 defines consideration as under:

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

**Example I** *X promises to deliver his good to Y and Y promises to pay ₹ 1,000 on delivery. In this case, the consideration for each of these promises is as under:*

Promise	Consideration
For X's promise	Y's promise to pay ₹ 1,000 on delivery
For Y's promise	X's promise to deliver his goods.

**Example II** *X owes Y ₹ 10,000. Y promises X not to file a suit against him for one year on X's agreeing to pay him ₹ 500 more. In this case, the consideration for each of the promise is as under:*

Promise	Consideration
For X's promise	Forbearance on the part of Y to file a suit
For Y's promise	X's promise to pay ₹ 500 more

## 2.0 ESSENTIAL ELEMENTS OF VALID CONSIDERATION

On the basis of definition of consideration as per Section 2(d), the essential elements of valid consideration are discussed below:

1. **It must be given only at the Desire of the Promisor** An act constituting consideration must have been done at the desire or request of the promisor. Thus, an act done at the desire of a third party or without the desire of the promisor cannot constitute a valid consideration.

**Example** *I A's son is lost and B goes in search for him. Can B claim remuneration from A, (a) if B does this act voluntarily, (b) if B does this act at the request of A, (c) if B does this act at the request of C?*

Case	Decision and reason
(a) If B does this act voluntarily	B cannot claim remuneration from A because he has not done at A's request.
(b) If B does this act at the request of A	B can claim remuneration from A because he has done at A's request.
(c) If B does this act at the request of C	B cannot claim remuneration from A because he has not done at A's request.

**Example II** *X spent ₹ 1,00,000 on the construction of shops at the request of the collector of the District. In consideration of this Y a shopkeeper promised to pay some money to X. It was held that this agreement was void being without consideration because X had constructed the shops at the request of collector and not at the desire of Y. [Durga Prasad v. Baldeo]*

2. **It may move from any Person** An act constituting consideration may be done by the promisee himself or any other person (i.e. stranger to consideration). Thus, it is immaterial who furnishes the consideration and therefore, may move from the promisee or any other person who may be stranger to the contract.

Thus, privity of consideration is not required.

**Example** *X, by a deed of gift transferred certain property to her daughter Y with a direction that Y should pay Z an annuity. On the same day, Y executed a deed in writing in favour of Z and agreed thereby to pay the annuity. Later, Y refused to pay the annuity on the plea that no consideration had moved from Z. It was held that Z was entitled to maintain suit because a consideration need not necessarily move from the promisee, it may move from any other person (i.e. X in the present case). [Chinnayya v. Ramayya]*

3. **It may be Past or Present or Future** The consideration may be past, present or future.

<b>Past Consideration</b>	<p>The consideration which has already moved before the formation of agreement.</p> <p><b>Example</b> <i>X renders some service to Y at Y's request in the month of May. In June, Y promises to pay X ₹ 1,000 for his past services. Past services amount to past consideration. X can recover ₹ 1,000 from Y.</i></p>
<b>Present Consideration</b>	<p>The consideration which moves simultaneously with the promise, is called present consideration.</p> <p><b>Example</b> <i>In case of cash sale, promise to pay the price and promise to deliver the goods are performed simultaneously.</i></p>
<b>Future Consideration or Executory consideration</b>	<p>The consideration which is to be moved after the formation of agreement is called future consideration.</p> <p>The liability is outstanding against both the parties.</p> <p><b>Example</b> <i>X promises to deliver certain goods to Y after 10 days and Y promises to pay after 10 days from the date of delivery.</i></p>

**Tutorial Note:** The English Law does not recognise the past consideration.

4. **It must be of Some Value** The consideration need not be adequate to the promise but it must be of some value in the eye of the law. It is understood in the sense of something in return and that something can be anything, adequate or grossly inadequate. According to Explanation 2 of Section 25, an agreement to which the consent of the promisor 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 promisor was freely given.

**Example** *A agrees to sell a horse worth ₹ 1,000 for ₹ 10. A denies that his consent to the agreement was freely given. The inadequacy of the consideration is a fact which the Court should take into account in considering whether or not A's consent was freely given.*

5. **It must be Real and not Illusory** The consideration must be real and not illusory. (i.e., existing only in name)

**Example I** *X engages Y for doing a certain work and promises to pay reasonable remuneration. This promise is not enforceable because the consideration is uncertain.*

**Example II** *X promises to put life into Y's dead wife and Y promises to pay ₹ 1,00,000. This agreement is void because consideration is physically impossible to perform.*

- 6. Something other than the Promisor's Existing Obligation** The act constituting consideration must be something which the promisor is not already bound to do because a promise to do what a promisor is already bound to do adds nothing to the existing obligation.

**Example I** *X promises Y, his advocate, to pay an additional sum if the suit was successful. The suit was declared in favour of X but X refused to pay additional sum. It was held that Y could not recover additional sum because the promise to pay additional sum was void for want of consideration as Y was already bound to render his best services under the original agreement. [Ramchandra Chintamana v. Kalu Raju]*

**Example II** *X had received summons to appear before a court of law as witness on behalf of Y who promised to pay some money for his trouble. It was held that the promise to pay money was void for want of consideration because X was under a legal duty to appear as witness before court of law. [Collins v. Godefrey]*

- 7. Lawful** The consideration must neither be unlawful nor opposed to public policy.

**Example I** *X promises Y to pay ₹ 1,000 to beat Z, Y beats Z and claims ₹ 1,000 from X, X refuses to pay. Y cannot recover because the agreement is void on the ground of unlawful consideration.*

**Example II** *X promises Y to obtain an employment in the public service and Y promises to pay ₹ 1,000 to X. The agreement is void on the ground of unlawful consideration.*

### 3.0 STRANGER TO CONSIDERATION CAN SUE BUT A STRANGER TO A CONTRACT CAN NOT SUE

#### A STRANGER TO CONSIDERATION CAN SUE

A stranger to consideration can sue because the consideration can be furnished or supplied by any person whether he is the promisee or not.

#### A STRANGER TO CONTRACT CAN NOT SUE

A stranger to a contract cannot sue because of the absence of privity of contract (i.e. relationship subsisting between the parties to a contract).

**Example I** *X owes Y ₹ 1,00,000 and sells his property to Z. Z promises to pay off X's debt to Y. Z fails to pay. Y cannot sue Z because he is a stranger to a contract.*

**Example II** *X bought tyres from Dunlop Rubber Co. and sold them to Y, a sub-dealer who agreed with X not to sell below Dunlop's list price and to pay to Dunlop Co. ₹ 150 as damages on every tyre he undersold. Y sold two tyres at less than the list price and thereupon, Dunlop Co. sued him for the breach. It was held that the Dunlop Co. could not maintain the suit because it was a stranger to the contract. [Dunlop P. Tyre Co. Ltd. v. Selfridge & Co. Ltd.]*

## EXCEPTIONS TO RULE 'A STRANGER TO A CONTRACT CAN NOT SUE'

The rule that a stranger to a contract cannot sue, is subject to the following exceptions:

1. **In case of Trusts** The beneficiary (i.e. the person for whose benefit the trust has been created) may enforce the contract.

**Example I** *X transferred certain properties to be held by Y for the benefit of Z. Z can enforce the agreement even though he is not a party to the agreement. [M.K. Rapai v. John]*

**Example II** *X sent an insured parcel to Y. On loss of such parcel, Y sued the post office. It was held that Y was entitled to sue though he was stranger to the contract because on receipt of such article, the post office becomes a trustee for the addressee. [Amir Ullah v. Central Govt.]*

**Example III** *X, the father of a minor daughter D, and Y, the father of a minor son S, entered into an agreement of marriage for D and S on the condition that after the marriage, Y would pay his daughter-in-law D, ₹ 500 as kharch-e-paan daan (betel box money). After the marriage took place, X died. On Y's refusal to pay the agreed amount to D, the Court held that D was entitled to recover the amount as a beneficiary of trust even if she was a stranger to the contract between X and Y. [Khawaja Mohd. v. Hussaini Begum (1910) 37.1A 152]*

2. **In Case of Family Settlement** The person for whose benefit the provision is made under family arrangements may enforce the contract.

**Example** *A provision of marriage expenses of a female member was made in a Joint Hindu Family. On partition, the female member sued for such expenses. It was held that she was entitled to sue. [Rakhmanbai v. Govind]*

3. **Acknowledgment** The person who becomes an agent of third party by acknowledgment or otherwise, can be sued by such third party.

**Example** *X receives ₹ 1,000 from Y for paying the same to Z. X acknowledges this receipt to Z. Z can recover the amount from X because X will be regarded as Z's agent. [Surjan v. Nanat]*

4. **Assignment of a Contract** Where a benefit under a contract has been assigned, the assignee can enforce the contract subject to all equities between the original parties to the contract e.g. the assignee of an insurance policy.

5. **Agency** A principal may enforce the contracts entered into by his duly authorised agent.

## 4.0 CONTRACTS WITHOUT CONSIDERATION

### GENERAL RULE 'NO CONSIDERATION, NO CONTRACT'

According to Section 25, an agreement made without consideration is void.

1. **Example:** In case of **Abdul Aziz v. Mazum Ali**, a promise to donate ₹ 500 towards construction of a mosque was held unenforceable as it was a gratuitous promise lacking consideration.
2. But gratuitous promise shall be enforceable by law if the promisee on the faith of

such promise suffered a liability as suffering of detriment forms a valid consideration  
[Kedarnath v. Gorie Mohd.]

### EXCEPTIONS TO THE GENERAL RULE "NO CONSIDERATION, NO CONTRACT"

The following are the exceptions to the general rule No Consideration, No Contract:

**1. Agreements made on Account of Natural Love and Affection [Section 25(1)]**

Such agreement made without consideration is valid if:

- (i) it is expressed in writing,
- (ii) it is registered under the law,
- (iii) it is made on account of love and affection, and
- (iv) it is between parties standing in a near relation to each other.

**Note:** Mere Nearness of relation by itself does not necessarily imply natural love and affection.

**Example I** A Hindu husband by a registered document promised to pay his wife ₹ 1,000 per month as her pin-pocket money. This agreement is valid.

**Example II** A Hindu husband by a registered document, after referring to quarrels and disagreements between himself and his wife, promised to pay his wife ₹ 1,000 p.m. for her maintenance. It was held that this agreement was void because there was no natural love and affection. [Rajlakhi Devi v. Bhoot Nath Mookherjee]

**2. Promise to Compensate for Past Voluntary Services [Section 25(2)]** Such promise made without consideration is valid if:

- (i) it is a promise to compensate (wholly or in part); and
- (ii) the person who is to be compensated has already done something voluntarily or has done something which the promisor was legally bound to do.

**Example I** X finds Y's purse and gives it to him. Y promises to give ₹ 500 to X. This is a valid contract even though the consideration did not move at the desire of Y, the promisor.

**Example II** X, a neighbour helped putting down the fire in Y's house. Afterwards, Y promised X to give ₹ 1,000. This is a valid contract even though the consideration did not move at the desire of the promisor.

**Example III** X, supported Y's infant son. Y promised to pay X's expenses in so doing. This is a valid contract. Here, X has done that act which Y was legally bound to do.

**Example IV** X writes to Y, "at the risk of your own life, you saved me from a serious motor accident. I promise to pay you ₹ 1 lakh." X does not pay. Advise Y. This is a valid contract since a promise to compensate for voluntary acts done in the past is valid even though without consideration. Y is advised to file a suit to recover ₹ 1 lakh.

**3. Promise to Pay Time Barred Debt [Section 25(3)]** Such promise without consideration is valid if:

- (i) it is made in writing,



- (ii) it is signed by the debtor or his agent, and
- (iii) it relates to a debt which could not be enforced by a creditor because of the Law of Limitation Act.

**Note:** According to The Law of Limitation Act, a debt which remains unpaid or unclaimed for a period of 3 years becomes a time barred debt which is legally not recoverable. But a promissory note issued in personal capacity by the wife of a debtor to pay his time barred debt of her husband is not enforceable [Pestonjee v. Bai Meharbai]

4. **Completed Gifts [Explanation to Section 25]** The gifts actually made by a donor and accepted by the donee are valid even without consideration. Thus, a completed gift needs no consideration.

**Example** *X transferred some property to Y by a duly written and registered deed as a gift. This is a valid contract even though no consideration moved.*

5. **Agency [Section 185]** No consideration is necessary to create an agency.
6. **Gratuitous Bailment** No Consideration is necessary for gratuitous bailment.

## PRACTICAL PROBLEMS

### PROBLEM 1

X promises to donate ₹ 10,000 towards the repairs of a temple. X does not pay. Can the trustees recover the promised amount from X (a) if they have not incurred any liability on the faith of the X's promise, (b) if they have incurred any liability on the faith of this promise.

**Solution:** Case (a)

**Decision:** The trustees cannot recover the promised amount from X.

**Reason:** The agreement is void in the absence of any consideration.

[**Leading case:** Abdul Aziz v. Masum Ali]

Case (b)

**Decision:** The trustees can recover the promised amount from X.

**Reason:** The agreement is valid because it was supported by consideration in the form of a detriment to the trustees who had incurred liability on the faith of the promise made by X.

[**Leading case:** Kedar Nath v. Gorie Mohammad]

### PROBLEM 2

X, a Hindu husband executed a registered document in favour of Y, his wife, whereby he promised to pay her ₹ 1,000 per month. Later, X did not pay. Can Y recover from X (a) if this promise was made without any disagreement and quarrels between them? (b) if this promise was made after disagreement and quarrels between them?

**Solution:** Section to which the given problem relates: Section 25(1).

**Case (a)**

**Decision:** Y could recover from X.

**Reason:** The agreement was valid because it was made on account of natural love and affection between X and Y.

**Case (b)**

**Decision:** Y could not recover from X.

**Reason:** The agreement was void because it was not made on account of natural love and affection between X and Y.

[**Leading case:** Rajlakhi Devi v. Bhoot Nath Mookherjee]

### PROBLEM 3

X supports Y's infant son without being asked to do so. Y promises to pay X ₹ 10,000 for doing so. Later, Y refuses to pay. Can X recover the promised amount from Y?

**Solution:** Section to which the given problem relates: Section 25(2).

**Decision:** X can recover the promised amount from Y.

**Reason:** X has done something which the promisor was legally bound to do.

### PROBLEM 4

X owes Y ₹ 10,000 but this debt is time barred. In a birthday party of Z, who is a friend of X and Y, X promises Y to pay this debt. Later, X refuses to Y. Can Y recover the promised amount from X?

**Solution:** Section to which the given problem relates: Section 25(3).

**Decision:** Y cannot recover anything from X.

**Reason:** X's promise was neither in writing nor signed by him or his agent.

### PROBLEM 5

X gifted ₹ 50,000 to Y his neighbour's wife by executing a registered gift deed without any consideration. There is no near relation between X and Y. Is this gift valid?

**Solution:** Section to which the given problem relates: Explanation I to Section 25.

**Decision:** The gift is valid.

**Reason:** A completed gift needs no consideration and need not be a result of natural love and affection or near relation.

### PROBLEM 6

X promises to make a gift of ₹ 50,000 to Y, his neighbour's wife. Is this promise valid?

**Solution:** Section to which the given problem relates: Explanation 1 to Section 25.

**Decision:** A promise to gift is not valid.

**Reason:** This agreement is void for want of consideration and at the same time, there is only a promise to gift and not a completed gift.

### PROBLEM 7

X, who was badly in need of money offered to sell his car worth ₹ 1,00,000 to Y for ₹ 10,000. Before the car was delivered, X received an offer of ₹ 20,000 and refused to carry out the contract on the ground of inadequacy of consideration. Is X liable to Y for damages?

**Solution:** Section to which the given problem relates: Explanation 2 to Section 25.

**Decision:** X is liable to Y for damages.

**Reason:** An agreement to which the consent of the party is freely given is not void merely because the consideration is inadequate.

### PROBLEM 8

X, a client promises to pay Y, his advocate ₹ 10,000 in addition to his fees if he succeeds. X succeeds but refuses to pay ₹ 10,000. Can Y recover from X?

**Solution:**

**Decision:** Y cannot recover the additional sum of ₹ 10,000.

**Reason:** X's promise to pay the additional sum was without any consideration. The consideration must be something which the promisor is not already bound to do. Here, Y was bound to render the best of his services under the original contract.

[**Leading case:** Ramchandra Chintaman v. Kalu Raju]

## IMPORTANT POINTS TO REMEMBER

### 1.0 Meaning and essential elements of valid consideration

<b>Meaning</b>	Consideration in simple term means something in return.
<b>Form</b>	Consideration must result <i>either</i> (a) a benefit to the promisor and detriment or loss to the promisee, (b) a detriment to both promisor or promisee.
<b>Essential Elements of Valid Consideration</b>	<ol style="list-style-type: none"> <li>1. It must be given at the desire of Promisor.</li> <li>2. It may be given by the promisee or any other person (i.e. stranger).</li> <li>3. It may be past or present or future.</li> </ol> <p>[<b>Note:</b> Past consideration is no consideration in England]</p>

	<p>4. It need not be adequate but it must be of some value in the eye of law.</p> <p>5. It must be real and not Illusory</p> <p>6. It must be something which the promisor is not already bound to do.</p> <p>7. It must be lawful.</p> <p>8. It must not be opposed to public policy.</p>
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## 2.0 Stranger to a Consideration and stranger to contract

<b>Stranger to Consideration</b>	A stranger to consideration can sue because the consideration can be furnished or supplied by any person whether he is the promisee or not.
<b>Stranger to Contract</b>	A stranger to a contract cannot sue because of the absence of <b>privity of contract</b> (i.e. relationship subsisting between the parties to a contract).
<b>Exception to above Rule</b>	<p>(a) <b>In case of Trusts</b> The beneficiary (i.e. the person for whose benefit the trust has been created) may enforce the contract.</p> <p>(b) <b>In case of Family Settlement</b> The person for whose benefit the provision is made under family arrangements may enforce the contract.</p> <p>(c) <b>Acknowledgments</b> The person who becomes an agent of third party by acknowledgment or otherwise, can be sued by such third party.</p> <p>(d) <b>Assignment of a Contract</b> Where a benefit under a contract has been assigned, the assignee can enforce the contract subject to all equities between the original parties to the contract e.g. the assignee of an insurance policy.</p>

## 3.0 No Consideration, No Contract

<b>Validity</b>	An agreement made without consideration is void.
<b>Six Exceptions to above Rule</b>	<p>1. <b>Written &amp; Registered Agreements made on Account of Natural Love and Affection</b> between parties standing in a near relation to each others.</p> <p>2. <b>Promise to Compensate</b> the person who has already done something voluntarily or has done something which the promisor was legally bound to do.</p> <p>3. <b>Written Promise</b> duly signed by debtor or his authorised agent to pay Time Barred Debt</p>

	<p>4. <b>Completed Gifts [Explanation to Section 25]</b> The gifts actually made by a donor and accepted by the donee are valid even without consideration. Thus, a completed gift needs no consideration.</p> <p>5. <b>Agency</b>—No consideration is necessary to create an agency.</p> <p>6. <b>Gratuitous Bailment</b></p>
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## TRUE OR FALSE QUESTIONS

**State with reasons whether the following statements are 'True' or 'False'.**

1. An act constituting consideration must have been done at the desire of the promisor or any other person.
2. An act constituting consideration must be done by the promisee only.
3. Consideration must result in a benefit to both parties.
4. Consideration must result in a detriment to both parties.
5. Consideration must result in a benefit to the promisor and a detriment to promisee.
6. Consideration may result in a detriment to both parties.
7. Past consideration is no consideration in India.
8. Consideration must be adequate.
9. An agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate.
10. The inadequacy of the consideration may be taken into account by the Court in determining the question whether the consent of the promisor was freely given.
11. Consideration must be something which a promisor is not already bound to do.
12. A stranger to consideration can sue.
13. A stranger to a contract cannot sue.
14. In case of trusts, the beneficiary being a stranger to a contract cannot sue.
15. An assignee cannot enforce the contract because he is a stranger to a contract.
16. Nearness of relation by itself does not necessarily import natural love and affection.
17. Natural love and affection by itself does not necessarily import nearness of relation.
18. A promise made without consideration to compensate the person who has already done something voluntarily is valid if it is made in writing.
19. A verbal promise to pay a time barred debt is valid.
20. Completed gifts need no consideration.
21. Completed gifts without consideration are valid only if they are out of natural love and affection, and near relation.
22. A promise to gift to wife is valid.
23. No consideration is required to create an agency.

24. If the promisee undertakes a liability on the faith of a promise made by a promisor to contribute to charity, the contract is valid.

### **ANSWERS**

1. False   2. False   3. False   4. False   5. False   6. True   7. False   8. False  
9. True   10. True   11. True   12. True   13. True   14. False   15. False   16. True  
17. True   18. False   19. False   20. True   21. False   22. False   23. True   24. True

### **VERY SHORT ANSWER TYPE QUESTIONS**

1. Define Consideration.
2. What is meant by 'Stranger to Consideration'?
3. What is meant by 'Stranger to Contract'?
4. What is meant by 'Privity of Contract'?
5. What is meant by 'Privity of Consideration'?

### **SHORT ANSWER TYPE QUESTIONS**

1. Comment on the following statements:
  - (a) No consideration, No contract.
  - (b) Insufficiency of consideration is immaterial but an agreement without consideration is void.
  - (c) A stranger to consideration can sue.
  - (d) A stranger to a contract cannot sue.

### **LONG ANSWER TYPE QUESTIONS**

1.
  - (a) Define Consideration.
  - (b) What are the essential elements of a valid consideration?
2.
  - (a) Explain the rule that a stranger to a contract cannot sue with the help of an illustration.
  - (b) Are there any exceptions to this rule?
3.
  - (a) Explain the rule 'No consideration, No contract'.
  - (b) Are there any exceptions to this rule?

# 5

## Free Consent

### 1.0 CONSENT

#### MEANING OF CONSENT

The consent means an act of assenting to an offer. *According to Section 13, "Two or more persons are said to consent when they agree upon the same thing in the same sense."* Thus, consent involves identity of minds in respect of the subject matter of the contract. In English Law, this is called 'consensus-ad-idem'.

#### EFFECT OF ABSENCE OF CONSENT

When there is no consent at all, the agreement is void *ab-initio*, i.e. it is not enforceable at the option of either party.

**Example I** *X has one Maruti car and one Fiat car. He wants to sell Fiat car. Y does not know that X has two cars. Y offers to buy X's Maruti car for ₹ 50,000. X accepts the offer thinking it to be an offer for his Fiat car. Here, there is no identity of mind in respect of the subject matter. Hence there is no consent at all and the agreement is void ab-initio.*

**Example II** *X, an illiterate woman, signed a gift deed thinking that it was a power of attorney. This gift deed was not explained to her. It was held that her mind did not go with that writing and she never intended to sign a gift deed. Hence, there was no consent at all and the agreement was void ab-initio. [Bala Devi v. S. Majumdar]*

### 2.0 FREE CONSENT

#### MEANING OF FREE CONSENT

Free consent is one of the essential elements of a valid contract as it is evidenced by Section 10 which provides that all agreements are contracts if they are made by the free consent of the parties...

*According to Section 14, "Consent is said to be free when it is not caused by (a) coercion, or (b) undue influence, or (c) fraud, or (d) misrepresentation, or (e) mistake".*

#### EFFECT OF ABSENCE OF FREE CONSENT

When there is consent but it is not free (i.e. when it is caused by coercion or undue

influence or fraud or misrepresentation), the contract is usually voidable at the option of the party whose consent was so caused.

**Example** *X threatens to kill Y if he does not sell his house to X. Y agreed to sell his house to X. In this case, Y's consent has been obtained by coercion and therefore, it cannot be regarded as free.*

### 3.0 COERCION

#### MEANING OF COERCION

Coercion means compelling a person to enter into a contract under a pressure or a threat. According to Section 15, a contract is said to be caused by coercion when it is obtained by—

- (a) committing any act which is forbidden by the Indian Penal Code; or
- (b) threatening to commit any act which is forbidden by the Indian Penal Code; or
- (c) unlawful detaining of any property; or
- (d) threatening to detain any property.

**Example I** *X beats Y and compels him to sell his car for ₹ 50,000. Here, Y's consent has been obtained by coercion because beating someone is an offence under the Indian Penal Code.*

**Example II** *A Hindu widow of 13 years was forced to adopt a boy under threat that her husband's dead body would not be allowed to be removed if she does not adopt the boy. She adopted the boy. Here, widow's consent has been obtained by coercion because preventing the dead body from being removed for cremation is an offence under Section 297 of the Indian Penal Code. [Ranganayakamma v. Alwar Setti]*

**Note:** The Indian Penal Code need not be in force at place where the coercion is employed and at the time when coercion is employed.

#### AGAINST WHOM/BY WHOM COERCION MAY BE EXERCISED?

Coercion may proceed from any person (whether a party to contract or stranger) and may be directed against any person (whether a party to contract or stranger)

**Example I** *X threatens to kill Z, Y's son, if Y refuses to sell his house to him. Y agrees to sell his house. Here, Y's consent has been obtained by coercion though Z is a stranger to the contract.*

**Example II** *X threatens to kill Y if Y refuses to sell his house to Z. Y agrees to sell his house. Here, Y's consent has been obtained by coercion though X is a stranger to the contract.*

#### EFFECT OF THREAT TO FILE A SUIT

A threat to file a suit (whether civil or criminal) does not amount to coercion unless the suit is on false charge. Threat to file a suit on false charge is an act forbidden by the Indian Penal Code and thus will amount to an act of coercion.



### EFFECT OF THREAT TO COMMIT SUICIDE

A 'suicide' and a 'threat to commit suicide' are not punishable but an attempt to commit suicide is punishable under the Indian Penal Code. It does not mean that 'suicide' and threat to commit suicide are permitted by Indian Penal Code. The question whether a 'threat to commit suicide' amounts to coercion or not was considered by **Madras High Court** in the case of *Chikham Ammiraju v. Seshamma*. In this case, a person threatened to commit suicide if his wife and son did not execute a release deed in favour of his brother in respect of certain property. It was **held that though a threat to commit suicide is not punishable under the Indian Penal Code, it is deemed to be forbidden by that code**. Hence, the threat to commit suicide amounted to coercion and the release deed was therefore, voidable.

**Duress V. Coercion:** The English law uses the term 'duress' for coercion. However, the two are different in the following way:

- (a) Duress does not include detaining of property or threat to detain property.
- (b) Duress can be employed only by a party to the contract or his agent.

### EFFECTS OF COERCION

The effects of coercion are as follows:

Effects	Provision
<b>(a) Option of aggrieved party to avoid the contract</b>	When consent to an agreement is obtained by coercion, the contract is voidable at the option of the party whose consent was obtained by coercion (also called aggrieved party). [Section 19]
<b>(b) Obligation of aggrieved party to restore benefit</b>	The party rescinding a voidable contract shall restore the benefit received by him under the contract, to the person from whom the benefit was received. [Section 64]
<b>(c) Obligation of other party to repay or return</b>	A person to whom money has been paid or anything delivered under coercion, must repay or return it. [Section 72]

**Example I** *X threatens to kill Y if he does not sell his house for ₹ 1,00,000 to X. Y sells his house to X and receives the payments. Here, Y's consent has been obtained by coercion. Hence, this contract is voidable at the option of Y. If Y decides to avoid the contract, he will have to return ₹ 1,00,000 which he had received from X.*

**Example II** *A railway company refused to deliver certain goods to the consignee, except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.*

### ON WHOM BURDEN OR ONUS OF PROOF LIES

The burden of proving that consent was obtained by coercion, and the aggrieved party would not have entered into contract had coercion not been employed, lies on the party intending to avoid the contract.

## 4.0 UNDUE INFLUENCE

### MEANING OF UNDUE INFLUENCE

The term 'undue influence' means dominating the will of the other person to obtain an unfair advantage over the other. According to Section 16(1), a contract is said to be induced by undue influence—

- (a) where the relations subsisting between the parties are such that one of them is in a position to dominate the will of the other, and
- (b) the dominant party uses that position to obtain an unfair advantage over the other.

### WHEN IS A PERSON DEEMED TO BE IN A POSITION TO DOMINATE THE WILL OF ANOTHER?

According to Section 16(2), a person is deemed to be in a position to dominate the will of another in the following three circumstances:

Circumstances	Examples
(a) Where he holds a real or apparent authority over the other	Master and servant, parent and child, Income Tax Officer and assessee, Principal and a temporary teacher
(b) Where he stands in a fiduciary relation to the other	Trustee and beneficiary, spiritual adviser (Guru) and his disciples, solicitors and client, guardian and ward
(c) Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress	Medical attendant and patient

### IN WHICH CASES THERE IS NO PRESUMPTION OF DOMINATION OF WILL?

According to judicial decisions held in various cases, there is no presumption of undue influence in the following relationships:

- (a) Husband and wife (other than parda-nashin)
- (b) Landlord and tenant
- (c) Creditor and debtor

**Example I** X advanced ₹ 10,000 to his son Y during his minority and obtained upon Y's coming of age, a bond from Y for ₹ 1,00,000. Here, there is misuse of parental influence.

**Example II** A poor Hindu widow agreed to pay interest at 100% p.a. because she needed the money to establish her right of maintenance. It was held that the lender was in position to dominate the will of widow. [*Ranee Annpurni v. Swaminath*]

**Example III** A devotee gifted her property to her spiritual guru to secure benefits to her soul in next world. It was held that spiritual guru was in position to dominate the will of devotee. [*Mannu Singh v. Umadat Pandey*]

**Example IV** *X, an illiterate old man of about 90 years, physically infirm and mentally in distress, executed a gift deed of his properties in favour of Y his nearest relative who was looking after his daily needs and managing his cultivation. It was held that Y was in a position to dominate the will of X. [Sher Singh v. Prithi Singh]*

### WHAT IS THE EFFECT OF UNDUE INFLUENCE?

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

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

**Example I** *A's son forged B's name to a promissory note. B, under threat of prosecuting A's son, obtains a bond from A, for the amount of the forged note. If B sues on this bond, the court may set the bond aside.*

**Example II** *A, a moneylender, advances ₹ 10,000 to B, an agriculturist, and by undue influence, induces B to execute a bond for ₹ 20,000 with interest at 6 per cent per month. The court may set the bond aside, ordering B to repay ₹ 10,000 with such interest as may seem just.*

### ON WHOM DOES THE BURDEN OF PROOF LIE?

When a contract is avoided on the ground of undue influence, the liabilities of dominant party and weaker party to prove are as under:

The <b>weaker party</b> has to prove—	<b>In case of unconscionable transaction, the dominant party</b> has to prove that such contract was not induced by undue influence.
<b>(a) that the other party was in a position to dominate the will</b>	<b>Note:</b> A transaction is said to be unconscionable if the dominant party makes an exorbitant profit of the other's distress.
<b>(b) that the other party actually used his influence to obtain an unfair advantage</b>	
<b>(c) that the transaction is unconscionable (unreasonable)</b>	

**Example** *X was in great need of money. The market rate of interest prevailing at that time was 15% to 24%. A lender agreed to grant the loan at 30% because of stringency in the money market. This cannot be called as unconscionable transaction merely because of an unusual high rate of interest. However, if the lender agreed to grant the loan at a rate which is so high (say 75% or 100%) then the Court considers it unconscionable, and the transaction will be called unconscionable.*

### HOW CAN PRESUMPTION OF UNDUE INFLUENCE BE REBUTTED?

The presumption of undue influence can be rebutted by showing—

- (a) that the dominant party has made a full disclosure of all the facts to the weaker party before making the contract;
- (b) that the price was adequate; and
- (c) that the weaker party was in receipt of competent independent advice before entering into the contract.

### WHAT IS THE POSITION OF CONTRACTS WITH PARDANASHIN WOMAN?

**Meaning of Pardanashin Woman:** A woman who observes complete seclusion (i.e. who does not come in contact with people other than her family members) is called pardanashin woman.

**Legal Presumption:** A contract with a pardanashin woman is presumed to have been induced by undue influence.

**Burden of Proof:** The other party who enters into a contract with a pardanashin woman must prove—

- (a) that he made full disclosure of all the facts to her;
- (b) that she understood the contracts and the implications of the contract;
- (c) that she was in receipt of competent independent advice before entering into the contract.

## 5.0 COMPARISON BETWEEN COERCION AND UNDUE INFLUENCE

1. **Similarities:** In case of both coercion and undue influence, the consent is not free and the contract is voidable at the option of the aggrieved party.
2. **Distinction:** Coercion differs from the undue influence in the following respects:

Basis of Distinction	Coercion	Undue Influence
1. Relevant Sec.	Sec. 15	Sec. 16
2. Relationship	Parties to a contract may or may not be related to each other.	Parties to a contract are related to each other under some sort of relationship.
3. Consent	Consent is obtained by giving a threat of an offence or committing an offence	Consent is obtained by dominating the will.
4. Nature of Pressure	It involves physical pressure.	It involves moral pressure.
5. Who can exercise	It can be exercised even by a stranger to the contract.	It can be exercised only by a party to a contract and not by a stranger.

<b>6. Restoration of benefit</b>	The aggrieved party who is rescinding the contract has to return the benefit received to the other party under Sec. 64.	The aggrieved party may or may not be required to return the benefit in whole or in part as per Court's direction.
<b>7. Presumption</b>	Coercion has to be proved by the aggrieved party alleging it in. It is not presumed by the law.	It may be presumed by the law under certain circumstances. The party against whom such presumption lies must disprove it.
<b>8. Nature of liability</b>	The party committing the crime may be punishable under I.P.C	It doesn't involve any criminal liability

## 6.0 FRAUD

### MEANING OF FRAUD

The term 'fraud' means a false representation of fact made willfully with a view to deceive the other party.

**Section 17 defines the fraud as follows:**

'Fraud' means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him, to enter into the contract:

- 1. the suggestion, as to a fact, of that which is not true, by one who does not believe it to be true;** e.g. X sells to Y locally manufactured goods as imported goods charging a higher price, it amounts to fraud.
- 2. the active concealment of a fact by one having knowledge or belief of the fact.** Mere concealment is no fraud. But where steps are taken by a seller concealing some material facts so that the buyer even after a reasonable examination cannot trace the defects, it will amount to fraud, e.g. X a furniture dealer, conceals the cracks in furniture sold by him by using some packing material and polishing it in such a way that the buyer even after reasonable examination cannot trace the defect, it would tantamount to fraud through active concealment.
- 3. a promise made without any intention of performing it;** e.g. in *Shireen v. John*, AIR (1952) Punj 227, a man and a woman underwent a ceremony of marriage with the husband not regarding it as a real marriage. Held, the husband had no intention to perform the promise from the time he made it and hence the consent of the wife was obtained under fraud.
- 4. any such act or omission as the law specially declares to be fraudulent,** e.g. under Companies Act and Insolvency Acts, certain kinds of transfers have been declared to be fraudulent.

5. **any other act fitted to deceive.** It covers those acts which deceive but are not covered under any other clause.

### ESSENTIAL ELEMENTS OF FRAUD

On the basis of aforesaid definition of fraud, the essential elements of fraud are as follows:

1. **By a party to a contract:** The fraud must be committed by a party to a contract or by anyone with his connivance or by his agent. Thus, the fraud by a stranger to the contract does not affect the validity of the contract.

**Example** *The directors of a company issued a prospectus containing false statements. A shareholder who had subscribed for the shares on the faith of the prospectus wanted to avoid the contract. It was held that he could do so because the false statement made by directors amounted to fraud. [Reese River Silver Mining Co. v. Smith]*

2. **False representation:** There must be a false representation and it must be made with the knowledge of its falsehood. Where the representation was true at the time when it was made but becomes untrue before the contract is entered into and this fact is known to the party who made the representation, it must be corrected. If it is not so corrected, it will amount to a fraud.

**Example I** *X fraudulently informs Y that X's estate is free from encumbrance. On the faith of X's statement, Y buys the estate. Actually the estate is subject to mortgage. Here, Y may avoid the contract because X with the intention to deceive Y induced Y to enter into a contract.*

**Example II** *On 1st January X correctly informs Y that the monthly sales of his business are ₹ 1,00,000. In May the contract of sale of business was signed. During this period the monthly sales decreased to ₹ 50,000. It was held that Y was entitled to avoid the contract because X's failure to disclose the fall in monthly sales amounted to fraud. [With V O' Flanagan]*

3. **Representation as to fact:** The representation must relate to a fact. In other words, a mere opinion, a statement of expression or intention does not amount to fraud.
4. **Actually deceived:** The fraud must have actually deceived the other party who has acted on the basis of such representation. In other words, an attempt to deceive the other party by which the other party is not actually deceived, is not a fraud.

**Example** *X had a defective cannon. In order to conceal the defect, he put a metal plug on it. Y bought this cannon without examining. When Y used it, it burst. Y refused to pay the balance. It was held that Y was liable to pay as he was not actually deceived by fraud because he would have bought it even if no deceptive plug was inserted. [Horsefull v. Thomas]*

5. **Suffered loss:** The party acting on the representation must have suffered some loss.

**Conclusion:** Fraud is said to have taken place where a party to the contract (Not stranger) made a false representation as to the fact with the knowledge of its falsehood with a view to deceive the other party who actually acted on the faith of such representation and suffered a loss.

## EFFECTS OF FRAUD

The effects of fraud are as follows:

1. **Right to Rescind the Contract** The party whose consent was caused by fraud can rescind (cancel) the contract but he cannot do so in the following cases:
  - (i) where silence amounts to fraud, the aggrieved party cannot rescind the contract if he had the means of discovering the truth with ordinary diligence;
  - (ii) where the party gave the consent in ignorance of fraud;
  - (iii) where the party after becoming aware of the fraud takes a benefit under the contract;
  - (iv) where an innocent third party before the contract is rescinded acquires for consideration some interest in the property passing under the contract,
  - (v) where the parties cannot be restored to their original position.
2. **Right to Insist Upon Performance** The party whose consent was caused by fraud may, if he thinks fit, insist that the contract shall be performed and that he shall be put in the position in which he would have been if the representation made had been true.
 

**Example** *A fraudulently informs B that A's estate is free from encumbrance. B thereupon buys the estate. The estate is subject to a mortgage. B may either avoid the contract, or may insist on its being carried out and the mortgage-debt redeemed.*
3. **Right to Claim Damages** The party whose consent was caused by fraud, can claim damages if he suffers some loss.

## DOES SILENCE AMOUNT TO FRAUD ?

1. **General Rule** According to explanation to Section 17, "Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud."
 

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

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

**Example III** *In Shri Krishna v. Kurukshetra University (AIR 1976 SC 376) a candidate failed to mention the fact of shortage of attendance in the examination form, It was held that there was no fraud.*
2. **Exceptions to the General Rule** The general rule that silence does not amount to fraud has the following exceptions:
 

Where the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak. Such duty arises in the following two cases:

  - (i) **Where parties stand in fiduciary relationship like parent-child, trustee-beneficiary.**

**Example** *A sells by auction to B, a horse which A knows to be unsound. B is A's daughter and has just come of age. Here, the relation between the parties would make it A's duty to tell B if the horse is unsound.*

(ii) **Where the silence itself is equivalent to speech.**

**Example** *B says to A, "If you do not deny it, I shall assume that the horse is sound." A says nothing. Here A's silence is equivalent to speech. If the horse turns out to be vicious A can be held liable for fraud.*

- (iii) **Half Truth:** Half truth is worse than a blatant lie. Partial truthful disclosures may easily deceive the other party, e.g. prospectus of a company disclosing only average dividend declared by the company in the last 5 years instead of the actually declining dividends over that period is a glaring example of half truth amounting to fraud.

## 7.0 MISREPRESENTATION

### MEANING OF MISREPRESENTATION

The term 'Misrepresentation' means a false representation of fact made innocently or non-disclosure of a material fact without any intention to deceive the other party.

Section 18 defines the term 'misrepresentation' as follows:

"Misrepresentation" means and includes-

1. the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
2. any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him, by misleading another to his prejudice or to the prejudice of anyone claiming under him;
3. causing, however innocently, a party to an agreement, to make a mistake as to the substance of the thing which is the subject of the agreement.

### ESSENTIAL ELEMENTS OF MISREPRESENTATION

On the basis of the aforesaid definition of misrepresentation, the essential elements of misrepresentation are discussed below:

1. **By a party to a contract:** The representation must be made by a party to a contract or by anyone with his connivance or by his agent. Thus, the representation by a stranger to the contract does not affect the validity of the contract.
2. **False representation:** There must be a false representation and it must be made without the knowledge of its falsehood i.e. the person making it must honestly believe it to be true.
3. **Representation as to fact:** The representation must relate to a fact. In other words, a mere opinion, a statement of expression or intention does not amount to misrepresentation.

**Example** *X sold his Hotel to Y and stated that a part of the hotel is occupied by a*



*tenant who is most desirable. In fact the rent from the tenant could only be recovered under pressure and was currently much in arrears. It was held that Y was entitled to avoid the contract because X's statement amounted to misrepresentation. [Smith's case]*

4. **Object:** The representation must be made with a view to inducing the other party to enter into contract but without the intention of deceiving the other party.
5. **Actually acted:** The other party must have acted on the faith of the representation.

**Example I** *X says to Y who intends to purchase his land, "My land produces 2 tons of rice per acre." X believes the statement to be true although he has no sufficient ground for the belief. Y purchases X's land believing X's statement. Later on, Y finds that the land produces only 1.5 tons of rice per acre. Here X's representation is misrepresentation.*

**Example II** *The prospectus of a company contained a statement that the company had been authorised by Special Act of the Parliament to use steam or mechanical power for running the trains. In fact, the authority to use the steam was subject to the approval of the 'Board of Trade'. But this fact was not mentioned in the prospectus. The Board of Trade did not approve the use of steam, and consequently the company wound up. The shareholders of the company filed a suit against the directors for fraud. But the court held that they were not liable for fraud. The directors were not guilty of fraud, as they honestly believed that once the Parliament had authorised the use of steam, the consent of the Board of Trade practically concluded. [Derry v. Peek]*

**Conclusion:** Misrepresentation is said to have taken place where a party to the contract (not stranger) made a false representation as to the fact without the knowledge of its falsehood without the intention of deceiving the other party who actually acted on the faith of such representation.

## EFFECTS OF MISREPRESENTATION [SECTION 19]

The effects of misrepresentation are as follows:

1. **Right to Rescind the Contract** The party whose consent was caused by misrepresentation can rescind (cancel) the contract but he cannot do so in the following cases:
  - (i) where the party whose consent was caused by misrepresentation had the means of discovering the truth with ordinary diligence;
  - (ii) where the party gave the consent in ignorance of misrepresentation;
  - (iii) where the party after becoming aware of the misrepresentation, takes a benefit under the contract;
  - (iv) where an innocent third party, before the contract is rescinded, acquires for consideration some interest in the property passing under the contract;
  - (v) where the parties cannot be restored to their original position.

**Example X**, *leads Y erroneously to believe that 1000 mounds of indigo are made annually at X's factory. Y examines the accounts of X's factory which show that*

*only 800 mounds of indigo have been made. After this Y buys the factory. Here, the contract is not voidable on account of X's misrepresentation because Y after becoming aware of misrepresentation takes the benefit under the contract.*

2. **Right to Insist upon Performance** The party whose consent was caused by misrepresentation may if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representation made had been true.

## 8.0 COMPARISON BETWEEN FRAUD AND MISREPRESENTATION

1. **Similarities** There are basically two similarities in case of fraud and misrepresentation as follows:
  - (a) In both the cases, a false representation is made by a party;
  - (b) In both the cases, the contract is voidable at the option of the party whose consent is obtained by fraud or misrepresentation.
2. **Distinction** Fraud differs from misrepresentation in the following respects:

Basis of Distinction	Fraud	Misrepresentation
1. Intention	A wrong representation is made wilfully with the intention to deceive the other party.	A wrong representation is made innocently, i.e., without any intention to deceive the other party.
2. Knowledge of falsehood	The person making the wrong statement does not believe it to be true.	The person making the wrong statement believes it to be true.
3. Right to claim damages.	The aggrieved party can claim damages.	The aggrieved party cannot claim damages.
4. Availability of means to discover the truth	Except where silence amounts to fraud, the contract is voidable even if the aggrieved party had the means of discovering the truth with ordinary diligence.	The aggrieved party cannot avoid the contract if he had the means of discovering the truth with ordinary diligence.

## 9.0 MISTAKE

### MEANING OF MISTAKE

A mistake is said to have occurred where the parties intending to do one thing by error do something else. Mistake is an erroneous belief concerning something.

### TYPES OF MISTAKE

The mistake can be of following two types:

### MISTAKE OF LAW

Type of mistake of law	Effect
(a) <b>Mistake of Indian Law</b>	The contract is not voidable because everyone is supposed to know the law of his country.
(b) <b>Mistake of Foreign Law</b>	A mistake of foreign law is treated as mistake of fact, i.e. the contract is void if both the parties are under a mistake as to a foreign law because one cannot be expected to know the law of other country.

**Mistake of Fact** Mistake of fact can be either bilateral mistake or unilateral mistake.

3. **Bilateral Mistake** The term 'bilateral mistake' means where both the parties to the agreement are under a mistake. According to Section 20, "Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void." Thus, the agreement is void if :

- (i) **Both the parties are under a mistake**
- (ii) **Mistake is of fact but not of law.**

According to explanation to Section 20, "An erroneous opinion as to the value of the thing which forms the subject matter of the agreement is not to be deemed a mistake as to a matter of fact."

**Example** *X buys a painting believing it to be worth ₹ 50,000 while in fact it is worth only ₹ 5,000. The contract is not void.*

- (iii) **Mistake relates to an essential fact.**

**Example I** *A agrees to sell to B a specific cargo of goods supposed to be on its way from England to Mumbai. It turns out that, before the date of the bargain, the ship conveying the cargo had been cast away and the goods lost. Neither party was aware of facts. The agreement is void.*

**Example II** *A agrees to buy from B a certain horse. It turns out that the horse was dead at the time of the bargain, though neither party was aware of the fact. The agreement is void.*

**Example III** *A, being entitled to an estate for the life of B, agrees to sell it to C. B was dead at the time of the agreement, but both parties were ignorant of the fact. The agreement is void.*

**Bilateral Mistake as to the Subject Matter:** An agreement is void where there is a bilateral mistake as to the subject matter. A bilateral mistake as to the subject matter includes the following:

- (i) Mistake as to the existence of subject matter
- (ii) Mistake as to the quantity of subject matter
- (iii) Mistake as to the quality of subject matter
- (iv) Mistake as to the price of subject matter
- (v) Mistake as to the identity of subject matter
- (vi) Mistake as to the title of subject matter

**Example I** A agrees to buy from B a certain horse. It turns out that the horse was dead at the time of bargain though neither party was aware of the fact. The agreement is void because there is bilateral mistake as to the existence of subject matter.

**Example II** A agrees to buy from B all his horses believing that B has two horses but B actually has three horses. The agreement is void because there is bilateral mistake as to the quantity of subject matter.

**Example III** A agrees to buy a particular horse from B. Both believe it to be a race horse but it turns to be a cart horse. The agreement is void because there is bilateral mistake as to the quality of the subject matter.

**Example IV** A agrees to buy a particular horse from B who mentioned in his letter the price as ₹ 1,150 instead of 5,150. The agreement is void because there is bilateral mistake as to the price of the subject matter.

**Example V** A agrees to buy from B a certain horse. B has one race horse and one cart horse. A thinks that he is buying race horse but B thinks that he is selling cart horse. The agreement is void because there is bilateral mistake as to the identity of subject matter.

**Example VI** A agrees to buy a particular horse from B. That horse is already owned by A. The agreement is void because there is bilateral mistake as to the title of the subject matter.

**Bilateral Mistake as to the Possibility of Performance:** The agreement is void where there is a bilateral mistake as to the possibility of performance. In other words, where the parties to an agreement believe that the agreement is capable of performance, while in fact it is not so, the agreement is treated as void. The impossibility may either be physical or legal.

4. **Unilateral Mistake** The term 'unilateral mistake' means where only one party to the agreement is under a mistake. According to Section 22, "**A contract is not voidable** merely because it was caused by one of the parties to it being under a mistake as to matter of fact."

**Example** X sold Oats to Y by sample and Y, thinking that they were old Oats, purchased them. In fact, the Oats were new. It was held that Y was bound by the contract. [Smith v. Hughes]

**Exceptions:** The agreement is void where a unilateral mistake relates to the identity of the person contracted with or as to the nature of the contract.

**Example I** One Blenkarn, knowing that Blenkarn & Co. was a reputed customer of Lindsay & Co., placed an order with Lindsay & Co. by imitating the signatures of Blenkarn. The goods were then sold to Cundy, an innocent buyer. A suit was filed by Lindsay & Co. against Cundy for recovery of goods. It was held that there was no contract between Lindsay & Co. and Blenkarn as Lindsay & Co. never intended to contract with Blenkarn and as such, Cundy did not get a good title and hence he must return the goods or make payment of goods. [**Cundy v. Lindsay & Co.**]

**Example II** A woman by falsely misrepresenting her to be wife of a well known Baron

(a millionaire) obtained two pearl necklaces from a firm of jewellers on the pretext of showing them to her husband before buying. She pledged them with a broker, who in good faith paid her ₹ 1,00,000. A suit was filed by the jeweller against the broker. It was held that there was no contract between the jeweller and the woman as the jeweller never intended to contract with her and as such, the broker did not get a good title and hence he must return the goods. **[Lake v. Simmons]**

**Example III** S knew that on account of his criticism of the plays in the past, he would not be allowed entry to the performance of a play at the theatre. The managing director of the theatre gave instructions that ticket should not be sold to S. S, however, obtained a ticket through one of his friends. On being refused admission to the theatre, he sued for damages for breach of contract. It was held that there was no contract between the theatre company and S as the theatre company never intended to contract with S. **[Said v. Butt]**

**Example IV** An old illiterate man was induced to sign a Bill of Exchange by means of a false representation that it was a mere guarantee. It was held that he was not liable for the Bill of Exchange because he never intended to sign a Bill of Exchange. **[Foster v. Mackinnon]**

But the contract shall be valid and binding in spite of the mistake as to the identity of the parties in all those cases where the parties were willing to enter into contract with any person. Thus, if the mistake only relates to the attributes or motives of the person such as creditworthiness, it will not make the contract void. It may at the most make it voidable for fraud, e.g. in **Phillips v. Brooks**. One Mr North entered a Jeweller's shop, selected a ring which the jeweller agreed to sell against payment by cheque which North signed in the name of Sir G B, a man of credit and standing. North pledged the ring with Brooks. In the meanwhile the cheque got dishonoured. It was held that the contract between North and the Jeweller was valid as the jeweller agreed to sell goods to the very person who entered the shop. Thus, the contract had been made before the goods were delivered to North. As the contract was induced by fraud, the jeweller could rescind the contract. However, the pledge made by North was valid. The jeweller's right was only confined to filing a suit against North to recover damages.

## EFFECTS OF MISTAKE

The effects of mistake are as follows:

<b>(a) In case of Bilateral Mistake as to essential fact</b>	The agreement is void.
<b>(b) In case of Unilateral Mistake</b>	
(i) as to the identity of the person contracted with	The agreement is void.
(ii) as to the nature of contract	The agreement is void.
(iii) as to other matter	The agreement is not void

<b>(c) Obligation of aggrieved party</b>	He must restore any benefit received by him under the contract to the other party from whom the benefit had been received [Section 64]
<b>(d) Obligation of other party</b>	The person to whom money has been paid or anything delivered by mistake must repay or return it. [Section 72]

## 10.0 DISTINCTION BETWEEN VOID AND VOIDABLE CONTRACT

Basis of Distinction	Void Contract	Voidable Contract
<b>1. Meaning</b>	A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable. [Sec. 2 (j)]	An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract. [Sec. 2(i)]
<b>2. Right to Rescind the contract</b>	No Question arises	The party whose consent was not free has the right to rescind the contract.
<b>3. Sue for Performance of contract</b>	No party can sue the other party for claiming the performance of a void contract.	If the aggrieved party does not, within reasonable time, exercise its right to avoid the contract, any party can sue the other for claiming the performance of the contract.
<b>4. Reason</b>	A contract becomes void due to change in law or change in circumstances beyond the contemplation of parties.	A contract becomes a voidable contract if the consent of a party was not free.
<b>5. Right to Claim Damages</b>	No party can claim damages for non-performance of a void contract.	A party whose consent was not free may claim damages.

# PRACTICAL PROBLEMS

## PROBLEM 1

X beats Y and compels him to sell his house for ₹ 1,00,000. Y agrees to sell his house to Y. Y signs the necessary documents for the sale of house and receives the payment. Later on, Y wants to avoid the contract? Will he succeed?

**Solution:** Sections to which the given problem relates: Sections 15 and 72.

**Decision:** Y can avoid the contract on the ground of coercion but he will have to return ₹ 1,00,000 which he has received from X.

**Reason:** Y's consent is not free as it has been obtained by committing an act which is forbidden by the Indian Penal Code.

### PROBLEM 2

X threatens to kill Y if he does not sell his house to X for ₹ 1,00,000. Y assigns the necessary documents for the sale of house and receives the payment. Later on, Y wants to avoid the contract. Will he succeed?

**Solution:** Sections to which the given problem relates: Sections 15 and 72.

**Decision:** Y can avoid the contract on the ground of coercion but he will have to return ₹ 1,00,000 which he has received from X.

**Reason:** Y's consent is not free as it has been obtained by giving a threat to commit an act which is forbidden by the Indian Penal Code.

### PROBLEM 3

X threatens to kill Y's son if Y does not sell his house to X for ₹ 1,00,000. Y signs the necessary documents for the sale of house and receives the payment. Later on, Y wants to avoid the contract. Will he succeed?

**Solution:** Sections to which the given problem relates: Sections 15 and 72.

**Decision:** Y can avoid the contract on the ground of coercion but he will have to return ₹ 1,00,000 which he has received from X.

**Reason:** Y's consent is not free as it has been obtained by committing an act which is forbidden by the Indian Penal Code.

### PROBLEM 4

X threatens to kill Y's son if Y does not sell his house to Z for ₹ 1,00,000. Y signs the necessary document for the sale of house and receives the payment. Later on, Y wants to avoid the contract. Will he succeed?

**Solution:** Sections to which the given problem relates: Sections 15 and 72.

**Decision:** Y can avoid the contract on the ground of coercion but he will have to return ₹ 1,00,000 which he has received from X.

**Reason:** Y's consent is not free as it has been obtained by committing an act which is forbidden by the Indian Penal Code.

### PROBLEM 5

X, an agent, refused to hand over the account books of Y, the principal to the new agent appointed in his place unless the principal released him from all liabilities. The principal

had to give a release deed as demanded. Is this release deed binding upon the principal?

**Solution:** Section to which the given problem relates: Section 15.

**Decision:** Y can avoid the contract on the ground of coercion.

**Reason:** Y's consent is not free as it has been obtained by unlawful detaining of the property (i.e. account books).

[**Leading case:** Muthia v. Karuppan]

#### PROBLEM 6

The Government of a State gave a threat of attachment against the property of Y for the recovery of a fine due from Y's son. Y paid the fine. Advise Y.

**Solution:** Section to which the given problem relates: Section 15.

**Decision:** Y could recover the amount paid on the ground of coercion.

**Reason:** Y's consent is not free as it has been obtained by threatening to detain an property unlawfully.

[**Leading case:** Bansraj v. The Secretary of State]

#### PROBLEM 7

X, by a threat to commit suicide induced Y, his wife, and Z, his son, to execute a release deed in favour of his brother in respect of certain property. Are Y and Z bound by such release deed?

**Solution:** Section to which the given problem relates: Section 15.

**Decision:** Y and Z are not bound by such release deed.

**Reason:** The consent of Y and Z is not free as it has been obtained by threatening to commit an act which is deemed to be forbidden by the Indian Penal Code.

[**Leading case:** Ammiraju v. Seshamma]

#### PROBLEM 8

X, an illiterate old man of about 90 years, physically infirm and mentally in distress, executed a gift deed of his properties in favour of Y his nearest relative who was looking after his daily needs and managing his cultivation. Is X bound by this gift deed.

**Solution:** Section to which the given problem relates: Section 16(2).

**Decision:** No. X is not bound by this gift deed.

**Reason:** Y's consent is not free as it has been obtained by exercising undue influence because Y was in position to dominate the will of X.

[**Leading case:** Sher Singh v. Prithi Singh]



**PROBLEM 9**

X, a poor Hindu widow, was in great need of money to establish her right to maintenance. She took a loan of ₹ 1,500 bearing a rate of interest of 100% p.a. Is this transaction an unconscionable?

**Solution:** Section to which the given problem relates: Section 16(3).

**Decision:** This transaction appears to be an unconscionable.

**Reason:** Not only the rate of interest is too high but also the lender has used the circumstances of poor Hindu widow to obtain an unfair advantage.

[**Leading case:** Rane Annappurni v. Swaminatha]

**PROBLEM 10**

X sells by auction to Y a horse which X knows to be unsound. The horse appears to be sound but X knows about the unsoundness of the horse. Is this contract valid in each of the following alternative cases:

**Case**

- (a) X says nothing about the unsoundness of the horse to Y.
- (b) If X says nothing about it to Y who is X's daughter who has just come of age.
- (c) If Y says to X "If you do not deny it, I shall assume that the horse is sound." X says nothing.

**Solution:** Section to which the given problem relates: Section 17.

**Case (a)**

**Decision:** This contract is valid.

**Reason:** Mere silence as to the facts likely to affect the willingness of a person to enter into a contract is not fraud. Here, it is not the duty of the seller to disclose defects.

**Case (b)**

**Decision:** This contract is not valid.

**Reason:** It becomes X's duty to tell Y about the unsoundness of the horse because a fiduciary relationship exists between X and his daughter Y. Here, X's silence is equivalent to speech and hence amounts to fraud.

**Case (c)**

**Decision:** This contract is not valid.

**Reason:** Here, X's silence is equivalent to speech and hence amounts to fraud.

**PROBLEM 11**

X chartered a ship to Y which was described in the 'Charter party' and was represented to him as being not more than 2,800 tonnage register. It turned out that the registered

tonnage was 3,045 tons. Y refused to accept the ship in fulfillment of the charter party. Is Y's action valid?

**Solution:** Section to which the given problem relates: Section 18.

**Decision:** Y was entitled to avoid the Chartered party.

**Reason:** X made erroneous statements as to tonnage.

[**Leading case:** The Oceanic Steam Navigation Co. v. Soonderdas Dhurmsy]

### PROBLEM 12

X is having two horses, a white and another black. X offers to sell his black horse to Y. Y not knowing that X has two horses, thinks of white horse and agrees to buy the horse. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 20.

**Decision:** This agreement is void.

**Reason:** Both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement.

### PROBLEM 13

X offers to sell his black horse to Y. Y agrees to buy that horse. It turns out that the horse was dead at the time of bargain though neither party was aware of the fact. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 20.

**Decision:** This agreement is void.

**Reason:** Both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement.

### PROBLEM 14

X buys a painting believing it to be worth ₹ 1,00,000 while in fact it is worth only ₹ 10,000. Is it a valid contract?

**Solution:** Section to which the given problem relates: Explanation to Section 20.

**Decision:** This contract is valid.

**Reason:** An erroneous opinion as to the value of the thing which forms the subject matter of the agreement is not treated as mistake relating to a matter of fact. Here, X will have to blame himself for ignorance of the true value of the painting.

### PROBLEM 15

X offers to sell a painting to Y which X knows is the copy of a well-known master piece. Y, thinking that the painting is the original one, decides to buy it at a very high price. Is this a valid contract?

**Solution:** Section to which the given problem relates: Explanation to Section 20.

**Decision:** This contract is valid.

**Reason:** An erroneous opinion as to the value of the thing which forms the subject matter of the agreement is not treated as mistake relating to a matter of fact. Here, X will have to blame himself for ignorance of the true value of the painting.

#### PROBLEM 16

P inquired about the price of rifles from H suggested that he might buy fifty rifles. On receiving the quotation, P telegraphed "Send three rifles". But because of the mistake of the telegraph authorities, the message transmitted was "Send the rifles". H despatched fifty rifles. P accepted three rifles and returned the remaining forty-seven rifles. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 20.

**Decision:** This agreement is void.

**Reason:** Both the seller and the buyer made a mistake regarding the quantity of the subject matter.

[**Leading case:** Henked v. Pape]

#### PROBLEM 17

X entered into a contract for the hiring of a room for witnessing the coronation procession of Edward VII. Unknown to both the parties, the procession had already been cancelled. Is this contract valid?

**Solution:** Section to which the given problem relates: Section 20.

**Decision:** This agreement is void on the ground of impossibility of performance of contract.

**Reason:** Both the parties are under a mistake as to the possibility of performance.

[**Leading case:** Griffith v. Brymer]

#### PROBLEM 18

X sold oats to Y by sample and Y, thinking that they were old oats, purchased them. In fact, the oats were new. Is Y bound by the contract?

**Solution:** Section to which the given problem relates: Section 22.

**Decision:** Y is bound by the contract.

**Reason:** A contract is not voidable because of unilateral mistake (i.e. mistake by only one party to the agreement) as to the matter of fact. Here, Y will have to blame himself for ignorance or wrong judgment.

[**Leading case:** Smith v. Hughes]

### PROBLEM 19

One Blenkarn, knowing that Blenkarn & Co. was a reputed customers of Lindsay & Co., placed an order with Lindsay & Co. by imitating the signature of Blenkarn & Co. The goods were then sold to Cundy, an innocent buyer. A suit was filed by Lindsay & Co. against Cundy for recovery of goods. Discuss the legal position.

**Solution:** Section to which the given problem relates: Section 72.

**Decision:** Cundy didn't get a good title and hence he must return the goods or make payment for the same.

**Reason:** There was no contract between Lindsay & Co. and Cundy as Lindsay never intended to contract with Blenkarn.

[**Leading case:** Cundy v. Lindsay & Co.]

### PROBLEM 20

A woman by falsely misrepresenting her to be wife of a well-known Baron (a millionaire), obtained two pearl necklaces from a firm of jewellers on the pretext of showing them to her husband before buying. She pledged them with a broker, who in good faith paid her ₹1,00,000. A suit was filed by the jeweller against the broker. Discuss the legal position.

**Solution:** Section to which the given problem relates: Section 72.

**Decision:** Broker did not get a good title and hence he must return the goods.

**Reason:** There was no contract between the jeweller and the woman as jeweller never intended to contract with her.

[**Leading case:** Lake v. Simmons]

### PROBLEM 21

S knew that on account of his criticism of the plays in the past, he would not be allowed entry to the performance of a play at the theatre. The managing director of the theatre gave instructions that no ticket should be sold to S. S, however, obtained a ticket through one of his friends. On being refused admission to the theatre, he sued for damages for breach of contract. Discuss the legal position.

**Solution:** Section to which the given problem relates: Section 22.

**Decision:** S is not entitled to claim any damages.

**Reason:** There was no contract between the theatre company and S as the theatre company never intended to contract with S.

[**Leading case:** Said v. Butt]

### PROBLEM 22

X, an old illiterate man, was induced to sign a Bill of Exchange by means of a false representation that it was a mere guarantee. Discuss the legal position.

**Solution:** Section to which the given problem relates: Section 22.

**Decision:** X is not liable for the bill of exchange.

**Reason:** X never intended to sign a bill of exchange.

[**Leading case:** Foster v. Mackinnon]

## IMPORTANT POINTS TO REMEMBER

### 1.0 Consent and Free Consent

<b>Meaning of Consent</b>	The consent means an act of assenting to an offer. According to Section 13, "Two or more persons are said to consent when they agree upon the same thing in the same sense." Thus, consent involves identity of minds in respect of the subject matter of the contract. In English Law, this is called ' <b>consensus-ad-idem</b> '.
<b>Effect of Absence of Consent</b>	When there is no consent at all, the agreement is <b>void -ab-initio</b> , i.e. it is not enforceable at the option of either party.
<b>Meaning of Free Consent</b>	Consent is said to be free when it is not caused by (a) coercion, or (b) undue influence, or (c) fraud, or (d) misrepresentation, or (e) mistake.
<b>Effect of Absence of Free Consent</b>	When there is consent but it is not free (i.e. when it is caused by coercion or undue influence or fraud or misrepresentation), the contract is usually <b>voidable</b> at the option of the party whose consent was so caused.

### 2.0 Coercion

<b>Meaning of Coercion</b>	Coercion means compelling a person to enter into a contract under a pressure or a threat. According to Section 15, a contract is said to be caused by coercion when it is obtained by— (a) committing any act which is forbidden by the Indian Penal Code; or (b) threatening to commit any act which is forbidden by the Indian Penal Code; or (c) unlawful detaining of any property; or (d) threatening to detain any property. <b>Note:</b> <i>The Indian Penal Code need not be in force in place where the coercion is employed.</i>
<b>Against Whom/ By Whom</b>	Coercion may proceed from any person, and may be directed against any person, even a stranger.

<b>Threat to file a Suit</b>	<p>A threat to file a suit (whether civil or criminal) does not amount to coercion unless the suit is on false charge. Threat to file a suit on false charge is an act forbidden by the Indian Penal Code and thus will amount to an act of coercion.</p> <p><b>Note:</b> <i>The Madras High Court held that though a threat to commit suicide is not punishable under the Indian Penal Code, it is deemed to be forbidden by that code. Hence, the threat to commit suicide amounted to coercion and the release deed was therefore, voidable.</i></p>
<b>Effects of Coercion</b>	<ol style="list-style-type: none"> <li>1. Right of aggrieved party to Rescind the contract</li> <li>2. Obligation of aggrieved party to restore benefit</li> <li>3. Obligation of other party to repay or return</li> </ol>

### 3.0 Undue Influence

<b>Meaning</b>	<p>The term 'undue influence' means dominating the will of the other person to obtain an unfair advantage over the other. According to Section 16(1), a contract is said to be induced by undue influence—</p> <p>(a) where the relations subsisting between the parties are such that one of them is in a position to dominate the will of the other, and</p> <p>(b) the dominant party uses that position to obtain an unfair advantage over the other.</p>	
<b>Presumption</b>	<p>A person is deemed to be in a position to dominate the will of another in the following <b>three circumstances</b>:</p>	
	<p style="text-align: center;"><b>Circumstances</b></p> <p>(a) <b><i>Where he holds a real or apparent authority over the other</i></b></p> <p>(b) <b><i>Where he stands in a fiduciary relation to the other</i></b></p> <p>(c) <b><i>Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress</i></b></p>	<p style="text-align: center;"><b>Examples</b></p> <p>Master and Servant, Parent and Child, Income Tax Officer and Assessee, Principal and a Temporary Teacher</p> <p>Trustee and beneficiary, Spiritual adviser (Guru) and his disciples, Solicitors and Client, Guardian and Ward</p> <p>Medical Attendant and Patient</p>

<b>No Presumption of Domination of Will ?</b>	According to judicial decisions held in various cases, there is no presumption of undue influence in the following relationships: 1. Husband and wife (other than <i>pardanashin</i> ) 2. Landlord and tenant 3. Creditor and debtor
<b>Effect of Undue Influence</b>	When Consent to an agreement is caused by undue influence, the agreement is a <b>contract voidable</b> at the option of the party whose consent was so caused.
<b>Similarities between Coercion and Undue Influence</b>	In case of both coercion and undue influence, the consent is not free and the contract is voidable at the option of the aggrieved party.

#### 4.0 Fraud

<b>Meaning</b>	The term 'Fraud' means a false representation of fact made by a party to a contract (i.e., not by a stranger to a contract) willfully (i.e., with knowledge of its falsehood) with a view to deceive the other party who has acted on the basis of such representation and has been actually deceived.
<b>Essential Elements</b>	1. By a party to a contract 2. False representation of fact 3. Intention of deceiving the other party 4. Act of other party on the basis of such representation
<b>Effects of Fraud</b>	1. Right to Rescind the Contract 2. Right to insist Upon Performance 3. Right to Claim Damages
<b>Silence does not amount to Fraud</b>	(a) <b>General Rule</b> According to explanation to Section 17, "Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud"  (b) <b>Three Exceptions to the General Rule</b> 1. Where parties stand in fiduciary relationship like parent-child, trustee-beneficiary. 2. Where the silence itself is equivalent to speech. 3. Half Truth
<b>Conclusion</b>	Fraud is said to have taken place where a party to the contract (i.e. not stranger) made a false representation as to the fact <b>with</b> the knowledge of its falsehood <b>with</b> the intention of deceiving the other party who actually acted on the faith of such representation and suffered a loss.

## 5.0 Misrepresentation

<b>Meaning</b>	The term 'Misrepresentation' means a false representation of fact made by a party to a contract (i.e. not by a stranger to a contract) made innocently (i.e. without knowledge of its falsehood) or non-disclosure of a material fact without any intention to deceive the other party who has acted on the basis of such representation.
<b>Essential Elements</b>	<ol style="list-style-type: none"> <li>1. By a party to a contract</li> <li>2. False representation of fact</li> <li>3. Inducing other party to enter into contract without any intention to deceive the other party</li> <li>4. Act of other party on the basis of such representation</li> </ol>
<b>Effects</b>	<ol style="list-style-type: none"> <li>1. Right to Rescind the Contract</li> <li>2. Right to Insist upon Performance</li> </ol>
<b>Conclusion</b>	Misrepresentation is said to have taken place where a party to the contract (i.e. not stranger) made a false representation as to the fact <b>without</b> the knowledge of its falsehood <b>without</b> the intention of deceiving the other party who actually acted on the faith of such representation.

## 6.0 Effects of Mistake

<b>Type of Mistake</b>	<b>Effect on Validity</b>
<b>1. Mistake of Indian Law</b>	The contract is not voidable because everyone is supposed to know the law of his country.
<b>2. Mistake of Foreign Law</b>	A mistake of foreign law is treated as mistake of fact, i.e. the contract is void if both the parties are under a mistake as to a foreign law because one cannot be expected to know the law of other country.
<b>3. In case of Bilateral Mistake as to essential fact (i.e., where both the parties to an agreement are under mistake to essential fact)</b>	The agreement is void.
<b>4. In case of Unilateral Mistake (i.e. where one of the parties to an agreement is under mistake)</b>	
<b>(i) as to the identity of the person contracted with</b>	The agreement is void.



(ii) <i>as to the nature of contract</i>	The agreement is void.
(iii) <i>as to other matter</i>	The agreement is not void.

### TRUE OR FALSE QUESTIONS

**State with reasons whether the following statements are True or False:**

1. The Indian Penal Code must be in force in place where the coercion is employed.
2. An act of coercion must necessarily proceed from a party to the contract.
3. An act of coercion must necessarily be against the promisor.
4. A threat to file a civil suit does not amount to coercion.
5. A threat to file a criminal suit amounts to coercion.
6. A threat to file a suit on false charges amounts to coercion.
7. A threat to commit suicide does not amount to coercion.
8. A contract is void if the consent of a party to an agreement is obtained by coercion.
9. Undue influence involves use of physical pressure.
10. There is a presumption of undue influence between creditor and debtor.
11. There is no presumption of undue influence between a husband and wife.
12. A contract is void if the consent of a party to an agreement is obtained by undue influence.
13. Undue influence can be exercised by a stranger to a contract.
14. Silence always amounts to fraud.
15. A contract is void if the consent of a party to an agreement is obtained by fraud.
16. In case of fraud, the aggrieved party cannot sue for damages.
17. A mere attempt to deceive is fraud.
18. If there is no damage, there is no fraud.
19. The aggrieved party in case of active fraud loses the right to rescind the contract if he had the means of discovering the truth by ordinary diligence.
20. The aggrieved party in case of misrepresentation can rescind the contract even if he had the means of discovering the truth by ordinary diligence.
21. Ignorance of law is no excuse.
22. The contract will be void if both the parties are under a mistake as to a foreign law.
23. The contract will be voidable if the parties are under a mistake as to the Indian law.
24. Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the contract is voidable.
25. A contract is void if one of the parties to the contract is under a mistake of fact.
26. A contract is voidable if there is a mistake as to the identity of the person contracted.

### **ANSWERS**

1. False 2. False 3. False 4. True 5. False 6. True 7. False 8. False  
9. False 10. False 11. True 12. False 13. False 14. False 15. False 16. False  
17. False 18. False 19. False 20. False 21. True 22. True 23. False  
24. False 25. False 26. False

### **VERY SHORT ANSWER TYPE QUESTIONS**

1. Define consent.
2. What is coercion?
3. On whom the burden of proof lies in case of coercion?
4. What is undue influence?
5. What is unconscionable transaction?
6. Can the presumption of undue influence be rebutted?
7. What is fraud?
8. What is misrepresentation?
9. What is mistake?
10. What is mistake of fact?
11. What is bilateral mistake?
12. What is unilateral mistake?

### **SHORT ANSWER TYPE QUESTIONS**

1. Comment on the following statements:
  - (a) A threat to commit suicide amounts to coercion.
  - (b) Mere silence as to facts is not fraud.
  - (c) Ignorance of law is no excuse.
2. Distinguish between the following:
  - (a) Coercion and undue influence.
  - (b) Fraud and misrepresentation.
  - (c) Unilateral mistake and bilateral mistake.
3. State the effects of coercion.
4. State the effects of undue influence.
5. When is a party said to be in a position to dominate the will of another?
6. State the effects of fraud.
7. State the circumstances under which the right of an aggrieved party to rescind the contract is lost in case of fraud.
8. State the effects of misrepresentation.

9. State the effects of mistake of law.
10. State the effect of mistake of fact.
11. Write short notes on the following:
  - (a) Contracts made with a pardanashin woman
  - (b) Free consent
  - (c) Coercion
  - (d) Undue influence
  - (e) Fraud
  - (f) Misrepresentation
  - (g) Mistake

### LONG ANSWER TYPE QUESTIONS

1. (a) Define Consent.  
(b) When is consent said to be free?
2. (a) Define Coercion.  
(b) State the effects of coercion on the validity of a contract.  
(c) Does a threat to commit suicide amount to coercion?  
(d) On whom the burden of proof lies in case of coercion?
3. (a) Define Undue Influence.  
(b) When is a person deemed to be in position to dominate the will of another?  
(c) What is an unconscionable transaction?  
(d) On whom the burden of proof lies in case of undue influence?
4. (a) Define Fraud.  
(b) Does silence amount to fraud?  
(c) State the effects of fraud.
5. (a) Define Misrepresentation.  
(b) State the effects of misrepresentation.
6. (a) Define 'Mistake'.  
(b) Explain and illustrate the effects of various types of mistake.
7. "Law Relating to mistake is a comedy of errors." Explain.





# Legality of Object and Consideration, and Agreements Opposed to Public Policy

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## 1.0 CIRCUMSTANCES UNDER WHICH THE OBJECT OR CONSIDERATION IS DEEMED TO BE UNLAWFUL

The object and the consideration of an agreement must be lawful, otherwise, the agreement is **void**. According to Section 23 of The Indian Contract Act, 1872, the consideration or the object of an agreement is unlawful in the following cases:

1. **If it is Forbidden by Law** If the object or the consideration of an agreement is the doing of an act which is forbidden (i.e. prohibited) by law, the agreement is void. An act is said to be forbidden by law when it is punishable either by the criminal law of the country or by special legislation.

**Example I** *A promises B to drop a prosecution which he has instituted against B for robbery, and B promises to restore the value of the things taken. The agreement is void, as its object is unlawful. [William v. Bayley]*

**Example II** *X granted a loan to the guardian of a minor to enable him to celebrate the minor's marriage. It was held that X could not recover back because agreement is void as its object (i.e. minor's marriage) is illegal. [C. Srinivas v. K. Raja Rama Mohana Rao]*

**Example III** *A promises to obtain for B an employment in the public service, and B promises to pay ₹ 1,000 to A. The agreement is void as the consideration for it is unlawful.*

**Example IV** *X, a Hindu already married and his wife alive, entered into a marriage agreement with Y an unmarried girl. This agreement is void because the second marriage is forbidden by Hindu Law.*

2. **If it Defeats the Provisions of any Law** If the object or the consideration of an agreement is of such nature that, if permitted, it would defeat the provisions of any law, the agreement is void.

**Example I** *A's estate is sold for arrears of revenue under the provisions of an Act of the Legislature, by which a defaulter is prohibited from purchasing the estate. B, upon an understanding with A, becomes the purchaser, and agrees to convey the estate to A, upon receiving from him the price which B has paid. The agreement is void as it tenders the transaction, in effect, a purchase by the defaulter, and would so defeat the object of the law.*

**Example II** *X borrowed ₹ 1,00,000 from Y and agreed not to raise any objection as to the limitation and that Y may recover the amount even after the expiry of*

*limitation period. This agreement is void as it defeats the provisions of the Law of Limitation Act. [Rama Murthi v. Goppyya]*

- 3. If it is Fraudulent** If the object of an agreement is to defraud others, the agreement is void.

**Example I** *A, B and C enter into an agreement of the division among them of gains acquired, or be acquired, by them by fraud. The agreement is void, as its object is unlawful.*

**Example II** *A, being agent for a landed proprietor, agrees for money, without the knowledge of his principal, to obtain for B a lease of land belonging to his principal. The agreement between A and B is void, as it implies a fraud by concealment by A, on his principal.*

- 4. If it Involves or Implies Injury to a Person or Property of Another** If the object of an agreement is to injure a person or the property of another, the agreement is void.

**Example I** *X borrowed ₹ 100 from Y and executed a bond under which he promised to work for Y without pay for 2 years and agreed to pay interest at 10% per month and the principal amount at once. It was held that the agreement was void because it involved injury to X. [Ramsaroop v. Bansi Mandar]*

**Example II** *X promised to pay ₹ 10,000 to Y when he agreed to publish a libel (i.e. defamatory article against someone). It was held that Y could not recover the amount because the agreement was void as it involved injury to someone. [Clay v. Yates]*

- 5. If the Court Regards it as Immoral or Opposed to Public Policy** If the object or consideration is immoral or is opposed to the public policy, the agreement is void.

**Example I** *A, who is B's mukhtar, promises to exercise his influence, as such, with B in favour of C, and C promises to pay ₹ 1,000 to A. The agreement is void, because it is immoral.*

**Example II** *A agrees to let her daughter to hire to B for concubinage. The agreement is void because it is immoral, though the letting may not be punishable under the Indian Penal Code (45 of 1860).*

**Example III** *X let a flat to Y on a monthly rent of ₹ 10,000. Y was a prostitute and used the flat for prostitution and did not pay the rent. X cannot recover the rent if he knew the purpose otherwise he can. [Pearce v. Brooks]*

**Example IV** *X gave ₹ 1,00,000 to Y a married woman to obtain a divorce from her husband. X agreed to marry her as soon as she obtained a divorce. It was held that X could not recover back the amount because the agreement was void as its object was immoral. [Baivijli v. Hamda Nagar]*

**Example V** *Agreements for past or future cohabitation are void because the consideration which is immoral at the time when it passes cannot become legal by passage of time [S. Yellappa v. Y. Sabu (Bombay High Court )]*

## 2.0 ILLEGAL AGREEMENTS

### MEANING OF ILLEGAL AGREEMENTS

Illegal agreements are those agreements which are—

- (a) void ab-initio, i.e. void from the very beginning, and
- (b) punishable by the criminal law of the country or by any special legislation/regulation.

### EFFECTS OF ILLEGAL AGREEMENTS

The effects of illegal agreements are as under:

- (a) The collateral transactions to an illegal agreement also become illegal and hence cannot be enforced.
- (b) No action can be taken for the recovery of money paid or property transferred under an illegal agreement and for the breach of an illegal agreement.
- (c) In case of an agreement containing the promise, some part of which is legal and other part illegal, the legal position is as under:

Case	Provision
<b>1. If the illegal part cannot be separated from the legal part</b>	The whole agreement is altogether illegal.
<b>2. If the illegal part can be separated from the legal part</b>	The Court will enforce the legal part and reject the illegal part.

**Example I** *X promises to pay Y ₹ 1,000 if Y beats Z. Y beats Z and claims ₹ 1,000 but X refuses to pay. Y cannot recover from X because the agreement between X and Y is illegal.*

**Example II** *X pays Y ₹ 1,000 to beat Z. Y does not beat. X cannot recover from Y because the agreement between X and Y is illegal.*

**Example III** *X lent ₹ 1,00,000 to Y to enable him to purchase certain smuggled goods from Z. X cannot recover the amount from Y if he knows the Y's purpose of borrowing.*

## 3.0 WHAT IS THE NATURE OF AGREEMENTS IF ONE OF THE SEVERAL CONSIDERATIONS OR OBJECTS IS UNLAWFUL ?

According to Section 24, if one of the several considerations or objects of an agreement is unlawful, the agreement is void.

**Example** *A promises to superintend, on behalf of B, a legal manufacturer of indigo and illegal traffic of other articles. B promises to pay to A, a salary of ₹ 10,000 a year. The agreement is void, the object of A's promise and the consideration for B's promise being in part unlawful.*

#### 4.0 WHAT ARE THE AGREEMENTS OPPOSED TO PUBLIC POLICY ?

It is not easy to define the term 'Public policy' with any degree of precision because 'public policy' by its very nature, is highly uncertain and keeps on fluctuating with the passage of time. An agreement which conflicts with morals of the time and contravenes any established interest of society may be said to be opposed to public policy. In India, it has been left to Court to hold any contract as unlawful on the ground of being opposed to public policy.

The following agreements have been held to be opposed to public policy:

1. **Agreements of Trading with Enemy** All agreements made with an alien enemy are illegal on the ground of public policy.
2. **Agreement for Stifling Prosecution** An agreement for stifling prosecution is illegal on the ground of public policy.

*Example X, who knows that Y has committed a murder, receives ₹ 7,00,000 from Y in consideration of not exposing Y. This agreement is illegal.*

3. **Agreements in the Nature of Maintenance and Champerty** Maintenance is an agreement whereby one party having no interest in suit, agrees to assist another to maintain suit. For example, X promises to pay Y ₹ 5,000 if Y files a suit against Z. This is a maintenance agreement.

Champerty is an agreement whereby one party agrees to assist another in recovering property and in turn is to share in the proceeds of the action.

*Example X, agreed to pay ₹ 10,000 to Y to enable him to file a suit for the recovery of his property and Y promised to give him 3/4th share in the property, if recovered. The agreement was held to be champertous and void. [Nuthahi Venkataswami v. Katta Nagi]*

*Position in England:* Both of these agreements are declared illegal and void.

*Position in India:* All of these agreements are not illegal. The Court may refuse to enforce such agreements if its object is not bonafide or the terms of reward are unreasonable in the opinion of court.

4. **Agreement for the Sale/Transfer of Public Offices and Titles** The agreements for the sale or transfer of public offices or to obtain public titles like Padma Shree, are illegal on the ground of public policy.

*Example X promises to pay Y ₹ 50,000 if Y secures him an employment in Govt. service. This agreement is opposed to public policy.*

5. **Agreements in Restraint of Parental Rights** An agreement which prevents a parent to exercise his right of guardianship, is void on the ground of public policy.

*Example G, a father having two sons, agreed to transfer guardianship in favour of A and also agreed not to revoke the transfer during his life. Subsequently, he filed a suit for the recovery of boys. It was held that he had a right to revoke his authority and get back his children. [Giddu Narayanish v. Mrs Annie Besant]*

6. **Agreements in Restraint of Personal Liberty** An agreement which unduly restricts the personal liberty of any person is void on the ground of public policy.

*Example X borrowed ₹ 1,00,000 from Y on the promise that he would not, without*



*the Y's written permission leave his job, borrow money, dispose of his property or change his residence. It was held that the agreement was illegal on the ground of public policy. [Harwood v. Miller's Timber and Trading Co.]*

7. **Agreement Tending to Create Monopoly** An agreement which tends to create monopoly is void on the ground of public policy.  
**Example** A local body granted a monopoly to X to sell vegetables in a particular locality. This agreement is void on the ground of being opposed to public policy.
8. **Agreements Interfering with Course of Justice** An agreement which interferes with course of justice is void on the ground of being opposed to public policy.
9. **Marriage Brokerage Contracts** A marriage contract is one whereby one or more persons receives money or money's worth in consideration of marriage.
10. **Agreement in Restraint of Marriage [Section 26]** Every agreement in restraint of marriage of any person other than a minor is void.
11. **Agreement in Restraint of Trade [Section 27]** Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.
12. **Agreement in Restraint of Legal Proceeding [Section 28]** An agreement which restricts a party absolutely from enforcing his legal rights arising under a contract or an agreement which curtails the period of limitation within which the legal rights may be enforced is void.

**Note:** The agreements referred to in 4.10, 4.11 and 4.12 have been discussed in detail in Chapter 7.

## PRACTICAL PROBLEMS

### PROBLEM 1

X granted a loan to Y a guardian of a minor to enable him to celebrate the minor's marriage. Can X recover his loan from Y?

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** X cannot recover his loan from Y.

**Reason:** The agreement is void because its object (i.e. minor's marriage in contravention of the Child Marriage Restraint Act) is unlawful.

[**Leading case:** C. Srinivas v. K. Raja Ram Mohan]

### PROBLEM 2

X promises to drop prosecution which he has instituted against Y for robbery and Y promises to restore the value of the things taken. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** This agreement is void.

**Reason:** The object of this agreement is unlawful.

[**Leading case:** William v. Bayley]

### PROBLEM 3

X's estate is sold for arrears of revenue under the provisions of an Act of the Legislature, by which a defaulter is prohibited from purchasing the estate. Y, upon the understanding with X, becomes the purchaser and agrees to convey the estate to X for the price which Y has paid. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** The agreement is void.

**Reason:** This agreement results in an indirect purchase by the defaulter and hence it defeats the object of the law by which a defaulter is prohibited from purchasing the estate.

### PROBLEM 4

X, Y and Z enter into an agreement for the division among them of gains acquired or to be acquired by them by fraud. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** This agreement is void.

**Reason:** The object of this agreement is unlawful as it is fraudulent.

### PROBLEM 5

X borrowed ₹ 1,000 from Y. X executed a bond promising to work for Y without pay for 2 years and in case of default agreed to pay interest at 10% per month and the principal amount at once. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** This agreement is void.

**Reason:** The object of this agreement is unlawful as it involves an injury to another person.

[**Leading case:** Ram Saroop v. Bansilal]

### PROBLEM 6

X let a flat on hire to Y, a prostitute, knowing that it would be used for immoral purposes. Is this agreement void?

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** The agreement is void.

**Reason:** The object of this agreement is immoral.

[**Leading case:** Pearce v. Brooks]

### PROBLEM 7

X promises to supervise the business on behalf of Y, a licensed manufacturer of some permissible chemicals and some contraband items. Y promises to pay X a salary of ₹ 30,000 per month. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 24.

**Decision:** The agreement is void.

**Reason:** The object of X's promise and the consideration for Y's promise being in part unlawful.

### PROBLEM 8

X, knowing that Y has committed a murder, obtains a promise from Y to pay him (X) ₹ 5,00,000 in consideration of not exposing Y. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** The agreement is void.

**Reason:** This agreement is opposed to public policy as it is for stifling prosecution.

### PROBLEM 9

X promises to pay Y ₹ 1,00,000 if Y secures him an employment in the public service. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** The agreement is void.

**Reason:** The agreement is opposed to public policy as it is for the sale of public office.

### PROBLEM 10

X promises to pay ₹ 1,00,000 to Y in order to induce him to retire so as to provide room for X's appointment to the public office held by Y. Is this agreement valid?

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** The agreement is void.

**Reason:** The agreement is opposed to public policy as it is for the sale of public office.

[**Leading case:** Venkataramanaya v. J.M. Labo]

### PROBLEM 11

X, a father having two minor sons agreed to transfer their guardianship in favour of Mrs. Y and also agreed not to revoke the transfer. Subsequently, he filed a suit for the recovery of the boys and declaration that he was the rightful guardian. Discuss the legal position.

**Solution:** Section to which the given problem relates: Section 23.

**Decision:** The agreement is void and hence X had the right to revoke his authority and get back the children.

**Reason:** This agreement is opposed to public policy as it is in restraint of parental rights.

[**Leading case:** Giddu Narayanish v. Mrs. Annie Basant]

## IMPORTANT POINTS TO REMEMBER

### 1.0 Five Circumstances Under Which the Object or Consideration is Deemed to be Unlawful

1. If it is Forbidden by Law
2. If it Defeats the Provisions of any Law
3. If it is Fraudulent
4. If it Involves or Implies Injury to a Person or Property of Another
5. If the Court Regards it as Immoral or Opposed to Public Policy

**Note:** If one of the several considerations or objects of an agreement is unlawful, the agreement is void.

### 2.0 Illegal Agreements

<b>Meaning</b>	Illegal agreements are those agreements which are— (a) void <i>ab-initio</i> , i.e. void from the very beginning, and (b) punishable by the criminal law of the country or by any special legislation/regulation.	
<b>Effects</b>	(a) The collateral transactions to an illegal agreement also become illegal and hence cannot be enforced. (b) No action can be taken for the recovery of money paid or property transferred under an illegal agreement and for the breach of an illegal agreement. (c) In case of an agreement containing the promise, some part of which is legal and other part illegal, the legal position is as under:	
	<b>Case</b>	<b>Provision</b>
	<b>1. In the illegal part cannot be separated from the legal part</b>	The whole agreement is altogether illegal.
	<b>2. If the illegal part can be separated from the legal part</b>	The Court will enforce the legal part and reject the illegal part.

### 3.0 Agreements Opposed To Public Policy

#### 1. Agreements of Trading With Enemy

#### 2. Agreement for Stifling Prosecution

#### 3. Agreements in the Nature of Maintenance and Champerty

Maintenance is an agreement whereby one party having no interest in suit, agrees to assist another to maintain suit. *For example*, X promises to pay Y ₹ 5,000 if Y files a suit against Z. This is a maintenance agreement.

Champerty is an agreement whereby one party agrees to assist another in recovering property and in turn is to share in the proceeds of the action.

#### 4. Agreement for the Sale/Transfer of Public Offices or to Obtain Public Titles

#### 5. Agreements in Restraint of Parental Rights

#### 6. Agreements in Restraint of Personal Liberty

#### 7. Agreement Tending to Create Monopoly

#### 8. Agreements Interfering with Course of Justice

#### 9. Marriage Brokerage Contracts

#### 10. Agreement in Restraint of Marriage of any person other than a minor is void.

#### 11. Agreement in Restraint of any lawful Trade profession, or business, is to that extent void.

#### 12. Agreement in Restraint of Legal Proceeding

## TRUE OR FALSE QUESTIONS

State with reasons whether the following statements are True or False:

1. If the object of an agreement is to defraud other, the agreement is voidable at the option of other party.
2. The collateral transaction to an illegal agreement also becomes illegal.
3. In India, the categories of contract that are opposed to public policy are limited and exhaustive.
4. Dowry provided voluntarily by the father of daughter is not unlawful.
5. Every agreement in restraint of the marriage of any person is void.
6. Every agreement in restraint of trade is altogether is void.
7. Agreement in restraint of legal proceeding is altogether void.

## ANSWERS

1. False 2. True 3. False 4. False 5. False 6. False 7. True

## VERY SHORT ANSWER TYPE QUESTIONS

1. What is an illegal agreement?
2. What is the nature of agreement if its consideration or object is unlawful?

### **SHORT ANSWER TYPE QUESTIONS**

1. Enumerate the circumstances under which the object or consideration of a contract is deemed to be unlawful.
2. Enumerate any ten agreements that are considered opposed to public policy.

### **LONG ANSWER TYPE QUESTIONS**

1. Under what circumstances is the object or consideration of a contract deemed unlawful? Illustrate with examples.
2. (a) What is an illegal agreement?  
(b) What are the effects of illegality?
3. "No action is allowed on an illegal agreement." Comment and state the exceptions (if any) to this rule.
4. Discuss the doctrine of public policy. Give examples of agreements that are contrary to public policy.



# Void Agreement and Contingent Contracts

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## 1.0 MEANING OF VOID AGREEMENTS

1. According to Section 2(g) of the Indian Contract Act, 1872, a void agreement is an agreement which is not enforceable by law. The agreements which are not enforceable by law right from the time when they are made, are void-ab-initio.
2. The following types of agreements have expressly been declared void under various sections of the Indian Contract Act.
  - (a) Agreements by or with persons incompetent to contract (Sections 10 & 11).
  - (b) Agreements entered into through a mutual mistake of fact between the parties (Section 20).
  - (c) Agreement, the object or consideration of which is unlawful (Section 23).
  - (d) Agreement, the consideration or object of which is partly unlawful (Section 24).
  - (e) Agreement made without consideration (Section 25).
  - (f) Agreements in restraint of marriage (Section 26).
  - (g) Agreements in restraint of trade (Section 27).
  - (h) Agreements in restraint of legal proceedings (Section 29).
  - (i) Wagering agreement (Section 30).
  - (j) Impossible agreement (Section 56).
  - (k) An agreement to enter into an agreement in the future.

Agreements from Nos 1 to 5 have already been discussed in earlier chapters. The other agreements are discussed in this chapter.

## 2.0 NATURE OF AGREEMENTS IN RESTRAINT OF MARRIAGE

According to Section 26 of the Indian Contract Act, every agreement in restraint of the marriage of any person other than a minor is void.

**Example I** *X promised to marry Y only and none else, and to pay ₹ 2,000 in default. X married Z and Y sued X for recovery of ₹ 2,000. It was held that Y could not recover anything because the agreement was in restraint of marriage. [Lowe v. Peers]*

It may be noted that an agreement which provides for a penalty upon remarriage may not be considered as a restraint of marriage.

**Example II** *An agreement between two co-widows that if one of them remarried, she*

*should forfeit her right to her share in the deceased husband's property, was not void because no restraint was imposed upon either of the two widows from remarrying. [Roa Rani v. Gulab Rani]*

**Example III** *Nikah Nama (i.e. a marriage agreement in Muslims) which authorises wife to divorce herself and to claim maintenance from the husband on his marrying a second wife, was not void because no restraint was imposed upon husband from marrying a second wife. [Badu v. Badarannessa]*

### 3.0 NATURE OF AGREEMENTS IN RESTRAINT OF TRADE

1. **Legal Position** According to Section 27 of Indian Contract Act, 1872, **"every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void."** This is because Article 19(g) of the Constitution of India regards the freedom of trade and commerce as a right of every individual. Therefore, no agreement can deprive or restrain a person from exercising such a right.
2. **Burden of Proof** Where an agreement is challenged on the ground of its being in restraint of trade, the party supporting the contract must show that the restraint is reasonably necessary to protect his interests, and the party challenging the contract must show that the restraint is injurious to the public.
3. **Meaning of Expression 'that Extent'** The expression 'that extent' may be interpreted in the sense that only that portion of such agreement is void which is considered either as unreasonable or as opposed to public policy being in restraint of trade. The rest of the agreement would continue to be valid.

**Example I** *In Patna city, 29 out of 30 manufacturers of combs agreed with R to supply him combs and not to anyone else. R was free to reject goods if he found that there was no market for them. It was held that the agreement was in restraint of trade and was thus void. [Shaikh Kalu v. Ram Saran Bhagat]*

**Example II** *X and Y carried on business in a certain locality in Kolkata. X promised to stop business in that locality if Y paid him ₹ 1,000. X stopped his business but Y did not pay him the promised money. It was held that X could not recover anything from Y because the agreement was in restraint of trade and was thus void. [Madhub Chander v. Raj Coomer]*

**Example III** *An agreement restraining a servant from competing for 5 years after the period of service, was held as void. [Brahmaputra Tea Co. v. E. Scarth]*

4. **Exceptions to the Rule that "An Agreement in Restraint of Trade is Void"** The exceptions here mean the cases where agreements in restraint of trade are not considered as void. Such exceptions are discussed below.

#### I. Exceptions Under Statutory Provisions

- (a) **Sale of Goodwill [Exception 1 to Section 27]:** An agreement which restrains the seller of a goodwill from carrying on a business is valid if all the following conditions are fulfilled:
  - (i) Such restriction must relate to a similar business.



- (ii) Such restriction must be within specified local limits.
- (iii) Such restriction must be for the time so long as the buyer or any person deriving title to the goodwill from him, carries on a like business in the specified local limits.
- (iv) Such specified local limits must be reasonable having regard to the nature of the business.

Thus, the buyer of goodwill may restrain the seller for carrying on any business similar to the one sold by him within a certain vicinity and for a certain period of time provided the restrictions in regard to time and vicinity are found reasonable.

- (b) **Partners' Agreements:** The Indian Partnership Act, 1932, recognises the following agreements in restraint of trade as valid:
  - (i) Restriction on existing partner [Section 11(2)]-A partner shall not carry on any business other than that of the firm while he is a partner.
  - (ii) Restriction on outgoing partner [Section 36(2)]-An outgoing partner may agree with his partners that he will not carry on any business similar to that of the firm within a specified period or within specified local limits. Such agreement shall be valid only if the restrictions are reasonable.
  - (iii) Restriction on partners upon or in anticipation of the dissolution of the firm [Section 54]-Partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such agreement shall be valid only if the restrictions are reasonable.
  - (iv) Restriction in case of sale of goodwill [Section 55(3)]-A partner may upon the sale of the goodwill of a firm, make an agreement that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits. Such agreement shall be valid if the restrictions are reasonable.

## II. Exceptions Under Judicial Interpretations

- (a) **Trade Combinations:** Trade combinations which have been formed to regulate the business or to fix prices are not void, but the trade combinations which tend to create monopoly and which are against the public interest are void.

**Example I** *An agreement among four ginning factories to fix uniform rate for ginning cotton and to divide the profits in a certain proportion is not void because such agreements are neither in restraint of trade nor opposed to public policy. [Haribhai v. Sharafali]*

**Example II** *An agreement by two firms to avoid competition is void because it tends to create monopoly and is against the public interest. [Jai Ram v. Kahna Ram]*

**Example III** *An agreement between certain persons to carry on business with the members of their caste only is void. [Vaithelingam v. Saminada]*

**Example IV** *An agreement among some ice manufacturing companies not to sell ice below a minimum price and to divide the profits in a certain proportion*

*is not void because such agreement was made to regulate the business and not to restrain it. [S.B. Fraser & Co. v. Bombay Ice Mfg. Co.]*

- (b) **Sole Dealing Agreements:** An agreement to deal in the products of a single manufacturer or to sell the whole produce to a single dealer are valid if their terms are reasonable.

**Example I** *An agreement by a person to sell all the mica produced by him to the plaintiffs and not to any other firm, and not to keep any in stock, is valid. [Subha Naidu v. Haj Badsha Sahib]*

**Example II** *An agreement by a buyer of goods for Delhi market, not to sell them in Kolkata, is valid.*

**Example III** *X, a seller of imitation jewellery in England sold his business to Y and agreed not to deal for two years (a) in imitation jewellery in England, (b) in real jewellery in certain foreign countries. The first promise was held lawful, the second promise was held as void because the restraint was unreasonable having regard to the nature of business.*

- (c) **Service Agreements:** A clause in service agreement may or may not be in restraint of trade. An analysis of some of the clauses of service agreement is as under:

Clause	Whether held as restraint of trade
(i) <b>A clause to serve the employer for a stipulated period.</b>	Such agreements if reasonable, do not amount to restraint of trade and hence, are enforceable.
(ii) <b>A clause to prevent the employee from accepting any other engagement during his employment.</b>	Such agreements do not amount to restraint of trade and hence, are enforceable. <b>Example</b> <i>Doctors employed in Govt. service are usually not allowed to carry on private practice.</i>
(iii) <b>A clause to prevent the employee from accepting a similar engagement after the termination of his services.</b>  (a) <i>If a restraint is intended only to protect an employer against an employee making use of trade secrets learned by him in the course of his employment.</i>	(a) Such agreements do not amount to restraint of trade and hence, are enforceable by law.  <b>Example</b> <i>An employee who possesses certain trade secrets, agreed not to carry on the similar business during 5 years after the termination of service [Forster &amp; Sons Ltd. v. Suggett]</i>

(a) <i>If a restraint is intended to serve any other purpose (say, to avoid competition)</i>	(b) Such agreements amount to restraint of trade and hence, are not enforceable by law.  <b>Example</b> <i>An agreement to restrain a servant from competing for 5 years after the period of service, is void [Brahmaputra Tea Co. v. E. Scarth]</i>
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#### 4.0 WHAT IS THE POSITION OF AGREEMENTS IN RESTRAINT OF LEGAL PROCEEDINGS?

According to Section 28, the following two agreements amount to restraint of legal proceedings and are thus, void to that extent.

1. **Agreements Restricting Enforcement of Rights** An agreement by which any party is restricted absolutely from enforcing his legal rights under or in respect of any contract is void to that extent.

**Example** *A clause in a contract provided that no action should be brought upon it in case of breach. Such a clause is void because it restricts both the parties from enforcing their legal rights.*

There are **two Exceptions** to the above rule:

**Exception I** An agreement between two or more persons to refer to arbitration any dispute which may arise between them, is not illegal.

**Exception II** An agreement in writing between two or more persons to refer to arbitration any dispute which has already arisen, is not illegal.

**Note:** Where two courts have jurisdiction to try a suit, an agreement between the parties that the suit should be filed in one of those courts alone and not in the other is not invalid. [*C. Milton & Co. v. Ojha Automobile Co.*]

However, an agreement not to go in appeal to a higher court against the judgement of a lower court, does not amount to restraint of legal proceedings.

2. **Agreements Limiting the Period of Limitation** An agreement which limits the time within which an action may be brought so as to make it shorter than that prescribed by the Law of Limitation, is void because its object is to defeat the provisions of law.

**Example** *A clause in a contract provides that no action should be brought after two years. Such a clause is void because it limits the period of limitation to two years which is less than the period of limitation (i.e. three years) prescribed by the law of limitation.*

#### 5.0 MEANING AND NATURE OF UNCERTAIN AGREEMENTS

An uncertain agreement means an agreement the meaning of which is not certain or capable of being made certain. Such agreements are void.

**Example I** *A agrees to sell to B "a hundred ton of oil." There is nothing whatever to show*

*what kind of oil was intended. The agreement is void for uncertainty.*

**Example II** *A agrees to sell to B a hundred ton of oil of a specified description, known as an article of commerce. There is no uncertainty here to make the agreement void.*

**Example III** *A, who is a dealer in coconut oil, agrees to sell to B "100 ton of oil." The nature of A's trade implies that A intends to sell 100 tons of coconut oil. Hence, there is no uncertainty.*

**Example IV** *A agrees to sell to B "all the grain in my granary at Ramnagar." There is no uncertainty since it is possible to determine the quantity of grain lying at A's granary at Ramnagar.*

**Example V** *A agrees to sell to B "100 tons of rice at a price to be fixed by C." As the price is capable of being made certain, there is no uncertainty here to make the agreement void.*

**Example VI** *A agrees to sell to B "my white horse for ₹ 5,000 or 10,000." There is nothing to show which of the two prices was to be given. The agreement is void.*

**Example VII** *An agreement to grant a lease when no date of commencement is expressly or impliedly fixed is void because it is not certain when the period of lease shall commence.*

**Example VIII** *A agrees to sell to B 10 tons of Punjab wheat. But the price is not indicated. Such agreement is not void because in such a case, a reasonable price shall be payable according to Section 2 of the Sale of Goods Act, 1930.*

**Example IX** *X agreed to buy a horse from Y for ₹ 5,000 and to pay ₹ 100 more if the horse proved lucky. It was held that the agreement was void because there was no mechanism to determine what luck bad or good the horse had brought to the buyer. [Guthing v. Lynn]*

**Example X** *X agreed to pay ₹ 10,000 when he was able to pay. It was held that the agreement was void for uncertainty. [Pushpabala v. LIC of India]*

**Example XI** *X agrees to agree in future. Such agreement is void because there is no certainty whether the parties will agree under the future circumstances.*

## 6.0 WAGERING AGREEMENTS (SEC. 30)

### MEANING OF WAGERING AGREEMENTS

An agreement between two persons under which money or money's worth is payable, by one person to another on the happening or non-happening of a future uncertain event is called a wagering event. Such agreements are chance oriented and therefore, completely uncertain.

**Example** *X promises to pay ₹ 1,000 to Y if it rained on a particular day, and Y promises to pay ₹ 1,000 to X if it did not. Such agreement is a wagering agreement.*

### ESSENTIALS OF A WAGERING AGREEMENT

The aforesaid definition highlights the following essentials of a wagering agreement:

- (a) **Promise to Pay Money or Money's Worth:** The wagering agreement must contain a promise to pay money or money's worth.
- (b) **Uncertain Event:** The performance of the promise must depend upon the determination of an uncertain event. An event is said to be uncertain when it is yet to take place or it might have already happened but the parties are not aware of its result.
- (c) **Mutual Chances of Gain or Loss:** Each party must stand to win or lose upon the determination of an uncertain event. If either of the parties may win but cannot lose, or may lose but cannot win, it is not a wagering agreement.
- (d) **Neither Party to have Control over the Event:** Neither party should have control over the happening of the event one way or the other.
- (e) **No other Interest in the Event:** Neither party should have interest in the happening or non-happening of the event other than the sum or stake he will win or lose.

### EXAMPLES OF WAGERING AGREEMENTS

- (a) An agreement to settle the difference between the contract price and market price of certain goods or shares on a particular day.
- (b) A lottery (i.e. a game of chance). But parties running a Government approved lottery cannot be prosecuted.
- (c) An agreement to buy a lottery ticket.
- (d) A crossword puzzle in which prizes depend upon correspondence of the competitor's solution with a previously prepared solution kept with the Editor of newspapers is a lottery and hence a wagering transaction [*State of Bombay v. R.M.D. Chamarbaugwala*]. But a crossword puzzle is generally a game of skill and intelligence and hence not a wager.

### EXAMPLES OF TRANSACTIONS WHICH ARE NOT HELD WAGERS

- (a) Prize competitions which are games of skill, e.g. picture puzzles, athletic competitions. For example, an agreement to enter into a wrestling event in which winner was to be rewarded by the entire sale proceeds of tickets, was held not to be a wagering contract. [*Babasaheb v. Rajaram*]
- (b) According to the Prize Competition Act, 1955, prize competition in games of skill are not wagers provided the prize money does not exceed ₹ 1,000.
- (c) An agreement to contribute to a plate or prize of the value of above ₹ 500 to be awarded to the winner of a horse race. [Section 30]
- (d) Contracts of insurance.

### EFFECTS OF WAGERING AGREEMENTS

The effects of wagering agreements are given as under:

- (a) Agreements by way of wager are void in India.
- (b) Agreements by way of wager have been declared illegal in the states of Maharashtra and Gujarat.

- (c) No suit can be filed to recover the amount won on any wager.
- (d) Transaction which are collateral to wagering agreements are not void in India except in the states of Maharashtra and Gujarat.
- (e) Transactions which are collateral to wagering agreements are illegal in the states of Maharashtra and Gujarat.

**Example** A Cricket match is to be held between India and Pakistan. X agrees to pay ₹ 1,00,000 to Y if India wins the match and agrees to deposit the money with Z a third person of confidence for this purpose. X borrows ₹ 1,00,000 from W. The implications of this case are summarised as under:

- (a) The agreement between X and Y is a wagering agreement because the performance of an agreement depends upon the happening or non-happening of a future uncertain event and each party stands to win or lose.
- (b) If India wins the match, Y (a winner) cannot recover the amount but X (a loser) can recover if the amount has not been paid to Y. Thus, a winner cannot recover the amount but a loser can if the amount has not been paid to the winner.
- (c) If India wins the match and Z (a stakeholder) pays the money to Y (a winner), X (a loser) cannot recover it from Z. [Bridger v. Savage]
- (d) The agreement between X and W which is a collateral to wagering agreement, is valid in India except in the States of Maharashtra and Gujarat. Thus, W can recover the money from X if the agreement between X and Y is entered into in India except in the States of Maharashtra and Gujarat but W cannot recover the money from X if the agreement between X and Y is entered into in the States of Maharashtra or Gujarat.

## 7.0 DISTINCTION BETWEEN CONTRACTS OF INSURANCE AND WAGERING AGREEMENT

The contracts of insurance differ from the wagering agreements in the following respects:

Basis of Distinction	Contracts of Insurance	Wagering Agreement
<b>1. Insurable interest</b>	Person having an insurable interest can insure his life or property.	Parties to a wagering agreement need not have insurable interest.
<b>2. Actual amount payable</b>	In case of contracts of insurance except life insurance, the actual amount payable need not necessarily be the full amount for which the property is insured.	In case of wagering agreement, the actual amount payable is usually fixed.
<b>3. Beneficial/against public policy</b>	These are regarded as beneficial to the public policy.	These are considered to be against public policy.
<b>4. Gamble</b>	Such agreements do not tantamount to gambling as they involve the element of investment and protection.	Being chance oriented, these are closer to gambling.

## 8.0 SPECULATIVE TRANSACTION

Speculative transaction is one in which mutual intention of parties is to settle the transaction either by actual delivery of goods or by payment of difference in price on settlement date. Speculative transaction is generally valid. If, however the mutual intention is only to settle the transaction by payment of difference in price on settlement date, the transaction would be wagering agreement which would be void.

## 9.0 COMPARISON BETWEEN WAGERING AGREEMENT AND ILLEGAL AGREEMENTS

1. **Similarity:** Both Wagering Agreements and Illegal Agreements are void in India.
2. **Distinction:** Transactions which are collateral to wagering agreements are not void in India (except in the States of Maharashtra & Gujarat) but transactions which are collateral to Illegal agreements are void.

## 10.0 WHAT IS THE NATURE OF AGREEMENTS CONTINGENT ON IMPOSSIBLE EVENTS?

According to Section 36 of the Indian Contract Act, 1872 "Contingent agreements to do or not to do anything, if an impossible event happens are void whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made".

**Example** *A agrees to pay ₹ 1000 if B marries C (a Hindu) who is already married to D. This agreement is void since happening of an event is impossible.*

## 11.0 WHAT IS THE NATURE OF AGREEMENTS TO DO IMPOSSIBLE ACTS?

According to Section 56 of the Indian Contract Act, 1872, "An agreement to do an impossible act is void."

**Example I** *A undertakes to put life into the dead wife of B. This agreement is void since the act is impossible at the time of making agreement.*

**Example II** *A (a Hindu who is already married) agrees to marry B. This agreement is void since the act is impossible at the time of making agreement.*

## 12.0 PRINCIPLE OF RESTITUTION

### MEANING OF RESTITUTION

**Restitution** means "return or restoration of benefit." The provisions relating to 'restitution' are given below:

Case	Provision
(a) When a person at whose option a contract is voidable rescinds it [Section 64].	The party rescinding a voidable contract must restore the benefit to the person from whom he has received it.
(b) When an agreement is discovered to be void or the contract becomes void [Section 65].	The person who has received any benefit or advantage under such agreement or contract must restore it or compensate for it to the person from whom he has received it.

**Example I** A, a singer contracts with B the manager of a theatre to sing at his theatre for two nights every week during the next two months and B agrees to pay her ₹ 100 for each night's performance. On the sixth night, A willfully absent herself from the theatre and B in consequence rescinds the contract, B must pay A for the five nights on which she had sung.

**Example II** A contracts to sing for B on a specified day and receives an advance of ₹ 1,000 but is unable to sing due to serious illness on that day. Since the contract has become void. A must return ₹ 1,000 to B.

### NON-APPLICABILITY OF THE PRINCIPLE OF RESTITUTION

The principle of restitution does not apply to contracts which are void ab-initio with the exception where the minor has entered into agreement by misrepresenting his age.

**Example I** X pays ₹ 1,000 to Y to beat Z. Y does not beat Z. X claims ₹ 1,000 from Y. X can not recover anything because this agreement is void ab-initio.

**Example II** X advances ₹ 10,000 to Y a married woman to enable her to obtain a divorce from her husband. Y agrees to marry X as soon as she obtained a divorce. Y obtains the divorce but refuses to marry X. X can not recover anything from Y because this agreement is void ab-initio. [Baiviji v. Hamda Nagar]

**Example III** X advances ₹ 10,000 to Y a married woman, if Y marries X in the event of death of Y's husband. Subsequently, Y's husband died but Y refused to marry X. X cannot recover anything from Y because this agreement is void ab-initio.

## 13.0 CONTINGENT CONTRACT

### MEANING OF A CONTINGENT CONTRACT [SECTION 31]

A 'contingent contract' is a contract to do or not to do something if some event, collateral to such contract, does or does not happen. Insurance contracts provide the best example of contingent contracts.

**Example I** A contracts to pay B ₹ 10,000 if B's house is burnt. This is a contingent contract.

**Example II** A promises to pay B ₹ 1 crore if a certain ship does not return within a year.

### ESSENTIAL FEATURES OF A CONTINGENT CONTRACT

The essential features of a Contingent Contract are discussed below.

- (a) **Dependence on a Future Event:** The performance of a contingent contract depends upon the happening or non-happening of some future event.
- (b) **Collateral Event:** The event must be collateral to the contract.
- (c) **Uncertain Event:** The event must be uncertain.

**Note:** The performance of a contingent contract must depend upon the happening or non-happening of an event and not on the mere will of the promisor. For example, if A promises to pay B ₹ 10,000 if he so chooses, it is not a contingent contract.



### RULES REGARDING CONTINGENT CONTRACTS

The various rules regarding the enforcement of contingent contract are given below:

Kind of Contingent Contract	Rule regarding enforcement
<b>1. Contracts contingent upon the happening of an uncertain future event. [Section 32]</b>	<p>Such contracts cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.</p> <p><b>Example I</b> <i>A makes a contract with B to buy B's horse if A survives C. This contract cannot be enforced by law unless and until C dies in A's life-time.</i></p> <p><b>Example II</b> <i>A makes a contract with B to sell a horse to B at a specified price, if C, to whom the horse has been offered, refuses to buy him. The contract cannot be enforced by law unless and until C refuses to buy the horse.</i></p> <p><b>Example III</b> <i>A contracts to pay B a sum of money when B marries C. C dies without being married to B. The contract becomes void.</i></p>
<b>2. Contracts contingent upon the non-happening of a certain future event. [Section 33]</b>	<p>Such contracts can be enforced when the happening of that event becomes impossible and not before.</p> <p><b>Example</b> <i>A agrees to pay B a sum of money if a certain ship does not return. This ship is sunk. The contract can be enforced when the ship sinks.</i></p>
<b>3. Contracts contingent upon the future conduct of a living person. [Section 34]</b>	<p>If the uncertain event is the future conduct of a living person, such event shall be considered impossible if that such person does anything by which it becomes impossible to perform the contract within any definite time.</p> <p><b>Example</b> <i>A agrees to pay B a sum of money if B marries C. C marries D. The marriage of B to C must now be considered impossible, although it is possible that D may die, and that C may afterwards marry B.</i></p>
<b>4. Contracts contingent upon the happening of an uncertain specified event within a fixed time. [Section 35]</b>	<p>Such contracts become void if before the expiry of fixed time—</p> <p>(a) such event does not happen, or</p> <p>(b) such event becomes impossible.</p> <p><b>Example</b> <i>A promises to pay B a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.</i></p>

<b>5. Contracts contingent upon the non- happening of an uncertain specified event within a fixed time. [Section 35]</b>	<p>Such contracts can be enforced by law if before the expiry of fixed time—</p> <p>(a) such event does not happen, or</p> <p>(b) it becomes certain that such event will not happen.</p> <p><b>Example</b> <i>A promises to pay B a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.</i></p>
<b>6. Agreements contingent upon impossible events. [Section 36]</b>	<p>Such agreements are void whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.</p> <p><b>Example I</b> <i>A agrees to pay B ₹ 1,000 if two straight lines should enclose a space. The agreement is void because two straight lines can never enclose a space.</i></p> <p><b>Example II</b> <i>A agrees to pay B, ₹ 1,000 if B will marry A's daughter C. C was dead at the time of the agreement. The agreement is void because B's marriage with C can never take place.</i></p>

#### 14.0 DISTINCTION BETWEEN A WAGERING AGREEMENT AND A CONTINGENT CONTRACT

A wagering agreement differs from a contingent contract in the following ways:

Basis of Distinction	Wagering Agreement	Contingent Contract
<b>1. Reciprocal promises</b>	It consists of reciprocal promises.	It may or may not consists of reciprocal promises.
<b>2. Void/valid</b>	It is void.	It is valid.
<b>3. Main/Collateral Future Event</b>	Future event is essential to the contract.	Future event is collateral to the contract.
<b>4. Nature</b>	It is always of a contingent nature.	It may not be of a wagering nature.
<b>5. Interest of parties</b>	Its parties have no other interest in the subject matter of the agreement except winning or losing of wagering amount.	Its parties may have other interest as well.

## PRACTICAL PROBLEMS

### PROBLEM 1

X promised to marry Y only and none else, and to pay ₹ 1,00,000 in default. X married Z. Y claimed ₹ 1,00,000 but X refused to pay. State the legal position.

**Solution:** Section to which the given problem relates: Section 26.

**Decision:** Y cannot recover anything from X.

**Reason:** The agreement between X and Y was in restraint of marriage.

### PROBLEM 2

X employed Y. The terms of service agreement are-

- (a) The employee has to serve the organisation for 5 years.
- (b) The employee shall not accept any other similar engagement during the term of agreement.
- (c) The employee shall not accept similar engagement after the termination of services.
- (d) The employee shall not compete with his employer after the termination of services.

State the legal position of the terms of service agreement.

**Solution:** Section to which the given problem relates: Section 27.

**Decision:** First two terms (a) and (b) are not in restraint of trade and hence valid. Last two terms (c) and (d), are restraint of trade and hence void.

### PROBLEM 3

X and Y were rival traders in South Delhi. X agreed to pay Y ₹ 5,00,000 if Y closes his business in that locality. Y accordingly did so but X refused to pay. Can Y claim ₹ 5,00,000?

**Solution:** Section to which the given problem relates: Section 27.

**Decision:** Y cannot claim anything from X.

**Reason:** The agreement between X and Y was in restraint of trade.

[**Leading case:** Madhub Chander v. Raj Coomar]

### PROBLEM 4

X sold his business including goodwill to Y for ₹ 5,00,000 by an agreement. The agreement provided that X shall not engage himself in the similar business in the whole of India for the next 10 years. X started the same business in the same city after 1 month. State the legal position.

**Solution:** Section to which the given problem relates: Section 27.

**Decision:** Y cannot take any legal action against X.

**Reason:** The agreement between X and Y was in restraint of trade because the limits were unreasonable.

#### PROBLEM 5

A clause in a life insurance policy was that "no suit to recover under the policy shall be brought after one year from the date of death of assured." X died and his legal representatives filed a suit to recover the assured sum after two and half years. Is this suit maintainable?

**Solution:** Section to which the given problem relates: Section 28.

**Decision:** This suit is maintainable.

**Reason:** The clause in policy is void because it curtailed the prescribed period of limitation (which is 3 years) according to Law of Limitation Act.

#### PROBLEM 6

X agrees to sell to Y "100 tons of oil."

State the legal position of this agreement in each of the following alternative cases:

Case (a) If X, who is a dealer in coconut oil only, decides to sell @ ₹ 10,000 per ton.

Case (b) If X is a dealer in coconut oil and price is not fixed.

Case (c) If X is a dealer in coconut oil and price is to be fixed by Z.

Case (d) If X who is a dealer in coconut oil agrees to sell at ₹ 10,000 per ton or ₹ 11,000 per ton.

Case (e) If X is a dealer in coconut oil and mustard oil.

**Solution:** Section to which the given problem relates: Section 29.

Case	Decision	Reason
(a)	Valid	There is no uncertainty as to the description of oil because the nature of X's trade indicates that this contract is for sale of coconut oil.
(b)	Valid	There is no uncertainty because in this case a reasonable price shall be payable according to Section 2 of the Sale of Goods Act, 1930.
(c)	Valid	There is no uncertainty because in this case the price fixed by Z shall be payable.
(d)	Void	There is no certainty as to which of the two price shall be payable.
(e)	Void	There is no certainty as to which of the two oils has been sold.

**PROBLEM 7**

X instructed Y to enter on his behalf a wagering transaction. Y lost ₹ 10,000 in that transaction and paid from his pocket. Y claimed ₹ 10,000 from X who refused on the ground of wagering transaction. State the legal position if wagering transaction was entered into (a) Delhi (b) Mumbai (c) Ahmedabad.

**Solution:** Section to which the given problem relates: Section 30.

**Decision:** Y's transaction is collateral to the main transaction (i.e. wagering transaction).

**Case (a):** Y can recover ₹ 10,000 from X because the collateral transaction to the main transaction which is void in Delhi, is not affected at all.

**Cases (b) and (c):** Y cannot recover ₹ 10,000 from X because the collateral transaction to the main transaction which is illegal in the state of Maharashtra and Gujarat, is also affected.

[**Leading case:** Daya Ram v. Murli Dhar]

**PROBLEM 8**

M lost a sum of ₹ 8,500 to L & Co. on bets on horse races, and on his failure to pay was reported to the race course club. M subsequently executed in favour of L & Co. a Hundi for ₹ 8,500 in consideration of their withdrawing his name from the club and thereby his being posted as a defaulter. When L & Co. demanded the payment. M pleaded that the consideration was unlawful. Decide.

**Solution:** Section to which the given problem relates: Section 30.

**Decision:** M shall be liable to pay.

**Reason:** A wagering contract being void only does not affect collateral transactions.

**PROBLEM 9**

A agrees to pay B ₹ 50,000 if B marries C within 1 year. State the legal position in each of the following alternative case:

Case (a) If B marries C after 1 year.

Case (b) If B marries C within 1 year.

Case (c) If B marries D within 6 months of agreement.

Case (d) If B marries D within 6 months of agreement. Subsequently, D dies and B marries C within 6 months of marriage D.

**Solution:**

**Case (a):** Section to which the given problem relates: Section 35.

**Decision:** B cannot recover anything from A.

**Reason:** The contract becomes void on the expiry of 1 year.

**Case (b):** Section to which the given problem relates: Section 32.

**Decision:** B can recover ₹ 50,000 from A.

**Reason:** The contract can be enforced by law when the event has happened (i.e. the marriage of B to C).

**Case (c):** Section to which the given problem relates: Sections 34, 35.

**Decision:** B cannot recover anything from A.

**Reason:** The contract becomes void because the event (i.e. the marriage of B to C) has become impossible.

**Case (d):** Section to which the given problem relates: Section 32.

**Decision:** B can recover ₹ 50,000 from A when he marries C.

**Reason:** The contract can be enforced by law when the event has happened (i.e., the marriage of B to C).

#### PROBLEM 10

A agrees to pay B ₹ 1,00,000 if a certain ship returns within a year. State the legal position in each of the following alternative cases:

Case (a) If the ship returns within the year.

Case (b) If the ship returns after the expiry of 1 year.

Case (c) If the ship is burnt within the year.

**Solution:** Section to which the given problem relates: Section 35.

**Case (a)**

**Decision:** B can recover ₹ 1,00,000 from A.

**Reason:** The contract can be enforced by law when the event has happened (i.e., return of ship).

**Case (b)**

**Decision:** B cannot recover anything from A.

**Reason:** The contract becomes void on the expiry of the fixed time if the event does not happen.

**Case (c)**

**Decision:** B cannot recover anything from A.

**Reason:** The contract becomes void when such event becomes impossible.

#### PROBLEM 11

A agrees to pay B ₹ 1,00,000 if a certain ship does not return within a year. State the legal position in each of the following alternative cases:

Case (a) If the ship does not return within a year.

Case (b) If the ship returns within a year.

Case (c) If the ship is burnt within a year.

**Solution:** Section to which the given problem relates: Section 35.

**Case (a)**

**Decision:** B can recover ₹ 1,00,000 from A.

**Reason:** The contract can be enforced on the expiry of the fixed time since the ship has not returned within a year.

**Cases (b)**

**Decision:** B cannot recover anything from A.

**Reason:** The Contract becomes void because the ship has returned within a year.

**Cases (c)**

**Decision:** B can recover ₹ 1,00,000 from A.

**Reason:** The Contract can be enforced since it has become certain that the ship will not return.

## PROBLEM 12

A agreed to pay B ₹ 50,000 if B marries C. C was already married to D at the time of agreement. State the legal position.

**Solution:** Section to which the given problem relates: Section 36.

**Decision:** Such agreement is void and hence not enforceable by law.

**Reason:** Marriage of B to C is impossible at present.

## IMPORTANT POINTS TO REMEMBER

### 1.0 Meaning and Examples of Void Agreements

<b>Meaning</b>	A void agreement is an agreement which is not enforceable by law. The agreements which are not enforceable by law right from the time when they are made, are <i>void-ab-initio</i> .
<b>Examples</b>	<p>Agreements which have expressly been declared void:</p> <ol style="list-style-type: none"> <li>1. Agreements by or with persons incompetent to contract (Sections 10 &amp; 11).</li> <li>2. Agreements entered into through a mutual mistake of fact between the parties (Section 20).</li> <li>3. Agreement, the object or Consideration of which is unlawful (Section 23).</li> </ol>

	4. Agreement, the Consideration or Object of which is partly unlawful (Section 24). 5. Agreement made without Consideration (Section 25). 6. Agreements in Restraint of Marriage of any person other than minor (Section 26). 7. Agreements in Restraint of Trade (Section 27). 8. Agreements in Restraint of Legal Proceedings (Section 29). 9. Wagering Agreement (Section 30). 10. Impossible Agreement (Section 56). 11. An agreement to enter into an Agreement in the Future.
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## 2.0 Agreements in Restraint of Trade

<b>Validity</b>	"Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void."
<b>Meaning of Expression 'that extent'</b>	The expression 'that extent' may be interpreted in the sense that only that portion of such agreement is void which is considered <i>either</i> as unreasonable <i>or</i> as opposed to public policy being in restraint of trade. The rest of the agreement would continue to be valid.
<b>Exceptions</b>	
<b><i>Under Statutory Provisions</i></b>	
1. Agreement with seller of Goodwill 2. Agreements with Partners <i>(a) Restriction on Existing Partner to carry any business other than that of firm while he is a partner. (b) Restrictions on outgoing Partner to carry on similar business within specified period or local limits if restrictions are reasonable. (c) Restriction on Partners on dissolution of firm to carry on similar business within specified period or local limits if restrictions are reasonable. (d) Restriction on Partners in case of sale of firm's goodwill, to carry on similar business within specified period or local limits if restrictions are reasonable.</i>	
<b><i>Under Judicial Interpretations</i></b>	
1. Trade Combinations to regulate the business or to fix prices (but not to create monopoly) 2. Sole Dealing Agreements on reasonable terms. 3. Service Agreements	



### 3.0 Agreements in Restraint of Legal Proceedings

<b>Restricting Enforcement of Rights</b>	Agreements Restricting Enforcement of Rights is void to that extent.
<b>Limiting Period of Limitation</b>	Agreements Limiting the Period of Limitation is void because its object is to defeat the provisions of law.

### 4.0 Meaning and Validity of Various Agreements

<i>Type of Agreement</i>	<i>Validity</i>
<b>1. Uncertain Agreement</b> [An agreement the meaning of which is not certain or capable of being made certain]	Void
<b>2. Wagering Agreement</b> [An agreement between two persons under which money or money's worth is payable, by one person to another on the happening or non-happening of a future uncertain event is called a wagering event.] <i>(a) In the States of Maharashtra &amp; Gujrat</i> <i>(b) In Rest of India</i>	Illegal Void
<b>3. Agreements collateral to Wagering Agreement</b> <i>(a) In the States of Maharashtra &amp; Gujrat</i> <i>(b) In Rest of India</i>	Illegal Valid
<b>4. Contingent Agreement based on Impossible Event</b> [An agreement to do or not to do anything if an impossible event happens whether impossibility of the event is known or not to the partner to the agreement at the time when it is made]	Void
<b>5. Agreement to do an Impossible Act</b>	Void
<b>6. Contingent Contract</b> [A contract to do or not to do something if some event collateral to such contract does or does not happen] [or A contract the performance of which depends upon the happening or non-happening of some future uncertain event which is collateral to the contract]	

**5.0 Restitution**

<b>Meaning</b>	Restitution means "Return or Restoration of Benefit." The provisions relating to 'restitution' are given on next page:
<b>Case</b>	<b>Provision</b>
<b>(a) When a person at whose option a contract is voidable rescinds it [Section 64].</b>	The party rescinding a voidable contract must restore the benefit to the person from whom he has received it.
<b>(b) When an agreement is discovered to be void or the contract becomes void [Section 65].</b>	The person who has received any benefit or advantage under such agreement or contract must restore it or compensate for it to the person from whom he has received it.
<b>Non-Applicability</b>	The principle of restitution does not apply to contracts which are void <i>ab-initio</i> with the exception where the minor has entered into agreement by misrepresenting his age.

**TRUE OR FALSE QUESTIONS**

**State whether the following statements are True or False:**

1. The performance of a contingent contract depends upon the happening of some future event.
2. The performance of a contingent contract depends upon the non-happening of some future event.
3. The event in a contingent contract must be essential to the contract.
4. The event in a contingent contract may be certain or uncertain.
5. The performance of a contingent contract must not depend upon mere will of the promisor.
6. Contracts contingent upon the happening of an uncertain future event becomes voidable at the option of promisee if that event becomes impossible.
7. Contracts contingent upon the non-happening of a certain future event cannot be enforced if the happening of that event becomes impossible.
8. Contracts contingent upon the happening of an uncertain specified event within a fixed time can become void only after the expiry of the fixed time.
9. Contracts contingent upon the non-happening of an uncertain specified event within a fixed time can be enforced only after the expiry of the fixed time.
10. Agreements contingent upon impossible events are void only if the impossibility of the event is known to the parties to the agreements at the time when these are made.

**ANSWERS**

1. False 2. False 3. False 4. False 5. True 6. False 7. False 8. False  
9. False 10. False

### VERY SHORT ANSWER TYPE QUESTIONS

1. Define Void Agreements.
2. Define Uncertain Agreements.
3. Define Wagering Agreements.
4. Give an example of agreements contingent on impossible acts.
5. What is meant by restitution?
6. State whether the party who has received some benefit under the following is bound to restore it to the other party in each of the following alternative cases?
  - (a) under a voidable contract
  - (b) under an agreement discovered to be void
  - (c) under a contract which becomes void
  - (d) under a void agreement
7. What is a contingent contract?
8. State whether the event in a contingent contract is main or collateral.
9. State whether the event in a contingent contract is certain or uncertain.
10. State whether the agreements contingent upon impossible events are void or voidable.

### SHORT ANSWER TYPE QUESTIONS

1. Comment on the following statements:
  - (a) An agreement is restraint of trade is void.
  - (b) Wagering agreements do not cover the insurance contracts.
2. Distinguish between the following:
  - (a) Void Agreements and Void Contracts
  - (b) Void Agreements and Illegal Agreements
  - (c) Void Contracts and Voidable Contracts
  - (d) Wagering Agreements and Insurance Contracts
3. Write short notes on the following:
  - (a) Void Agreements
  - (b) Wagering Agreements
  - (c) An agreements in restraint of trade
  - (d) Restitution
4. Enumerate the agreements which have been expressly declared void by the Indian Contract Act, 1872.
5. Distinguish between wagering agreement and contingent contract.
6. Write short note on 'contingent contracts'.

### **LONG ANSWER TYPE QUESTIONS**

1. "An agreement in restraint of trade is void." Examine this statement mentioning exceptions, if any.
2. (a) What are agreements by way of wagers?  
(b) State the legal effects of such agreements.  
(c) Is a contract of insurance a wager?
3. (a) What are contingent contracts?  
(b) State the rules regarding enforcement of such contracts. Give illustrations also.



# Performance of a Contract

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## 1.0 WHAT IS THE MEANING OF PERFORMANCE?

1. Performance of the contract is one of the various modes of discharge of the contract.
2. A contract is said to have been performed when the parties to a contract either perform or offer to perform their respective promises.
3. *According to section, 37, "The parties to a contract must either perform or offer to perform their respective promises, unless such performance is dispensed with or excused under the provisions of this Act, or of any other law."*

## 2.0 WHAT ARE THE TYPES OF PERFORMANCE OF THE CONTRACT ?

There may be two types of performance as follows:

### ACTUAL PERFORMANCE

Where a promisor has made an offer of performance to the promisee and the offer has been accepted by the promisee, it is called an actual performance.

**Example** *X contracted to deliver to Y at his warehouse on 1st October, 100 bales of cotton of a particular quality. X brought the cotton of requisite quality to the appointed place on the appointed day during the business hours, and Y took the delivery of goods. This is an actual performance.*

### ATTEMPTED PERFORMANCE (OR TENDER OR OFFER TO PERFORM)

Where a promisor has made an offer of performance to the promisee, and the offer has not been accepted by the promisee, it is called an attempted performance (Section 38).

**Example** *If in the aforesaid example, Y refused to take the delivery of goods, it is a case of attempted performance because X has done what he was required to do under the contract.*

## 3.0 WHAT ARE THE EFFECTS OF TENDER?

There are two effects of tender as under:

1. The promisor is not responsible for non-performance.
2. The promisor does not lose his rights under the contract.

## 4.0 WHAT ARE THE TYPES OF TENDER?

There can be two types of tender as follows:

Types of tender	Meaning	Effects
<b>I. Tender of goods or services</b>	Where the promisor offers to deliver the goods or services but the promisee refuses to accept the delivery.	(a) Goods or services need not be offered again. (b) Promisor may sue the promisee for non-performance. (c) Promisor is discharged from his liability.
<b>II. Tender of money</b>	Where the promisor offers to pay the amount but the promisee refuses to accept the same.	(a) Promisor is not discharged from his liability to pay the amount. (b) Promisor will not be liable for interest from the date of a valid tender.

### 5.0 WHAT ARE THE ESSENTIALS OF A VALID TENDER?

The essentials of a valid tender are discussed below:

- 1. Unconditional:** It must be unconditional. Tender is said to be unconditional when it is made in accordance with the terms of the contract.  
**Example** *X offers to deliver 100 bales of cotton to Y if Y sells his one machine to X. It is a conditional tender and hence invalid.*
- 2. At Proper Time:** It must be at proper time, i.e. at the stipulated time (if there is an agreement as to time) or during business hours (if there is no agreement as to time). Tender of goods or money before the due date is also not a valid tender.
- 3. At Proper Place:** It must be at proper place, i.e. at the stipulated place (if there is an agreement as to place) or at promisee's business place (if there is business) or at promisee's residence (if there is no business place).
- 4. Reasonable Opportunity to Promisee:** It must give a reasonable opportunity to the promisee of ascertaining that the goods offered are the same as the promisor is bound to deliver.
- 5. For Whole Obligation:** It must be for the whole obligation and not for a part of the whole obligation. However, a minor deviation from the terms of the contract may not render the tender invalid.  
**Example:** *Delivery of 100.10 tons of wheat in a contract for 100 tons of wheat is a valid tender but delivery of 120 tons of wheat is invalid tender.*
- 6. To Proper Person:** It must be made to the promisee or his duly authorised agent. In case of several joint promisees, a tender made to one of them has the same legal consequences as tender to all of them.
- 7. Of Exact Amount and in Legal Tender:** In case of tender of money, it must be of exact amount and in legal tender.

## 6.0 WHAT IS THE EFFECT OF REFUSAL OF PARTY TO PERFORM PROMISE WHOLLY ?

When a party to a contract has refused to perform or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract, unless he has signified, by words or conduct, his acquiescence in its continuance. [Sec. 39]

**Example I** *A, a singer enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week during the next two months, and B engages to pay her ₹ 100 for each night's performance. On the sixth night, A willfully absents herself from the theatre. B is at liberty to put an end to the contract.*

**Example II** *A, a singer enters into a contract with B, the manager of a theatre, to sing at his theatre two nights every week during the next two months and B engages to pay her at the rate of ₹ 100 for each night. On the sixth night, A willfully absents herself. With the assent of B, A sings on the seventh night. B has signified his acquiescence in the continuance of the contract, and cannot now put an end to it, but is entitled to compensation for damage sustained by him through A's failure to sing on the sixth night.*

## 7.0 WHO MAY DEMAND PERFORMANCE OF A CONTRACT?

The following persons may demand performance of a contract:

- 1. Promisee** Promisee can only demand the performance of the promise under a contract. For example, X promises Y to pay ₹ 1,000 to Z. It is only Y who can demand performance and not Z.
- 2. Legal Representative** In case of death of the promisee, his legal representative can demand performance unless a contrary intention appears from the contract or the contract is of a personal nature. For example, X promises to marry Y on the specified day. Y dies before the specified day. The legal representatives of Y cannot demand performance of the promise from X because the contract is of personal nature.
- 3. Third Party** A third party can also demand the performance of the contract in some exceptional cases like beneficiary in case of trust, the person for whose benefit the provision is made in family arrangements.
- 4. Joint Promisees** In case of several promisees, unless a contrary intention appears, the performance can be demanded by the following persons:

Case	Who can demand the performance of promise
<b>I. In case all the promisees are alive</b>	All the promisees jointly.
<b>II. In case of death of any of joint promisees</b>	Representatives of deceased promisee jointly with the surviving promisee (s).
<b>III. In case of death of all joint promisees</b>	Representatives of all of them jointly.

**Example** *X promises Y and Z jointly to repay loan of ₹ 1,000 on a specified day. Y dies before that specified day. Y's representative jointly with Z can demand the performance*

from X on specified day. If Y and Z die before that specified day, the representatives of Y and Z jointly can demand the performance from X on specified day.

## 8.0 WHO MAY PERFORM THE CONTRACT?

A contract may be performed by the following persons:

1. **Promisor** If it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it must be performed by the promisor himself, such promise must be performed by the promisor.

**Example I** *X promises to marry Y. X must perform this promise personally.*

**Example II** *X promises to paint a picture for Y. X must perform the promise personally.*

2. **Promisor's Agent** If it was not the intention of the parties that the promise must be performed by the promisor himself, such contracts can be performed by the promisor himself or any competent person employed by him.

**Example** *A promises to pay B a sum of money. A may perform this promise either by personally paying the money to B, or by causing it to be paid to B by another, and if A dies before the time appointed for payment, his representatives must perform the promise, or employ some proper person to do so.*

3. **Legal Representatives** In case of death of promisor, his legal representative can perform the contract unless a contrary intention appears or the contract is of personal nature.

**Example** *X promises to marry Y. X dies. X's legal representatives cannot perform this promise.*

4. **Third Party** A contract can be performed by a third party if the promisee accepts the arrangement. According to Section 41, when a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor.
5. **Joint Promisors** In case of several promisors, unless a contrary intention appears, the following persons must perform the promise:

Case	Who must perform the promise
I. In case all the promisors are alive	All the promisors jointly.
II. In case of death of any of joint promisors	Representatives of the deceased promisor jointly with the surviving promisor(s).
III. In case of death of all joint promisors	Representatives of all of them jointly.

**Example** *X and Y jointly promise to repay a loan of ₹ 1,000 on a specified day. X dies before that specified day. X's representative jointly with Y must perform the promise on the specified day.*



## 9.0 DEVOLUTION OF JOINT LIABILITIES AND JOINT RIGHTS

### MEANING OF DEVOLUTION

Devolution means passing over from one person to another.

### MEANING OF DEVOLUTION OF JOINT LIABILITIES [SECTION 42]

When two or more persons have made a joint promise, then, unless a contrary intention appears by the contract, all such persons, during their joint lives, and, after the death of any of them, his representative jointly with the survivor or survivors, and, after the death of the last survivor, the representatives of all jointly, must fulfil the promise. —When two or more persons have made a joint promise, then, unless a contrary intention appears by the contract, all such persons, during their joint lives, and, after the death of any of them, his representative jointly with the survivor or survivors, and, after the death of the last survivor, the representatives of all jointly, must fulfil the promise.

### RULES REGARDING THE PERFORMANCE OF JOINT PROMISE [SEC. 43 & 44]

The rules regarding the performance of joint promises are as follows:

- (a) **Joint and Several Liability of Joint Promisors:** In the absence of express agreement to the contrary, the promisee may compel anyone or more of such joint promisors to perform the whole of the promise.

**Example** *A, B and C jointly promise to pay D ₹ 3,000. D may compel either A or B or C to pay him ₹ 3,000.*

- (b) **Joint Promisor's Right to Claim Contribution:** Each of the joint promisors may compel every other joint promisor to contribute equally with himself to the performance of the promise, unless a contrary intention appears from the contract.

**Example** *A, B and C jointly promise to pay D a sum of ₹ 3,000. C is compelled to pay the whole. A is insolvent, but his assets are sufficient to pay one-half of his debts. C is entitled to receive ₹ 500 from A's estate and ₹ 1,250 from B.*

- (c) **Joint Promisor's Duty to Share Loss from Default in Contribution:** If any of the joint promisors makes default in such contribution, the remaining joint promisor must bear the loss arising from such default in equal shares.

**Example** *A, B and C are under a joint promise to pay D ₹ 3,000. C is unable to pay anything and A is compelled to pay the whole. A is entitled to receive ₹ 1,500 from B.*

- (d) **Effect of Release of One Joint Promisor:** A release of one of such joint promisors by the promisee, does not discharge the other joint promisors neither does it free the joint promisor so released from responsibility to the other joint promisors.[Sec 44]

**Example** *A, B and C jointly promise to pay D ₹ 3,000. D releases A from his liability and sues B and C for payment. Here, neither B and C are released from their liability to D nor A is released from his liability to B and C for contribution.*

However, under English law, the liability of joint promisors is only joint and not joint and several and therefore, the release of one of the joint promisors shall relieve all the other promisors of their liability.

**MEANING OF DEVOLUTION OF JOINT RIGHTS [SECTION 45]**

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

**Example** *A, in consideration of ₹ 5,000 lent to him by B and C, promises B and C jointly to repay them that sum with interest on a day specified. B dies. The right to claim performance rests with B's representative jointly with C during C's life, and, after the death of C, with the representatives of B and C jointly.*

**10.0 WHAT ARE THE RULES AS TO TIME AND PLACE OF PERFORMANCE?**

The various rules regarding the time and place of performance are given below:

Case	Rule
<b>1. Where the time for performance is not specified in a contract and the promisor has undertaken to perform without application by the promisee.</b>	The contract must be performed within a reasonable time. The question 'What is reasonable time' is a question of fact [Section 46].
<b>2. Where the time for performance is specified in a contract and the promisor has undertaken to perform it without application by the promisee.</b>	The promisor must perform his promise on that particular day during the usual business hours and at a place where the promise ought to be performed [Section 47].
<b>3. Where the time for performance is specified in a contract and the promisor has not undertaken to perform it without application by the promisee.</b>	The promisee must apply for performance at a proper place and within usual business hours [Section 48].
<b>4. Where the place for performance is not specified in a contract and the promise is to be performed without application by the promisee.</b>	The promisor must apply to the promisee to appoint a reasonable place for the performance and to perform the promise at such place [Section 49].
<b>5. Where the promisee prescribes the manner or time for performance.</b>	The promise must be performed in the manner and at the time prescribed by the promisee [Section 50].

**Example I** *B owes A ₹ 2,000. A desires B to pay the amount to A's account with C, a banker. B who also banks with C, orders the amount to be transferred from his account to A's credit, and this is done by C. Afterwards, and before A knows of the transfer, C fails. There has been a good payment by B.*

**Example II** *A and B are mutually indebted. A and B settle an account by setting off one item against another, and B pays A the balance found to be due from him upon such*

settlement. This amounts to payment by A and B, respectively, of the sums which they owed to each other.

**Example III** A owes B ₹ 2,000. B accepts some of A's goods in reduction of the debt. The delivery of the goods operates as a part payment.

**Example IV** A desires B, who owes him ₹ 100, to send him a note for ₹ 100 by post. The debt is discharged as soon as B posts a letter containing the note duly addressed to A.

## 11.0 IS TIME AN ESSENCE OF CONTRACT?

### MEANING OF TIME AS ESSENCE OF CONTRACT

Time is an essence of a contract means that it is essential for the parties to a contract to perform their respective promises within the specified time.

### CASES WHERE TIME IS CONSIDERED TO BE ESSENCE OF CONTRACT

In the following cases, time is usually considered to be the essence of contract:

- (a) Where the parties have expressly agreed to treat the time as the essence of the contract.
- (b) Where the non-performance at the specified time operates as an injury to the party.
- (c) Where the nature and necessity of the contract requires the performance of the contract within the specified time.

### PRESUMPTION AS TO TIME AS ESSENCE OF CONTRACT

In Commercial or Mercantile Contracts	In Non-Commercial or Non-Mercantile Contracts
(a) Time fixed for the delivery of goods is considered to be the essence of a contract.	(a) Usually, the presumption is that time is not the essence of a contract.
(b) Time fixed for the payment of the price is not considered to be the essence of a contract.	For example, in case of the sale of an immovable property, time is presumed to be not the essence of a contract.

### CONSEQUENCES OF NON-PERFORMANCE OF CONTRACT WITHIN SPECIFIED TIME

The consequences of non-performance of a contract within the specified time depends upon whether the time is essence of the contract or not:

When time is essence of a contract	When time is not essence of a contract
(a) The contract becomes voidable at the option of the promisee.	(a) The contract does not become voidable at the option of the promisee.

(b) If performance beyond the specified time is accepted, the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise at the agreed time unless at the time of such acceptance, he gives notice to the promisor of his intention to do so.	(b) The promisee is entitled to claim compensation for any loss occasioned to him by non-performance of the promise at the agreed time.
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## 12.0 RECIPROCAL PROMISES

### MEANING OF RECIPROCAL PROMISES

Promises which form the consideration or part of the consideration for each other, are called 'reciprocal promises'. [Section 2(f)]

**Example** *In a contract for sale, A promises to deliver the goods to B at a fixed price and B promises to give security for the payment of the price. Such promises are called reciprocal promises.*

### TYPES OF RECIPROCAL PROMISES

Lord Mansfield in Jones v. Barkley case have classified the reciprocal promises as under:

Case	Who must perform the promise
(a) Mutual and Independent	When the promises are to be performed by each party independently, without waiting for the other party to perform his promise.
(b) Mutual and Dependent	When the performance of one party depends on the prior performance of the other party.
(c) Mutual and Concurrent	When the promises are to be performed simultaneously.

### WHAT ARE RULES REGARDING PERFORMANCE OF RECIPROCAL PROMISES?

The rules regarding the performance of reciprocal promises are as follows:

- (a) **Regarding Simultaneous Performance [Section 51]** When a contract consists of reciprocal promises to be simultaneously performed, the promisor need not perform his promise unless the promisee is ready and willing to perform his reciprocal promise.

**Example I** *A and B contract that A shall deliver goods to B to be paid for by B on delivery. A need not deliver the goods unless B is ready and willing to pay for the goods on delivery. B need not pay for the goods, unless A is ready and willing to deliver them on payment.*

**Example II** *A and B contract that A shall deliver goods to B at a price to be paid in instalments, the first installment to be paid on delivery. A need not deliver unless B is ready and willing to pay the first installment on delivery. B need not pay the first installment, unless A is ready and willing to deliver the goods on payment of the first installment.*

- (b) **Regarding Order of Performance [Section 52]** Where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they must be performed in that order, and where the order is not expressly fixed by the contract, they must be performed in the order which the nature of the transaction requires.

**Example I** *A and B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before B's promise to pay for it.*

**Example II** *A and B contract that A shall make delivery of his stock-in-trade to B at a fixed price, and B promises to give security for the payment of the money. A's promise need not be performed until the security is given, because the nature of the transaction requires that A should have security before he delivers up his stock.*

- (c) **Effects of Preventing the Performance [Section 53]** When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise, the contract becomes voidable at the option of the party so prevented; and such party is entitled to compensation from the other party for any loss which he may sustain in consequence of the non-performance of the contract.

**Example** *A and B contract that B shall execute certain work for A, for ₹ 1,000. B is ready and willing to execute the work accordingly, but A prevents him from doing so. The contract is voidable at the option of B; and, if he elects to rescind it, he is entitled to recover from A compensation for any loss which he has incurred by its non-performance.*

- (d) **Effects of non-performance in case of Mutual and Dependent Reciprocal Promises [Section 54]** Where the performance of one party depends on the prior performance of the other party and the party who is liable to perform first, fails to perform it, then such party cannot claim the performance from the other party and must make compensation to the other party for any loss which the other party may sustain by the non-performance of the contract.

**Example I** *A hires B's ship to take in and convey, from Kolkata to Mauritius a cargo, to be provided by A, B receiving a certain freight for its conveyance. A does not provide any cargo for the ship. A cannot claim the performance of B's promise, and must make compensation to B for the loss which B sustains by the non-performance of the contract.*

**Example II** *A contracts with B to execute certain builder's work for a fixed price, B supplying the scaffolding and timber necessary for the work. B refuses to furnish any scaffolding or timber. A need not execute the work, and B is bound to make compensation to A for any loss caused to him by the non-performance of the contract.*

**Example III** *A contracts with B to deliver to him, at a specified price, certain merchandise on board of a ship which cannot arrive for a month, and B engages to pay for the merchandise within a week from the date of the contract. B does not pay within the week. A's promise to deliver need not be performed, and B must make compensation.*

**Example IV** *A promises B to sell him 1000 bales of merchandise to be delivered next day, and B promises A to pay them within a month. A does not deliver according to his promise. B's promise to pay need not be performed, and A must make compensation.*

- (e) **Effect of Promise to do Legal and Illegal things [Section 57]** Where persons reciprocally promise, firstly, to do certain things which are legal, and secondly, under specified circumstances, to do certain other things which are illegal, the first set of promises is a contract, but the second is a void agreement.

**Example** *A and B agree that A shall sell B a house for ₹ 10,000 but that, if B uses it as a gambling house, he shall pay ₹ 50,000 for it.*

The first set for reciprocal promises, namely to sell the house and to pay ₹ 10,000 for it, is a contract. The second set is for an unlawful object, namely, that B may use the house as a gambling house and is a void agreement.

- (f) **Effect of alternative Promise being Illegal [Section 58]** In the case of an alternative promise, one branch of which is legal and the other illegal, the legal branch alone can be enforced.

**Example** *A and B agree that A shall pay B ₹ 1,000 for which B shall afterwards deliver to A either rice or smuggled opium. This is a valid contract to deliver rice, and a void agreement as to the opium.*

### 13.0 ASSIGNMENT OF CONTRACTS

#### MEANING OF ASSIGNMENT OF CONTRACTS

Assignment of a contract means transfer of contractual rights and liabilities to a third party.

#### MODES OF ASSIGNMENT OF CONTRACTS

Assignment of a contract may take place in the following ways:

1. Assignment by act of parties
2. Assignment by operation of law

#### ASSIGNMENT BY ACT OF PARTIES

Assignment by act of parties takes place when the parties to a contract themselves make the assignment. Such an assignment is subject to the following rules:

Case	Rule
<b>I. Assignment of Contractual Liabilities</b>	
(a) In case the contractual obligation involves personal skill or taste or ability (e.g. contract to marry)	(a) Such obligation cannot be assigned.
(b) In other cases	
(i) If the contract expressly or impliedly provides that the contract shall be performed by the promisor only	(i) Such obligation cannot be assigned.
(ii) If the contract does not expressly or impliedly provide that the contract shall be performed by the promisor only	(ii) The promisor or his representative may employ a competent person to perform such obligation [Sec. 40] but even the promisor remains liable to the promisee for proper performance.

(iii) By novations	(iii) The promisor may transfer his liability to a third party with the consent of promisee and the transferee by entering into a tripartite agreement.
<b>II. Assignment of Contractual Rights</b>	
(a) In case of contractual rights involving personal skill	(a) Such rights cannot be assigned.
(b) In other cases	(b) Such rights can be assigned subject to all equities between the original parties.
(c) Actionable claims (i.e. claim to any debt [except a secured debt] or to any beneficial interest in movable property e.g. book debts, right of action arising out of a contract etc.).	(c) Such claims can always be assigned

### ASSIGNMENT BY OPERATION OF LAW

Assignment by operation of law takes place when the law intervenes. Such assignment takes place in the following cases:

Case	Rule
<b>I. In case of death of any party</b>	The rights and obligations (other than those of personal nature) of the deceased party pass on to his legal representatives.
<b>II. In case of insolvency of any party</b>	The rights and obligations (other than those of personal nature) of the insolvent party pass on to the Official Receiver or Assignee.

**Example I** *X promises to marry Y. Here, neither X can assign his obligation nor Y can assign his right because the contract is of personal nature.*

**Example II** *X owes Y ₹ 10,000 and Z owes X ₹ 10,000. Here X cannot compel Y to recover the amount from Z. However, he can transfer his liability to Z with the consent of Y and Z. Y can also transfer his right to a third party to recover the amount from X.*

### ASSIGNMENT AND SUCCESSION

Under succession, both benefits and burden attached to the contract devolve upon the legal heir. A son succeeding his father's estate shall be liable to meet the debts and liability of his father to the extent of the property inherited. However, in assignment, only the benefit of a contract can be assigned and not the liabilities attached thereto.

**Why this is so?** This is because when liability is assigned, a third party gets involved therein. Thus a debtor cannot relieve himself of his liability to creditor by assigning to someone else his obligation to repay the debt.



On the other hand, if a creditor assigns the benefit of a promise, he thereby entitles the assignee to realise the debt from the debtor but where the benefit is coupled with a liability or when a personal consideration has entered into the making of the contract then the benefit cannot be assigned. In *Zaffer Mehar Ali v. Budge Budge Jute Mills Company Ltd.* 33 Cal., X agreed to sell certain gunny bags to Y, which were to be delivered in monthly instalments for a period of 6 months and the contract contained certain options for the buyer as regards quality and packing. It was held that the clause as to the buyer's option did not preclude from assigning the contract.

### **DISTINCTION BETWEEN SUCCESSION AND ASSIGNMENT**

<b>Basis of Distinction</b>	<b>Succession</b>	<b>Assignment</b>
<b>1. Meaning</b>	The transfer of rights and liabilities of a deceased person to his legal representative is called as succession.	The transfer of rights by a person to another person is called as assignment.
<b>2. What can be transferred?</b>	All the rights and liabilities of a person are transferred.	Only rights can be assigned.
<b>3. Notice</b>	Notice of succession is not required to be given to any person.	Notice of assignment is required to be given to the creditor.
<b>4. Time when takes place</b>	It takes place on the death of a person.	It takes place during the lifetime of a person.
<b>5. Written document</b>	It does not require any written document.	It requires execution of an assignment deed.
<b>6. Voluntary Act</b>	Succession is not a voluntary act.	Assignment is a voluntary act of the parties.
<b>7. Consideration</b>	Consideration is not required for succession	Consideration is must for assignment.

## **14.0 APPROPRIATION OF PAYMENT [SECTIONS 59-61]**

### **MEANING OF APPROPRIATION OF PAYMENT**

Appropriation of payment means application of payment to a particular debt.

### **RULES REGARDING APPROPRIATION OF PAYMENTS**

Where a debtor owes several distinct debts to a creditor and makes payment to a creditor, the following various rules regarding appropriation of payments shall apply:



Case	Rule
<b>I. Where debt to be discharged is indicated,</b> <i>(i.e. where a debtor who owes several distinct debts to one creditor, makes a payment to the creditor either with express intimation or under circumstances implying that the payment is to be applied to the discharge of some particular debt.)</i>	<b>The payment, if accepted must be applied accordingly.</b> (a) A owes B, among other debts, ₹ 1,000 upon a promissory note, which falls due on the first June. He owes B one other debt of that amount. On the first June, A pays to B ₹ 1,000. The payment is to be applied to the discharge of the promissory note. (b) A owes to B, among other debts, the sum of ₹ 567. B writes to A and demands payment of this sum. A sends to B ₹ 567. This payment is to be applied to the discharge of the debt of which B had demanded payment.
<b>II. Where debt to be discharged is not indicated,</b> <i>(i.e. where the debtor who owes several distinct debts makes a Payment to a the creditor but does not indicate the debt for which the payment is to be applied and there are no circumstances indicating the debt for which the payment is to be applied.)</i>	The creditor has option to apply the payment to any lawful debt due from the debtor even if it is a time barred debt. But he cannot apply to a disputed debt.
<b>III. Where neither party makes any appropriation,</b> <i>(i.e. where the debtor who owes several distinct debts makes a payment to a the creditor but does not indicate the debt for which the payment is to be applied)</i>	The payment shall be applied in discharge of the debts in order of time whether or not they are time barred. If the debts are of equal standing, the payment shall be applied in discharge of each, proportionately. In other words all payments shall be applied towards the payment of first debt till it gets extinguished. Similarly, all subsequent payments applied towards second debt till it gets fully paid and so on and so forth.

### RULE IN CLAYTON'S CASE

This rule applies where parties have a running account between them. According to this rule, in the absence of any contract to the contrary, an item of receipt side must be appropriated against the items of payment side in order of date.

## PRACTICAL PROBLEMS

### PROBLEM 1

W promises X, Y and Z jointly to repay a sum of ₹ 9,000. Who can demand the performance of the promise in each of the following alternative cases:

(a) If X dies (b) If Y dies (c) If Z dies (d) If X, Y and Z die?

**Solution:** Section to which the given problem relates: Section 45.

**Decision:**

Case (a) Legal representatives of X jointly with Y and Z

Case (b) Legal representative of Y jointly with X and Z

Case (c) Legal representatives of Z jointly with X and Y

Case (d) Legal representatives of X, Y and Z jointly

### PROBLEM 2

X, Y and Z jointly promise to pay ₹ 9,000 to W. Who is liable to pay the amount to W in each of the following alternative cases:

Case (a) If X dies, Case (b) X, Y and Z die?

**Solution:** Section to which the given problem relates: Section 42.

**Decision:**

Case (a) Legal representatives of X jointly with Y and Z.

Case (b) Legal representatives of X, Y and Z jointly.

### PROBLEM 3

X, Y and Z jointly promise to pay ₹ 9,000 to W. Can W compel X to pay him in full?

**Solution:** Section to which the given problem relates: Section 43, Para 1.

**Decision:** W can compel X to pay him in full.

**Reason:** In the absence of an express agreement to the contrary, the promisee may compel anyone or more of such joint promisors to perform the whole of the promise.

### PROBLEM 4

X, Y and Z jointly promise to pay ₹ 9,000 to W. W compelled X to pay the whole amount. Can X recover anything from Y and Z (a) if both Y and Z are solvent, (b) if Y is solvent and Z being insolvent pays only 60 paise in a rupee.

**Solution:** Section to which the given problem relates: Section 43.

**Decision:**

Case (a) X can recover ₹ 3,000 each from Y and Z.

Case (b) X can recover ₹ 1,800 from Z and 3,600 from Y.

**PROBLEM 5**

X owes Y three sums, one for ₹ 2,000 which is barred by limitation, second for ₹ 3,000 which is not barred, and third for ₹ 4,000 which is not barred. X sends ₹ 1,000 to Y. Can Y appropriate ₹ 1,000 towards ₹ 2,000 (a) if X gives no direction in this regard (b) if X asks Y to appropriate ₹ 1,000 towards the third debt of ₹ 4,000?

**Solution:** Section to which the given problem relates: Section 59.

**Decision:**

Case (a) Y can appropriate ₹ 1,000 towards ₹ 2,000.

Case (b) Y cannot appropriate ₹ 1,000 towards ₹ 2,000. He must appropriate ₹ 1,000 towards ₹ 4,000 only because the creditor is bound to follow the instruction of debtor regarding application of the payment.

**PROBLEM 6**

X owes Y ₹ 1,000 and Z owes X ₹ 1,000. Can Y recover ₹ 1,000 from Z (a) if no agreement has been entered into between X, Y and Z (b) if Y accepts Z as his debtor in pursuance of an agreement entered into between X, Y and Z?

**Solution:** Section to which the given problem relates: Section 62.

**Decision:**

Case (a) Y cannot recover from Z because there is privity of contract between Y and Z.

Case (b) Y can recover from Z because X, the promisor has transferred his liability by novation (i.e. by tripartite agreement between promisor, promisee and transferee)

**PROBLEM 7**

X, Y and Z jointly borrowed ₹ 60,000 from L. Decide in the light of The Indian Contract Act, 1872:

- (i) whether L can compel only Y to pay the entire loan of ₹ 60,000,
- (ii) If X, Y and Z died, whether L can compel only the Legal representatives of X to pay the loan of ₹ 60,000,
- (iii) If the whole amount was repaid to L by Y. How much Y can recover from X and Z?
- (iv) If the whole amount was repaid to L by Y and Z became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts. How much Y can recover from X and Z?
- (v) If the whole amount was repaid to L by Y, Z became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts and X died and his son W inherited the assets of ₹ 17,000. How much Y can recover from X and Z?

- (vi) If L releases X from his liability and sues Y and Z for payment. whether Y and Z are also released from their liability to L and X is released from his liability to Y and Z for contribution.

**Solution:** Section to which the given problem relates: Section 42 to 45

**Decision:**

- (i) Yes. L can compel only Y to pay ₹ 60,000 since as per Sec. 43 in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise.
- (ii) No. L can compel the Legal representatives of X, Y and Z **jointly** to pay the loan of ₹ 60,000, since as per Sec. 45 unless a contrary intention appears from the contract, the right to claim performance rests, as between him and them, with them during their joint lives, and, after the death of any of them, with the representative of such deceased person jointly, with the survivor or survivors and after the death of the last survivor, with the representatives of all jointly.
- (iii) Y can recover the contribution of ₹ 20,000 each from X and Z since as per Sec. 43 in the absence of express agreement to the contrary, the promisors, may compel every joint promisor to contribute equally to the performance of the promise (unless a contrary intention appears from the contract).
- (iv) Y can recover the contribution of ₹ 28,000 (i.e. ₹ 60,000 × 1/3) + (16,000 × 1/2) from X and ₹ 4,000 (i.e. ₹ 60,000 × 1/3 × 1/5) from Z since as per Sec. 43 in the absence of express agreement to the contrary, if any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.
- (v) Y can recover the contribution of ₹ 17,000 from X and ₹ 4,300 [i.e. (₹ 60,000 × 1/3) + (3,000 × 1/2)] × 1/5 from Z since as per Sec. 43 in the absence of express agreement to the contrary, if any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

**Note:** A legal representative is liable only to the extent of property of the deceased received by him as per Sec. 42.

- (vi) If L releases X from his liability and sues Y and Z for payment **neither** Y and Z are released from their liability to L **nor** X is released from his liability to Y and Z for contribution since as per Sec. 44 a release of one of such joint promisors by the promisee, does not discharge the other joint promisors neither does it free the joint promisor so released from responsibility to the other joint promisors.

## IMPORTANT POINTS TO REMEMBER

### 1.0 Meaning and types of Performance

<b>Meaning of Performance</b>	A contract is said to have been performed when the parties to a contract <i>either</i> perform <i>or</i> offer to perform their respective promises.
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<b>Two Types of Performance</b>	<b>1. Actual Performance:</b> Where a promisor has made an offer of performance to the promisee and the offer has been accepted by the promisee, it is called an actual performance.
	<b>2. Attempted Performance (or Tender):</b> Where a promisor has made an offer of performance to the promisee, and the offer has not been accepted by the promisee, it is called an attempted performance.

## 2.0 Effects, types and essentials of a valid tender

<b>Two Effects of Tender</b>	<ol style="list-style-type: none"> <li>1. The promisor is not responsible for non-performance.</li> <li>2. The promisor does not lose his rights under the contract.</li> </ol>
<b>Two Types of Tender</b>	<ol style="list-style-type: none"> <li>1. Tender of Goods/Services</li> <li>2. Tender of Money</li> </ol>
<b>Essentials of a Valid Tender</b>	<ol style="list-style-type: none"> <li>1. Unconditional</li> <li>2. At Proper Time</li> <li>3. At Proper Place</li> <li>4. Reasonable Opportunity to Promisee</li> <li>5. For Whole Obligation</li> <li>6. To Proper Person</li> </ol>

## 3.0 Who may demand Performance and who may perform

<b>Who may Demand Performance</b>	<ol style="list-style-type: none"> <li>1. Promisee</li> <li>2. Legal Representative</li> <li>3. Third Party</li> <li>4. Joint Promisees</li> </ol>
<b>Who may Perform the Contract</b>	<ol style="list-style-type: none"> <li>1. Promisor</li> <li>2. Promisor's Agent</li> <li>3. Legal Representatives</li> <li>4. Third Party</li> <li>5. Joint Promisors</li> </ol>

**4.0 Devolution of Joint Liabilities and Joint Rights**

<b>Meaning of Devolution</b>	Devolution means passing over from one person to another.
<b>Meaning of Devolution of Joint Liabilities</b>	When two or more persons have made a joint promise, then, unless a contrary intention appears by the contract, all such persons, during their joint lives, and, after the death of any of them, his representative jointly with the survivor or survivors, and, after the death of the last survivor, the representatives of all jointly, must fulfil the promise. —When two or more persons have made a joint promise, then, unless a contrary intention appears by the contract, all such persons, during their joint lives, and, after the death of any of them, his representative jointly with the survivor or survivors, and, after the death of the last survivor, the representatives of all jointly, must fulfil the promise.
<b>Rules Regarding the Performance of Joint Promise</b>	<ul style="list-style-type: none"> <li>(a) Joint and Several Liability of Joint Promisors</li> <li>(b) Joint Promisor's Right to Claim Contribution</li> <li>(c) Joint Promisor's Duty to Share Loss from Default in Contribution</li> <li>(d) Effect of Release of One Joint Promisor</li> </ul>
<b>Meaning of Devolution of Joint Rights</b>	When a person has made a promise to two or more persons jointly, then, unless a contrary intention appears from the contract, the right to claim performance rests, as between him and them, with them during their joint lives, and, after the death of any of them, with the representative of such deceased person jointly, with the survivor or survivors and after the death of the last survivor, with the representatives of all jointly.

## 5.0 Rules As to Time and Place of Performance of a Contract

<b>Case where. . .</b>	<b>Rule as to Performance</b>
<b>1. Time not specified</b>	Within a reasonable time
<b>2. Time specified but promise is to be performed without promisee's application</b>	During the usual business hours on that particular day
<b>3. Time specified but promises is to be performed on promisee's application</b>	The promisee must apply for performance at a proper place and within usual business hours.
<b>4. Place not specified</b>	The promisor must apply to the promisee to appoint a reasonable place for the performance and to perform the promise at such place.
<b>5. Manner for performance prescribed</b>	The promise must be performed in the manner and at the time prescribed by the promisee.

## 6.0 Is time an essence of contract?

<b>Meaning</b>	Time is an essence of a contract means that it is essential for the parties to a contract to perform their respective promises within the specified time.	
<b>When Time Essence?</b>	In the following cases, time is usually considered to be the essence of contract: (a) Where the parties have expressly agreed to treat the time as the essence of the contract. (b) Where the non-performance at the specified time operates as an injury to the party. (c) Where the nature and necessity of the contract requires the performance of the contract within the specified time.	
<b>In Commercial Contracts</b>	In commercial contracts time fixed for the delivery of goods and not for the payment of price is considered to be the essence of a contract.  Consequences of Non-performance of contract within specified time.	
<b>Consequences of Non-Performance of Contract within Specified Time</b>	<b>Where Time is essence</b>	<b>Where Time is not essence</b>
	1. Contract becomes voidable	1. Contract does not become voidable
	2. Promisee cannot claim compensation	2. Promisee can claim compensation

## 7.0 Reciprocal Promises

<b>Meaning</b>	Promises which form the consideration or part of the consideration for each other, are called 'reciprocal promises'.	
<b>Types</b>	Lord Mansfield in <b>Jones v. Barkley</b> case have classified the reciprocal promises as under:	
	<b>Types of reciprocal promises</b>	<b>Meaning</b>
	(a) Mutual and Independent	When the promises are to be performed by each party independently, without waiting for the other party to perform his promise.
	(b) Mutual and Dependent	When the performance of one party depends on the prior performance of the other party.
	(c) Mutual and Concurrent	When the promises are to be performed simultaneously.

## 8.0 Assignment of Contracts

<b>Meaning</b>	Assignment of a contract means transfer of contractual rights and liabilities to a third party.	
<b>Mode</b>	<b>Case</b>	<b>Rule</b>
	(a) By Act of Parties	
	1. Assignment of contractual liabilities	Contractual liabilities cannot be assigned unless Novation takes place. (Novation is a tripartite agreement between promisor, promisee and third party)
	2. Assignment of contractual Rights	Contractual Rights can be assigned subject to all equities between the original parties
	(b) By Operation of law	The rights and obligations (other than those of personal nature) of the deceased/insolvent party pass on to legal representatives/Official Receiver/Assignee.
<b>Assignment &amp; Succession</b>	Under succession, both benefits and burden attached to the contract devolve upon the legal heir. A son succeeding his father's estate shall be liable to meet the debts and liability of his father to the extent of the property inherited. However, in assignment, only the benefit of a contract can be assigned and not the liabilities attached thereto.	



## 9.0 Meaning of Appropriation of Payment

<b>Meaning</b>	It means application of payment to a particular debt.	
<b>Rules</b>	<b>Case</b>	<b>Rule</b>
	<b>I. Where debt to be discharged is indicated,</b>	The payment, if accepted must be applied accordingly.
	<b>II. Where debt to be discharged is not indicated</b>	The creditor has option to apply the payment to any lawful debt due from the debtor even if it is a time barred debt. But he cannot apply to a disputed debt.
	<b>III. Where neither party makes any appropriation</b>	The payment shall be applied in discharge of the debts in order of time whether or not they are time barred. If the debt are of equal standing, the payment shall be applied in discharge of each, proportionately. In other words all payments shall be applied towards the payment of first debt till it gets extinguished. Similarly, all subsequent payments applied towards second debt till it gets fully paid and so on and so forth.

## TRUE OR FALSE QUESTIONS

State with reasons whether the following statements are 'True' or 'False':

1. Tender means actual performance.
2. Tender of money discharges the debtor from his liability to pay the debt.
3. Conditional offer of performance is a valid tender.
4. An offer to perform promise in part is a valid tender.
5. In case of several joint promisees, the performance of the contract may be demanded by any of them.
6. In case of several joint promisors, the promisee can demand the performance from anyone or more of joint promisors.
7. Unless otherwise agreed, each of a joint promisor cannot compel other joint promisors to contribute equally to the performance of the promise.
8. Unless otherwise agreed, if anyone of the joint promisor makes default in making the payment, the other joint promisor must share the loss arising from such default equally.

9. When a promisee releases one of the joint promisors, the released joint promisor remains no longer liable to contribute to the other joint promisors.
10. Where time for performance is specified and the promise is to be performed on demand by the promisee, the promisor must apply for the performance.
11. Where no place for performance is specified and the promise is to be performed without demand by the promisee, the promisor must apply for the performance.
12. Where time is the essence of the contract and the promisor fails to perform his promise in time, the contract becomes void.
13. Where a promisee accepts the performance from a third person, even then he can compel the promisor to perform the promise again.
14. Promises forming consideration for each other are called joint promises.
15. Promises which are to be performed simultaneously are called mutual and independent.
16. Where one party to a reciprocal promise prevents the other from performing his promise, the contract becomes void.
17. All contractual obligations can be assigned by executing an instrument in writing.
18. A promisor can compel the promisee to accept a third person as the promisor in this place.
19. The assignee takes assignment subject to all equities between the original parties.
20. An actionable claim can always be assigned.
21. Assignment by operation of law takes place only in case of death of any party.
22. The creditor has always a discretion to apply the payment made by a debtor towards any debt.
23. In the absence of any direction by debtor, a creditor cannot apply the payment towards a time barred debt.
24. In the absence of any specific appropriation by either party, the money received must first be applied towards the payment of principal and then towards the payment of interest.

#### **ANSWERS**

1. False   2. False   3. False   4. False   5. False   6. True   7. False   8. True  
9. False   10. False   11. True   12. False   13. False   14. False   15. False   16. False  
17. False   18. False   19. True   20. True   21. False   22. False   23. False   24. False

#### **VERY SHORT ANSWER TYPE QUESTIONS**

1. What do you understand by performance of a contract?
2. What is meant by tenders?
3. Is performance of a contract by a third party valid?
4. Define the term 'reciprocal promise'.

5. What is meant by 'assignment of contracts?'
6. What is meant by 'appropriation of payment?'
7. When joint promisors are liable under the Indian Contract Act?

### SHORT ANSWER TYPE QUESTIONS

1. Comment on the following:
  - (a) Time is the essence of a contract. Comment.
  - (b) Tender is attempted performance.
  - (c) Appropriation is a right primarily of the debtor and for his benefit.
2. Write short notes on the following:
  - (a) Time as essence of contract
  - (b) Appropriation of payment
  - (c) Assignment of contract
  - (d) Reciprocal promises
  - (e) Valid tender or attempted performance
  - (f) Joint promise
3. Distinguish between Assignment and Succession.

### LONG ANSWER TYPE QUESTIONS

1.
  - (a) What do you understand by performance of a contract?
  - (b) Explain the rules of law relating to time and place of performance of a contract.
2.
  - (a) What is meant by tender?
  - (b) What are the essentials of a valid tender?
3.
  - (a) Who can demand performance of the contract?
  - (b) Who should perform a contract?
  - (c) Is performance of a contract by a third party valid?
4.
  - (a) When is time deemed to be the essence of a contract in the performance of the contract?
  - (b) What are the consequences of non-performance of contract within specified time?
5.
  - (a) Discuss the provisions relating to the rights and liabilities of joint promisors.
  - (b) Discuss the provisions relating to the joint rights.
6.
  - (a) Define the term 'reciprocal promise'.
  - (b) State the rules for the performance of reciprocal promises.
7.
  - (a) What is meant by 'assignment of contracts'?
  - (b) Discuss the law relating to assignment of contracts.
8.
  - (a) What is meant by appropriation of payment?
  - (b) State the rules regarding appropriation of payment.





# Discharge of a Contract

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## 1.0 WHAT IS THE MEANING OF DISCHARGE OF A CONTRACT?

Discharge of a contract means termination of the contractual relations between the parties to a contract. A contract is said to be discharged when the rights and obligations of the parties under the contract come to an end.

## 2.0 WHAT ARE THE MODES OF DISCHARGE OF CONTRACT?

A contract may be discharged in various modes shown on next page.

## 3.0 WHAT IS THE MEANT BY DISCHARGE OF PERFORMANCE?

A contract can be discharged by performance in any of the following ways:

### BY ACTUAL PERFORMANCE

A contract is said to be discharged by actual performance when the parties to the contract perform their promises in accordance with the terms of the contract.

### BY ATTEMPTED PERFORMANCE OR TENDER

A contract is said to be discharged by attempted performance when the promisor has made an offer of performance (i.e. a Valid Tender) to the promisee but it has not been accepted by the promisee.

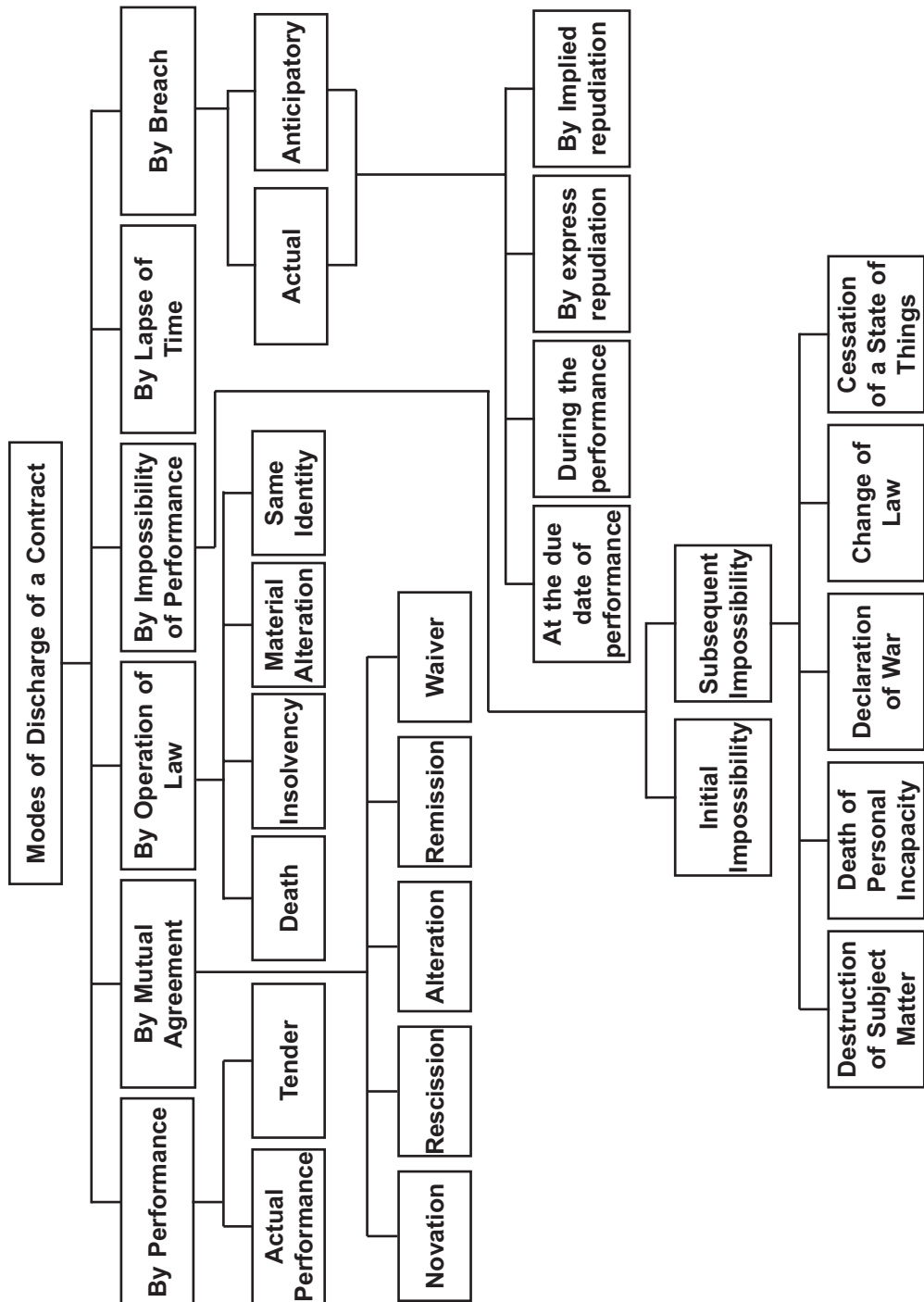
## 4.0 WHAT IS MEANT BY DISCHARGE BY MUTUAL AGREEMENT?

Since a contract is created by mutual agreement, it can also be discharged by mutual agreement. A contract can be discharged by mutual agreement in any of the following ways:

### NOVATION [SECTION 62]

Novation means the substitution of a new contract for the original contract. Such a new contract may be either between the same parties or between different parties. The term of contracts may or may not be changed. The consideration for the new contract is the discharge of the original contract.

**Example I** *A owes money to B under a contract. It is agreed between A, B and C that B shall henceforth accept C as his debtor, instead of A. The old debt of A to B no longer exists and a new debt from C to B has been contracted.*



**Example II** A owes B ₹ 10,000. A enters into an agreement with B, and gives B a mortgage of his (A's) estate for ₹ 5,000 in place of the debt of ₹ 10,000. This is a new contract and extinguishes the old.

### RESCISSION [SECTION 62]

Rescission means cancellation of the contract by any party or all the parties to a contract.

**Example** X promises Y to sell and deliver 100 Bales of cotton on 1st October at his godown and Y promises to pay for goods on 1st Nov. X does not supply the goods. Y may rescind the contract.

### ALTERATION [SECTION 62]

Alteration means a change in the terms of a contract with mutual consent of the parties. Alteration discharges the original contract and creates a new contract. However, parties to the new contract must not change.

**Example** X promises to sell and deliver 100 bales of cotton on 1st October and Y promises to pay for goods on 1st November. Afterwards, X and Y mutually decide that the goods shall be delivered in five equal instalments at Z's godown. Here, original contract has been discharged and a new contract has come into effect.

### REMISSION [SECTION 63]

Remission means acceptance by the promisee of a lesser fulfillment of the promise made. According to Section 63, "Every promisee-

- may dispense with or remit, wholly or in part, the performance of the promise made to him, or
- may extend the time for such performance, or
- may accept any other consideration than agreed to in the contract instead of it any satisfaction which he thinks fit."

No consideration is necessary for remission.

**Example I** A promises to paint a picture for B. B afterwards forbids him to do so. A is no longer bound to perform the promise.

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

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

**Example IV** A owes B, under a contract a sum of money, the amount of which has not been ascertained. A, without ascertaining the amount, gives to B, and B, in satisfaction thereof, accepts the sum of ₹ 2,000. This is a discharge of the whole debt, whatever may be its amount.

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**Example V** A owes B ₹ 2,000, and is also indebted to other creditors. A makes an arrangement with his creditors, including B, to pay them a composition of 50 paise in a rupee upon respective demands. Payment to B of ₹ 1,000 is a discharge of B's demand.

### WAIVER

Waiver means intentional relinquishment of a right under the contract. Thus, it amounts to releasing a person of certain legal obligation under a contract, e.g. X promises to supply goods to Y. Subsequently, Y exempts X from carrying out the promise. This amounts to waiving the right of performance on the part of Y.

### DISTINCTION BETWEEN NOVATION AND ALTERATION

Basis of Distintion	Novation	Alteration
1. Parties	The parties of contract may or may not be changed.	The parties to contract must not change.
2. Terms	The terms of contract may or may not be changed.	The terms of contract are changed.

## 5.0 WHAT IS MEANT BY DISCHARGE BY OPERATION OF LAW ?

A contract may be discharged by operation of law in the following cases:

### BY DEATH OF THE PROMISOR

A contract involving the personal skill or ability of the promisor is discharged automatically on the death of the promisor.

### BY INSOLVENCY

When a person is declared insolvent, he is discharged from his liability up to the date of his insolvency.

### BY UNAUTHORISED MATERIAL ALTERATION

If any party makes any material alteration in the terms of the contract without the approval of the other party, the contract comes to an end.

### BY THE IDENTITY OF PROMISOR AND PROMISEE

When the promisor becomes the promisee, the other parties are discharged.

**Example** X draws a bill receivable on Y who accepts the same. X endorses the bill in favour of Z who in turn endorses in favour of Y. Here, Y is both promisor and promisee and hence the other parties are discharged.

## 6.0 WHAT IS MEANT BY DISCHARGE BY IMPOSSIBILITY OF PERFORMANCE?

The effects of impossibility of the performance of a contract may be discussed under the following **two** heads:



1. Effects of Initial Impossibility
2. Effects of Supervening Impossibility

### EFFECTS OF INITIAL IMPOSSIBILITY [SECTION 56, PARAS 1 AND 3]

Initial impossibility means the impossibility existing at the time of making the contract. The effects of initial impossibility are as follows:

Case	Effect
<b>I. Where both the promisor and promisee know about the initial impossibility</b>	Such agreement is void abinitio. <b>Example</b> <i>X undertakes to put life into the dead wife of Y. This agreement is void.</i>
<b>II. Where both the promisor and promisee do not know about the initial impossibility</b>	Such agreement is void on the ground of mutual mistake. <b>Example</b> <i>X agrees to sell his horse to Y. Unknown to both the parties, the horse was dead at the time of making the agreement. This agreement is void.</i>
<b>III. Where the promisor alone knows about the initial impossibility</b>	Such promisor must compensate for any loss which such promisee sustains through the non-performance of the promise. <b>Example</b> <i>A contracts to marry B, being already married to C, and being forbidden by the law to which he is subject to practise polygamy. A must make compensation to B for the loss caused to her by the non-performance of his promise.</i>

### EFFECTS OF SUPERVENING IMPOSSIBILITY [SECTION 56, PARA 2]

Supervening impossibility means impossibility which does not exist at the time of making the contract but which arises subsequently after the formation of the contract and which makes the performance of the contract impossible or illegal. The effects of supervening impossibility are as under:

Case	Effect
<b>I. Where an act becomes impossible after the contract is made</b>	The contract to do such an act becomes void when the act becomes impossible. [Section 56, Para 2]
<b>II. Where an act becomes unlawful by reason of some event beyond the control of promisor</b>	The contract to do such an act becomes void when the act becomes unlawful. [Section 56, Para 2]

<b>III. Were the promisor alone knows about the impossibility</b>	Such promisor must compensate the promisee for any loss which such promisee might have suffered on account of non-performance of the promise. [Section 56, Para 3]
<b>IV. Where an agreement is discovered to be void or where a contract becomes void</b>	Any person who has received any benefit under such agreement or contract is bound to restore it or to make compensation for it, to the person from whom he received it. [Section 65]  <b>Example</b> <i>X contracts to sing for Y at a concert for ₹ 1,000 which is paid in advance. X is too ill to sing. X must refund ₹ 1,000 to Y.</i>

## 7.0 CASES WHEN A CONTRACT IS DISCHARGED ON THE GROUND OF SUPERVENING IMPOSSIBILITY

A contract is discharged by supervening impossibility in the following cases:

### DESTRUCTION OF SUBJECT MATTER

The contract is discharged if the subject matter of the contract is destroyed after the formation of the contract without any fault of either party.

**Example I** *X agreed to sell his crop of wheat. The entire crop was destroyed by fire though no fault of the party. The contract was discharged.*

**Example II** *A music hall was rented out for a series of concerts on certain days. The hall caught fire before the date of first concert. It was held, the contract has become void on ground of supervening impossibility.*

### DEATH OR PERSONAL INCAPACITY

The contract is discharged on the death or incapacity or illness of a person if the performance of a contract depends on his personal skill or ability.

**Example** *X agreed to sing on a specified day. X fell seriously ill and could not perform on that day. The contract was discharged.*

### DECLARATION OF WAR

The pending contracts at the time of declaration of war are either suspended or declared as void.

**Example** *X contracts to take in cargo for Y at a foreign port. X's government afterwards declares war against the country in which the port is situated. The contract becomes void when the war is declared.*

### CHANGE OF LAW

The contract is discharged if the performance of the contract becomes impossible or unlawful due to change in law after the formation of the contract.

**Example** *X agreed to sell his land to Y. After the formation of the contract, the Government issued a notification and acquired the land. The contract was discharged. [Shyam Sunder v. Durga]*

### NON-EXISTENCE OR NON-OCCURRENCE OF A PARTICULAR STATE OF THINGS NECESSARY FOR PERFORMANCE

The contract is discharged if that particular state of thing which forms the basis of a contract, ceases to exist or occur.

**Example I** *X and Y contract to marry each other. Before the time fixed for the marriage. X goes mad. The contract becomes void.*

**Example II** *X hired a room from Y for viewing the coronation process of King Edward VII. The procession was cancelled because of King's illness. It was held that X was not liable to pay the room rent because the procession which formed the basis of the contract did not occur. (Krell v. Henry)*

### 8.0 CASES WHEN THE CONTRACT IS NOT DISCHARGED ON THE GROUND OF SUPERVENING IMPOSSIBILITY

Impossibility of performance is, as a rule, not an excuse from performance. It means that when a person has promised to do something, he must perform his promise unless the performance becomes absolutely impossible. A contract is not discharged by the supervening impossibility in the following cases:

#### DIFFICULTY OF PERFORMANCE

A contract is not discharged simply on the ground that its performance has become more difficult, more expensive or less profitable than that agreed at the time of its formation.

**Example** *X agreed to supply coal within a specified time. He failed to supply in time because of government's restriction on the transport of coal from collieries. Here X will not be discharged because the coal was available in the open market from where X could have obtained it.*

#### COMMERCIAL IMPOSSIBILITY

A contract is not discharged simply on the ground of commercial impossibility, i.e. when the contract becomes commercially unviable or unprofitable.

**Example** *X, a furniture manufacturer agreed to supply certain furniture to Y at an agreed rate. Afterwards, there was a sharp increase in the rates of the timber and rates of wages. Since, it was no longer profitable to supply at the agreed rate, X did not supply. X will not be discharged on the ground of commercial impossibility.*

### DEFAULT OF A THIRD PARTY

A contract is not discharged if it could not be performed because of the default of a third party on whose work the promisor relied.

**Example** *X entered into a contract with Y for the sale of goods to be manufactured by Z, a manufacturer of those goods. Z did not manufacture those goods. X will not be discharged and will be liable to Y for damages.*

### STRIKES, LOCKOUTS AND CIVIL DISTURBANCES

A contract is not discharged on the grounds of strikes, lockouts and civil disturbances unless otherwise agreed by the parties to the contract.

**Example** *X agreed to supply to Y certain goods to be imported from Algeria. The goods could not be imported due to riots in that country. It was held that this was no excuse for non-performance of the contract. [Jacobs v. Credit Lyonnais]*

### PARTIAL IMPOSSIBILITY

A contract is not discharged simply on the ground of impossibility of some of the objects of the contract.

**Example** *X agreed to let a boat to H (i) to view the naval review at the coronation of king and (ii) to cruise round the fleet. Due to the illness of the king, the naval review was cancelled but the fleet was assembled and the boat could have been used to cruise round the fleet. It was held that the contract was not discharged. [H.B. Steamboat Co. v. Hutton]*

## 9.0 WHAT IS MEANT BY DISCHARGE BY LAPSE OF TIME?

A contract is discharged if it is not performed or enforced within a specified period, called period of limitation. The Limitation Act, 1963 has prescribed the different periods for different contracts, e.g. period of limitation for exercising right to recover a debt is 3 years, and to recover an immovable property is 12 years. The contractual parties cannot exercise their rights after the expiry of period of limitation.

**Example** *On 1st July 20X1 X sold goods to Y for ₹ 1,00,000 and Y has made no payment till August 20X4. State the legal position as on 1st August 20X4 if no credit period was allowed (b) if 2 months credit period was allowed.*

**Solution:** Case (a) The contract is discharged by lapse of time (i.e. 3 years) from 1st July 20X1 because the debt has become time barred and hence X cannot exercise his right to recover this debt.

Case (b) The contract is not discharged by lapse of time because the period of limitation is yet to expire on 31st August 20X4 (i.e. 3 years from the expiry of the credit period).

## 10.0 WHAT IS MEANT BY DISCHARGE BY BREACH OF CONTRACT?

A contract is said to be discharged by breach of contract if any party to the contract refuses or fails to perform his part of the contract or by his act makes it impossible to perform his obligation under the contract. A breach of contract may occur in the following two ways:

## ANTICIPATORY BREACH OF CONTRACT

Anticipatory breach of contract occurs when the party declares his intention of not performing the contract before the performance is due.

## ACTUAL BREACH OF CONTRACT

Actual breach of contract occurs in the following two ways:

- (i) **On Due Date of Performance:** If any party to a contract refuses or fails to perform his part of the contract at the time fixed for performance, it is called an actual breach of contract on due date of performance.
- (ii) **During the Course of Performance:** If any party has performed a part of the contract and then refuses or fails to perform the remaining part of the contract, it is called an actual breach of contract during the course of performance.

## 11.0 CONSEQUENCES OF BREACH OF CONTRACT

The aggrieved party (i.e. the party not at fault)—

- (a) is discharged from his obligation, and
- (b) is entitled to proceed against the party at fault.

The various remedies available to an aggrieved party have been discussed in detail in the next chapter.

# PRACTICAL PROBLEMS

## PROBLEM 1

X undertakes to put life into the dead wife of Y and takes his fees ₹ 5,000 in advance. X fails to do so. Y claims ₹ 5,000. Is Y's claim valid?

**Solution:** Section to which the given problem relates: [Section 56 (Para 1), and Section 65].

**Decision:** Y's claim is void.

**Reason:** (a) The agreement is void ab-initio [Section 56 (Para 2)].

- (b) The person who received any advantage under a void agreement, is bound to restore it [Section 65].

## PROBLEM 2

X of Delhi agreed to sell 100 bales of cotton @ ₹ 1,000 per bale and to deliver within a fortnight at buyer's godown at Lahore. X failed to supply these goods. State the legal position in each of the following alternative cases:

Case (a) If, unknown to both the parties, the goods were destroyed by fire at the time of agreement.

Case (b) If X knew that goods were destroyed by fire at the time of agreement.

Case (c) If the goods were destroyed by fire after the formation of agreement.

Case (d) If war is declared between India and Pakistan.

Case (e) If these goods were to be manufactured by Z who is ready to supply @ ₹ 1,100 per bale because of unexpected increase in the cost of material and labour.

Case (f) If these goods were to be manufactured by Z who did not manufacture those goods.

Case (g) If these goods could not be delivered because of strike of transport operators.

**Solution: Section to which the given problem relates:** Section 56.

**Decision and Reason:**

Case (a) The contract is void on the ground of mutual mistake.

Case (b) The contract is void but X, the promisor, must compensate the buyer for the promisee for any loss which such promisee sustains through the non-performance of the promise.

Case (c, d) The contract has become void on the ground of supervening possibility.

Case (e) The contract is not discharged because of commercial impossibility.

Case (f) The contract is not discharged because of default of third party.

Case (g) The contract is not discharged because of non-performance due to strikes, lock-out or civil disturbances.

### PROBLEM 3

Mr X, a Hindu contracts to marry Y a muslim. State the legal position in each of the following alternative cases:

Case (a) If Mr X is already married to Z who lives with X;

Case (b) If Mr X goes mad before the date fixed for marriage;

Case (c) If Mr X dies before the date fixed for marriage.

**Solution: Section to which the given problem relates:** Section 56.

**Decision and Reason:**

Case (a) The contract is void ab-initio because such contract is forbidden by law. X must compensate Y for the loss caused to her by the non-performance of the promise.

Case (a) The contract becomes void because of change in the state of things which formed the basis of the contract.

Case (c) The contract is discharged on the death of X.

**PROBLEM 4**

X, a singer enters into a contract with Y, the manager of a theatre, to sing at his theatre two nights every week during the next two months and Y engages to pay her at the rate of ₹ 100 for each night on completion of the contract. State the legal position in each of the following alternative cases:

Case (a) On sixth night if X willfully absents herself from the theatre and wants to sing on the seventh night but Y does not allow her to sing on the seventh night.

Case (b) On the sixth night if X willfully absents herself from the theatre and Y allows X to sing on seventh night.

Case (c) On sixth night, X is too ill to sing.

Case (d) On sixth night, X dies before she sings.

**Solution: Section to which the given problem relates:** Sections 39, 56.

**Decision and Reason:**

Case (a) Y can rescind the contract and can claim the damages for the breach of contract [Section 39].

Case (b) Y cannot rescind the contract but can claim the compensation for the damages sustained by him through X's failure to sing on the sixth night [Section 39].

Cases (c,d) X is discharged on the sixth night because of her incapability to sing and Y cannot claim the compensation for the damages sustained by him through Y's failure to sing on the sixth night.

**PROBLEM 5**

On 1st June, X contracted to supply Y 1000 cubic feet of Finland Timber @ ₹ 500 per cubic feet to be delivered at Mumbai from 1st July to 30th September. On 15th June, X informs that he could not supply those goods. The rates of timber per cubic feet on various dates were-on 15th June ₹ 1,200, on 1st July ₹ 1,300, on 30th September ₹ 1,400. State the legal position in each of the following alternative cases:

Case (a) If Y filed a suit for breach of contract on 15th June.

Case (b) If Y filed a suit for breach of contract on 30th September

Case (c) If on 29th September the import of such goods was banned and Y filed a suit for breach of contract on 30th September

**Solution: Section to which the given problem relates:** Sections 73 and 56.

**Decision and Reason:**

Case (a) Y is entitled to claim ₹ 7,00,000 being the difference between the market price on the date of repudiation of contract (i.e. on 15th June) and the contract price [Section 73].

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Case (b) Y is entitled to claim ₹ 9,00,000 being the difference between the market price on the date of repudiation of contract (i.e. on 30th September) and the contract price [Section 73].

Case (c) Y is not entitled to claim anything because the contract has already been discharged by supervening illegality [Section 56].

### IMPORTANT POINTS TO REMEMBER

#### 1.0 Meaning and Modes of Discharge of a Contract

<b>Meaning</b>	Discharge of a contract means termination of the contractual relations between the parties to a contract.
<b>Mode</b>	Discharge by Performance.
	Discharge by Mutual Agreement
	Discharge by Operation of Law
	Discharge by Impossibility of Performance
	Discharge by Lapse of Time as per The Limitation Act, 1963
	Discharge by Breach of Contract

#### 2.0 Discharge by Performance

<b>Actual Performance</b>	A contract is said to be discharged by actual performance when the parties to the contract perform their promises in accordance with the terms of the contract.
<b>Attempted Performance or Tender</b>	A contract is said to be discharged by attempted performance when the promisor has made an offer of performance to the promisee but it has not been accepted by the promisee.

#### 3.0 Discharge by Mutual Agreement

<b>Novation</b>	Substitution of a new contract for the original contract.
<b>Rescission</b>	Cancellation of original contract by any party (s) to contract.
<b>Alteration</b>	Change in the terms of a contract with mutual consent
<b>Remission</b>	Acceptance by the promisee of a lesser fulfillment of the promise made.
<b>Waiver</b>	Intentional relinquishment of a right under the contract.

#### 4.0 Discharge by Operation of Law

1. By Death of the Promisor in case of a contract involving the personal skill or ability of the promisor.
2. By Insolvency



## 3. By Unauthorised Material Alteration

## 4. By the Identity of Promisor and Promisee

## 5.0 Discharge by Impossibility of Performance

<b>Meaning of Initial Impossibility</b>	Initial impossibility means the impossibility existing at the time of making the contract.	
<b>Effects of Initial Impossibility</b>	<b>Case</b>	<b>Effect</b>
	<b>I. Where both the Promisor and Promisee know about the initial impossibility</b>	Such agreement is <b>void ab-initio</b> .
	<b>II. Where both the Promisor and Promisee do not know about the initial impossibility</b>	Such agreement is <b>void</b> on the ground of mutual mistake.
	<b>III. Where the Promisor alone knows about the initial impossibility</b>	Such promisor <b>must compensate</b> for any loss which such promisee sustains through the non-performance of the promise.
<b>Meaning of Supervening Impossibility</b>	Supervening impossibility means impossibility which does not exist at the time of making the contract but which arises subsequently after the formation of the contract.	
<b>Effects of Supervening Impossibility</b>	<b>Case</b>	<b>Effect</b>
	<b>I. Where an act becomes impossible after the contract is made</b>	The contract to do such an act becomes <b>void</b> when the act becomes impossible
	<b>II. Where an act becomes unlawful by reason of some event beyond the control of promisor</b>	The contract to do such an act becomes <b>void</b> when the act becomes unlawful.
	<b>III. Where the promisor alone knows about the impossibility</b>	Such promisor <b>must</b> compensate the promisee for any loss which such promisee might have suffered on account of non performance of the promise.

	<b>IV. Where an agreement is discovered to be void or where a contract becomes void</b>	Any person who has received any benefit under such agreement or contract is bound to restore it or to make compensation for it, to the person from whom he received it.
<b>Cases when a Contract is Discharged on the Ground of Supervening Impossibility</b>	<ol style="list-style-type: none"> <li>1. Destruction of Subject Matter after the formation of the contract without any fault of either party.</li> <li>2. Death or Personal Incapacity of a person if the performance of a contract depends on his personal skill or ability.</li> <li>3. Declaration of War:</li> <li>4. Change of Law after the formation of the contract.</li> <li>5. Non-existence or Non-occurrence of a Particular State of Things Necessary for Performance:</li> </ol>	
<b>Cases when the Contract is not Discharged on the Ground of Supervening Impossibility</b>	<ol style="list-style-type: none"> <li>1. Difficulty of Performance</li> <li>2. Commercial Impossibility</li> <li>3. Default of a Third Party</li> <li>4. Strikes, Lockouts and Civil Disturbances</li> <li>5. Partial Impossibility</li> </ol>	

**6.0 Discharge by Lapse of Time as per The Limitation Act, 1963 (e.g., 3 years to recover a debt, 12 years to recover an immovable property)**

**7.0 Discharge by Breach of Contract**

<b>Anticipatory Breach</b>	Anticipatory Breach of Contract occurs when the party declares his intention of not performing the contract before the performance is due.
<b>Actual Breach</b>	Actual Breach of Contract may take place: (a) <i>On Due Date of Performance:</i> (b) <i>During the Course of Performance:</i>
<b>Consequences of Breach of Contract</b>	The aggrieved party (i.e. the party not at fault) is discharged from his obligation and gets rights to proceed against the party at fault.

## TRUE OR FALSE QUESTIONS

**State with reasons whether the following statements are True or False.**

1. Substitution of a new contract in place of an existing contract is called alteration.
2. Cancellation of contract is called remission.

3. In case the goods are sold on credit and a debt is not recovered within three years from the date of grant of credit, the debt becomes time barred and is discharged by lapse of time.
4. The death of the promisor always discharges the contract.
5. The insolvency of the promisor discharges the contract.
6. An agreement to do an impossible act is voidable at the option of the promisee.
7. Where initial impossibility is unknown to both the parties, the contract will not be void.
8. When the performance of a contract becomes subsequently impossible or unlawful, the contract becomes voidable at the option of promisee.
9. When a contract becomes void, any person who had received any advantage under such contract must restore it.
10. Impossibility of performance is not an excuse for non-performance of a contract.
11. Commercial impossibility makes the contract void.
12. A contract which could not be performed because of a default by a third person on whose work the promisor relied, becomes void.
13. Discharge of contract by anticipatory breach of contract takes place when the performance is due.

### ANSWERS

1. False 2. False 3. False 4. False 5. True 6. False 7. False 8. False 9. True  
10. True 11. False 12. False 13. False

### VERY SHORT ANSWER TYPE QUESTIONS

1. What is discharge of a contract?
2. What is meant by discharge of a contract by tender?
3. What is meant by 'Novation'?
4. What is meant by 'Rescission'?
5. What is meant by 'Alteration'?
6. What is meant by 'Remission'?
7. When is a contract said to be discharged by lapse of time?
8. What is the period of limitation for exercising the right to recover an immovable property?
9. What is the period of limitation for exercising the right to recover a debt?
10. Does the death of the promisor discharge the contract in all cases?
11. Does the insolvency of the promisor discharge the contract in all cases?
12. What is meant by supervening impossibility?
13. What is meant by discharge of contract by anticipatory breach of contract?

### SHORT ANSWER TYPE QUESTIONS

1. Comment on the following:
  - (a) Impossibility of performance is as a rule not an excuse for non-performance of a contract. Discuss.
  - (b) Commercial impossibility is not a valid excuse for the non-performance of a contract.
  - (c) The death of the promisor discharges the contract.
  - (d) The insolvency of the promisor discharges the contract.
2. Distinguish between the following:
  - (a) Novation and Alteration
  - (b) Novation and Rescission
  - (c) Initial Impossibility and Supervening Impossibility.
3. Write short notes on the following:
  - (a) Discharge of a contract by tender
  - (b) Discharge of a contract by consent
  - (c) Novation of a contract
  - (d) Discharge of a contract by lapse of time
  - (e) Discharge of a contract by operation of law
  - (f) Doctrine of Supervening Impossibility
  - (g) Effects of Supervening Impossibility
  - (h) Discharge of a contract by breach.

### LONG ANSWER TYPE QUESTIONS

1.
  - (a) What is discharge of a contract?
  - (b) What are the various ways in which a contract may be discharged?
2. Explain with examples the doctrine of supervening impossibility.



# Remedies for Breach of Contract

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## 1.0 WHAT IS THE MEANING OF BREACH OF CONTRACT ?

A breach of contract occurs if any party refuses or fails to perform his part of the contract or by his act makes it impossible to perform his obligation under the contract. In case of breach, the aggrieved party (i.e. the party not at fault) is relieved from performing his obligation and gets a right to proceed against the party at fault. A breach of contract may arise in two ways, (a) anticipatory breach and (b) actual breach.

## 2.0 ANTICIPATORY BREACH OF CONTRACT

### MEANING OF ANTICIPATORY BREACH OF CONTRACT

Anticipatory breach occurs when the party declares his intention of not performing the contract before the performance is due. Thus, when a party refuses to perform a contract even before it is due for performance, it is called anticipatory breach.

### MODES OF DECLARING AN INTENTION NOT PERFORMING THE CONTRACT

A party may declare his intention of not performing the contract in the following two ways:

#### 1. When a party to a contract has refused to perform his promise.

**Example** X, a farmer agrees to sell to Y his entire crop of 10 tons of wheat @ ₹ 8,000 per ton to be delivered on 20th October. On 1st October, X informs Y that he is not going to supply the goods. X has committed anticipatory breach of contract by express repudiation.

#### 2. When a party to a contract has disabled himself from performing his promise in its entirety.

**Example** X, a farmer agrees to sell to Y his entire crop of 10 tons of wheat @ ₹ 8,000 per ton to be delivered on 20th October. On 1st October, X sold his entire crop to Z @ ₹ 10,000 per ton. X has committed anticipatory breach of contract by implied repudiation.

### TWO OPTIONS AVAILABLE TO AGGRIEVED PARTY

In case of anticipatory breach, the aggrieved party has the following two options:

**Option I.** He can rescind the contract and claim damages for breach of contract without waiting until the due date for performance, or

**Option II.** He may treat the contract as operative and wait till the due date for performance and claim damages if the promise still remains unperformed.

### CONSEQUENCES OF TREATING CONTRACT AS OPERATIVE

In case of anticipatory breach, if the aggrieved party treats the contract as operative and waits till the due date for performance, the consequences will be as follows:

1. The promisor may perform his promise on or before the due date of performance and the promisee will be bound to accept the performance.
2. The promisor may take advantage of the discharge by supervening impossibility arising between the date of breach and the due date of the performance and in such a case, the promisee shall lose his right to sue for damages.

**Example** X, a farmer agreed to sell to Y his entire crop of wheat @ ₹ 8,000 per ton to be delivered on 20th October. On 1st October, X informed Y that he was not going to supply the goods. Y decided not to rescind the contract on 1st October and to wait till 20th October. On 19th October, the entire crop was destroyed by fire without the fault of either party. Since the contract had become void on the ground of impossibility of performance, Y had lost his right to sue X for damages.

### AMOUNT OF DAMAGES

The amount of damages in each of the options exercised by an aggrieved party will be calculated as under:

Option exercised	Amount of damages
<b>I. When the aggrieved party rescinds the contract at the date of breach</b>	The amount of damages will be equal to the difference between the price prevailing on the date of breach and the contract price.
<b>II. When the aggrieved party does not rescind the contract at the date of breach</b>	The amount of damages will be equal to the difference between the price prevailing on the due date of performance and the contract price.

**Example** X, a farmer, agreed to sell to Y his entire crop of 10 tons of wheat @ ₹ 8,000 per ton to be delivered on 20th October. On 1st October, X informed Y that he was not going to supply the goods. Calculate the amount of damages which could be recovered by Y from X (a) if Y rescinded the contract on 1st October when the market price of wheat was ₹ 10,000 per ton, (b) If Y did not rescind the contract on 1st October and waited till 20th October when the market price of wheat was ₹ 12,000 per ton.

Case	A Market Price per ton	B Contract Price per ton	C = A – B Difference per ton	D Qty. in tons	E = C × D Amount of Damages
(a) If Y rescinded the contract	₹ 10,000	₹ 8,000	₹ 2,000	10	₹ 20,000

<b>(b) If Y did not rescind the contract</b>	₹ 12,000	₹ 8,000	₹ 4,000	10	₹ 40,000
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### 3.0 ACTUAL BREACH OF CONTRACT

#### MEANING OF ACTUAL BREACH OF CONTRACT

Actual breach of contract may take place in any of the following two ways:

1. On due Date of Performance If any party to contract refuses or fails to perform his part of the contract at the time fixed for performance, it is called an actual breach of contract on due date of performance.

Example X agreed to sell to Y 10 tons of wheat @ ₹ 8,000 per ton to be delivered in two equal instalments on 20th October and on 21st October. On 20th October, X refused to deliver the goods. It is an actual breach of contract on due date of performance.

2. During the Course of Performance If any party has performed a part of the contract and then refuses or fails to perform the remaining part of the contract, it is called an actual breach of contract during the course of performance.

Example X agreed to sell to Y 10 tons of wheat @ ₹ 8,000 per ton to be delivered in two equal instalments on 20th October and 21st October. On 20th October, X delivered 5 tons and refused to deliver remaining 5 tons. It is an actual breach of contract during the course of performance.

#### CONSEQUENCES OF ACTUAL BREACH [SECTION 55]

The consequences of actual breach depends upon whether the time was the essence of the contract or not. The consequences in both the cases may be summarised as under:

	Where time is the essence of a contract	Where time is not the essence of a contract
<b>I. Whether the contract becomes voidable at the option of the promisee.</b>	Yes	No
<b>II. Whether the promisee is entitled to claim the compensation for any loss occasioned to him by the non-performance of the promise at the stipulated time</b>		
<b>(i) Where performance beyond the stipulated time is not accepted</b>	Yes	Yes

<b>(ii) Where performance beyond the stipulated time is accepted</b>	No, unless the promisee gives notice to the promisor of his intention to do so.	No, unless the promisee gives notice to the promisor of his intention to do so.
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**Example** *X, a singer, enters into a contract with Y, the manager of a theatre, to sing at his theatre two nights in every week for the next two months. Y agrees to pay her ₹ 100 for each performance. On the sixth night, X wilfully absents herself from the theatre.*

In this case, Y has the following two options:

- Y may rescind the contract and claim compensation for the loss occasioned to him by X's failure to sing on the sixth night.
- Y may permit X to sing on the seventh night and claim compensation for loss from X by giving a notice to X of his intention to do so.

#### 4.0 REMEDIES FOR BREACH OF CONTRACT

##### MEANING OF REMEDY

A remedy is the course of action available to an aggrieved party (i.e. the party not at default) for the enforcement of a right under a contract.

##### REMEDIES FOR BREACH OF CONTRACT

The various remedies available to an aggrieved party are as follows:

##### RESCISSION OF CONTRACT [SECTION 39]

Rescission means a right not to perform obligation.

In case of breach of a contract, the promisee may put an end to the contract. In such a case, the aggrieved party is discharged from all the obligations under the contract and is entitled to claim compensation for the damage which he has sustained because of the non-performance of the contract.

**Example** *X agrees to supply 10 tons of wheat to Y on 20th October. Y promises to pay for the goods on its receipt. X does not supply the goods on the due date. Here, Y is discharged from the liability of paying the price. Y is entitled to rescind the contract and to claim compensation for the damage which he has sustained because of non-supply of goods on the due date.*

##### SUIT FOR DAMAGES

Damages are monetary compensation allowed for loss suffered by the aggrieved party due to breach of a contract. The object of awarding damages is not to punish the party at fault but to make good the financial loss suffered by the aggrieved party due to the breach of contract.

In India, the rules relating to damages are based on the judgement in English case of *Hadley v. Baxendale*. The facts of this case were: H's mill was stopped due to the



breakdown of a shaft. He delivered the shaft to B, a common carrier, to be taken to a manufacturer to copy it and make a new one. H had not made it known to B that delay would result in a loss of profits. By some neglect on the part of B, the delivery of the shaft was delayed in transit beyond a reasonable time. Held, B was not liable for loss of profits during the period of delay as the circumstances communicated to B did not show that a delay in the delivery of shaft would entail loss of profits to the mill. The following rule of law was laid down in this case: 'Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.'

### **COMPENSATION FOR LOSS OR DAMAGE CAUSED BY BREACH OF CONTRACT [SECTION 73]**

Section 73, of the Indian Contract Act which deals with compensation for loss or damage caused by breach of contract is based on the judgement in the above case. It states that the aggrieved party may claim the damages as follows:

- (a) Such damages which naturally arose in the usual course of things from such breach. This relates to ordinary damages arising in the usual course of things.
- (b) Such damages which the parties knew, when they made the contract, to be likely to result from the breach. This relates to special damages.
- (c) The aforesaid compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach, and
- (d) Such compensation for damages arising from breach of quasi contract shall be same as in any other contract.
- (a) **Ordinary Damages** Ordinary damages are those which naturally arise in the usual course of things from such breach. These damages can be recovered if the following two conditions are fulfilled:
  - (i) The aggrieved party must suffer by breach of contract, and
  - (ii) The damages must be proximate (i.e. direct) consequence of the breach of contract and not the indirect consequence.

**Measure of Ordinary Damages:** In a contract for the sale of goods, the measure of ordinary damages is the difference between the contract price and the market price of such goods on the date of breach.

**Example** On 1st December, X contracted to sell and deliver 50 tons of wheat @ ₹ 8,000 per ton to Y on 1st January. On 20th December Y, afterwards, contracted to sell those goods to Z at ₹ 10,000 per ton. X failed to deliver goods on 1st January when the price of the wheat was ₹ 9,500 per ton. Y is entitled to recover ₹ 75,000 [i.e. (₹ 9,500 - ₹ 8,000) 50]. Y is not entitled to recover ₹ 1,00,000 as profit which would have arisen to Y from the sale to Z because the profit is the indirect consequence of the breach of contract.

- (b) **Special Damages** Special damages are those which may reasonably be supposed to have been in the contemplation of both parties as the probable result of the breach of a contract.

**Condition for Recovery of Special Damage**—These damages can be recovered if the special circumstances which would result in a special loss in case of breach of a contract are communicated to the promisor, e.g. loss of profits on account of default by the other party to the contract can be claimed only when an advance notice of such damages has been given before.

**Example I** *A, a builder, contracts to erect and finish a house by the first of January, in order that B may give possession of it at that time to C, to whom B has contracted to let it. A is informed of the contract between B and C. A builds the house so badly that, before the first of January it falls down, and has to be rebuilt by B, who, in consequence, loses the rent which he was to have received from C, and is obliged to make compensation to C for the breach of his contract. A must make compensation to B for the cost of rebuilding the house, for the rent lost, and for the compensation made to C.*

**Example II** *A delivers to B, a common carrier, a machine to be delivered without delay, to A's mill informing that his mill has stopped for want of the machine. B unreasonably delays the delivery of machine, and A, in consequence, loses a profitable contract with the Government. A is entitled to receive from B, by way of compensation, the average amount of profit, which would have been made by the working of the mill during the time that delivery of it was delayed, but not the loss sustained through the loss of the Government contract.*

- (c) **Exemplary or Punitive or Vindictive Damages** Exemplary damages are those which are in the nature of punishment. The court may award these damages in case of (i) a breach of promise to marry, where damages shall be calculated on the basis of mental injury sustained by the aggrieved party, (ii) Wrongful dishonour of a cheque by a banker. In case of wrongful dishonour of a cheque, the rule is smaller the amount of the cheque, larger will be the amount of damages awarded. A trader may recover such damages as wrongful dishonour of cheque shall adversely affect his goodwill but a non-trader whose cheque is wrongfully dishonoured will have to prove the loss of goodwill before claiming such damages.
- (d) **Nominal Damages** Nominal damages are those which are awarded where there is only a technical violation of a legal right but the aggrieved party has not in fact suffered any loss because of breach of contract. These damages are called nominal because they are very small, say, one rupee. The court may or may not award these nominal damages.
- (e) **Damages for Inconvenience and Discomfort** If a party has suffered physical inconvenience and discomfort due to breach of contract, that party can recover the damages for such inconvenience and discomfort.

**Example** *H with his wife and children booked a ticket for a midnight train, to be transported to a particular place where he lived. They were, however, transported to a wrong place and they had to walk several miles on a drizzling night and as*

*a result, his wife caught cold and he had to incur some medical expenses. It was held that he could recover compensation for inconvenience and not for medical expenses for the sickness of his wife because it was very remote consequence. [Hobbs v. London & S.W. Rail Co.]*

- (f) **Liquidated Damages and Penalty** When the parties to a contract at the time of formation of contract, specify a sum which will become payable by the party responsible for breach, such specified sum is called:

- (i) **Liquidated Damages** if the specified sum represents a fair and genuine pre-estimate of the damages likely to result due to breach;
- (ii) **Penalty** if the specified sum is disproportionate to the damages likely to result due to breach.

In India, there is no distinction between penalty and liquidated damages. The Courts in India allow only reasonable compensation not exceeding the sum specified in the contract. [Section 74].

But under English law, liquidated damages are enforceable and not penalty.

- (g) **Stipulation for Interest** The stipulations for interest may or may not be in the nature of a penalty. If the stipulation for interest is in the nature of a penalty, the court may award reasonable compensation only. On the basis of various judicial pronouncements, the following guidelines may be adopted to decide whether a particular stipulation for interest is in the nature of a penalty or not:

Stipulation	Whether the stipulation is in the nature of a penalty or not
(i) For payment of interest in case of default	It is not in the nature of a penalty if the interest is reasonable.
(ii) For payment of increased interest from the date of the contract	It is always in the nature of a penalty.
(iii) For payment of increased interest from the date of default only	It may or may not be in the nature of a penalty depending on the terms and circumstances of the case.
(iv) For payment of compound interest on default at the same rate as simple interest	It is not in the nature of a penalty.
(v) For payment of compound interest on default at the rate higher than that of simple interest	It is in the nature of a penalty.
(vi) For payment of interest at a rate lower than that of original rate if interest is paid on due date	It is in the nature of a penalty.

- (h) **Forfeiture of Security Deposit (or Earnest Money)** A clause in a contract which provides for forfeiture of security deposit in the event of failure to perform is in the nature of a penalty. In such cases, the court may award reasonable compensation only.

### SUIT FOR SPECIFIC PERFORMANCE

Suit for specific performance means demanding the court's direction to the defaulting party to carry out the promise according to the terms of the contract.

#### Cases where suit for specific performance is maintainable

- (i) Where Actual damages arising from breach are not measurable
- (ii) Where Monetary compensation is not an adequate remedy.

**Example** *X agreed to sell an old painting to Y for ₹ 50,000. Subsequently, X refused to sell the painting. Here, Y may file a suit against X for the specific performance of the contract.*

#### Cases where suit for specific performance is not maintainable

- (i) Where the damages are considered as an adequate remedy.
- (ii) Where the contract is of personal nature, e.g. contract to marry.
- (iii) Where the contract is made by a company beyond its powers as laid down in its Memorandum of Association.
- (iv) Where the court cannot supervise the performance of the contract.
- (v) Where one of the parties is a minor.
- (vi) Where the contract is inequitable to either party.

### SUIT FOR INJUNCTION

Suit for injunction means demanding court's stay order. Injunction means an order of the court which prohibits a person to do a particular act. Where a party to a contract does something which he promised not to do, the court may issue an order prohibiting him from doing so.

**Example** *W agreed to sing at L's theatre only during the contract period. During the contract period, W made contract with Z to sing at another theatre and refused to perform the contract with L. It was held that W could be restrained by injunction from singing for Z. [Lumely v. Wagner]*

### SUIT FOR QUANTUM MERUIT

Quantum Meruit means as much as is earned. Right to Quantum Meruit means a right to claim the compensation for the work already done. (For more details, see the next chapter.)

**Example** *C an owner of a magazine engaged P to write a book to be published by instalments in his magazine. After a few instalments were published, the publication of the magazine was stopped. It was held that P could claim payment for the part already published. [Planche v. Calburn]*

## PRACTICAL PROBLEMS

### PROBLEM 1

X contracts to repair Y's house in a certain manner and receives payment in advance. X repairs the house but not according to the contract. Y incurs ₹ 1,000 to remedy the defect. Can Y recover ₹ 1,000 from X.

**Solution:** Section to which the given problem relates: Section 73.

**Decision and Reason:** Y can recover ₹ 1,000 from X because he suffered the loss which naturally arose in the usual course of things from such a breach.

### PROBLEM 2

X sells certain merchandise to Y warranting it to be of a particular quality, and Y in reliance upon this warranty, sells it to Z with a similar warranty. The goods prove to be not according to the warranty, and Y becomes liable to pay Z ₹ 1,000 by way of compensation. Can Y recover ₹ 1,000 from X?

**Solution:** Section to which the given problem relates: Section 73.

**Decision and Reason:** Y can recover ₹ 1,000 from X because the damages were the direct consequence of the breach of contract.

### PROBLEM 3

X contracts to pay a sum of money to Y on a day specified. X does not pay the money on that day. Y in consequence of not receiving the money on that day, is unable to pay his debt and is totally ruined. Discuss the legal position.

**Solution:** Section to which the given problem relates: Section 73.

**Decision and Reason:** Y will not be able to recover anything except the principal sum together with interest up to the date of payment because Y's insolvency is an indirect consequence of breach of contract.

### PROBLEM 4

X contracts to sell and deliver 500 bales of cotton to Y on a fixed day. X knows nothing of Y's mode of conducting business. X breaks his promise and Y, having no cotton is obliged to close his mill. Is X responsible to Y?

**Solution:** Section to which the given problem relates: Section 73.

**Decision and Reason:** X is not responsible to Y for the loss caused to Y by the closure of the mill because it is an indirect consequence of the breach of the contract.

### PROBLEM 5

A, a ship owner, contracts with B to convey him from Kolkata to Sydney in A's ship, sailing on the first of January, and B pays to A, by way of deposit, one-half of his passage-money. The ship does not sail on the first of January, and B, after being, in consequence, detained in Kolkata, for sometime, and thereby put to some expense, proceeds to Sydney in another vessel, and, in consequence, arriving too late in Sydney, loses a sum of money. Is A liable to pay anything to B?

**Solution:** Section to which the given problem relates: Section 73.

**Decision and Reason:** A is liable to repay to B deposit with interest, and the expense to which he is put by his detention in Kolkata, and the excess, if any, of the passage-money paid for the second ship over that agreed upon for the first, but not the sum of money which B lost by arriving in Sydney too late.

### PROBLEM 6

X contracts with Y to pay ₹ 1,000 if he fails to pay Y ₹ 500 on a given day. X fails to pay ₹ 500 on that day. Can Y recover ₹ 1,000?

**Solution:** Section to which the given problem relates: Section 74.

**Decision and Reason:** Y is entitled to recover from X such compensation not exceeding ₹ 1,000 as the court considers reasonable because in case of stipulation for penalty, the aggrieved party is entitled to receive only reasonable compensation not exceeding the sum specified in the contract.

### PROBLEM 7

X borrows ₹ 1,00,000 from Y @ 12% p.a. interest payable by five half-yearly instalments of ₹ 20,000 each. State the legal position in each of the following alternative stipulations:

Case (a) "In case of default in payment of any instalment, interest rate shall be raised to 15% p.a."

Case (b) "In case of default in payment of any instalment, interest rate shall be raised to 75% from the date of default."

Case (c) "In case of default in payment of any instalment, the interest shall be calculated @ 12% p.a. on monthly compounding basis."

Case (d) "In case of default in payment of any instalment, the interest shall be calculated @ 15% p.a. on monthly compounding basis."

Case (e) "In case of no default, the interest rate shall be 9% p.a."

Case (f) "In case of default in payment of any instalment, the whole sum shall become due."

**Solution:** Section to which the given problem relates: Section 74.

**Decision and Reason:**

Cases (a), (b) and (d) Y is entitled to recover from X such compensation as the court considers reasonable because the stipulation is in the nature of a penalty.

Cases (c) and (e) Y is entitled to recover from X as per stipulation because the stipulation is not in the nature of a penalty.

Case (f) The contract may be enforced according to its terms because the stipulation is not in the nature of a penalty.

**PROBLEM 8**

X borrows ₹ 100 from Y and gives him a bond for ₹ 200 payable by five yearly instalments of ₹ 40 with a stipulation that in default of payment of any instalment, the whole shall become due. Discuss the legal position.

**Solution:** Section to which the given problem relates: Section 74.

**Decision and Reason:** Y is entitled to recover from X such compensation as the court considers reasonable because the stipulation is in the nature of a penalty.

**PROBLEM 9**

X lends ₹ 10,000 to Y without interest for one month with a stipulation that in case of default, interest shall be payable. State the legal position if rate of interest is (a) 2% p.m. (b) 3% p.m.

**Solution:** Section to which the given problem relates: Section 74.

**Decision and Reason:** Case (a) X is entitled to recover from X as per stipulation because the stipulation is not in the nature of a penalty.

Case (b) X is entitled to recover from Y such compensation as the court considers reasonable because the stipulation is in the nature of a penalty.

**PROBLEM 10**

A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months and engages to pay her ₹ 100 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contract.

**Solution:** Section to which the given problem relates: Section 75.

**Decision and Reason:** B is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract because a person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract.

**PROBLEM 11**

X contracted with Y to write a book in 12 volumes for ₹ 1,00,000 payable on the completion of the whole work. Discuss the legal position in each of the following alternative cases:



- (a) If after completion and delivery of six volumes, Y abandoned the publication.
- (b) If after completion and delivery of six volumes, X died.

**Solution:** Case (a) X is entitled to claim compensation for the work already done on quantum meruit basis.

**[Leading case:** Planche v. Colburn]

Case (b) X's legal representatives are not entitled to claim compensation for the work already done by X because the contract to write a book in 12 volumes is an indivisible contract.

### PROBLEM 12

X bought a horse with a warranty that it was free from any disease. The horse was suffering from a disease at the time of sale. As a result, not only that horse died but infected other horses also. Discuss the legal position.

**Solution:** Section to which the given problem relates: Section 73.

**Decision and Reason:** X is entitled to claim not only the loss occasioned by the death of the horse bought but the entire loss which occurred as a result of the breach of warranty.

**[Leading case:** Smith v. Green]

### PROBLEM 13

On 20th September X agreed to sell to Y of 10 tons of a particular chemical to be manufactured in his factory @ ₹ 8,000 per ton to be delivered on 20th October. Calculate the amount of damages which could be recovered by Y from X in each of alternative cases:

**Case(a):** The chemical could not be manufactured because of strike by the workers and X failed to supply the said chemical to Y on 20th October.

**Case (b):** On 19th October, the entire chemical in the factory was destroyed by fire without the fault of either party and X failed to supply the said chemical to Y on 20th October.

**Case (c):** On 1st October, X informed Y that he was not going to supply the goods since the price of that chemical rose to ₹ 10,000 per ton on 1st October. The price of that chemical further rose to ₹ 12,000 per ton on 20th October. Y decided to rescind the contract on 1st October

**Case (d):** On 1st October, X informed Y that he was not going to supply the goods since the price of that chemical rose to ₹ 10,000 per ton on 1st October. The price of that chemical further rose to ₹ 12,000 per ton on 20th October. Y decided not to rescind the contract on 1st October and to wait till 20th October.

**Case (e):** On 1st October, X informed Y that he was not going to supply the goods since the price of that chemical rose to ₹ 10,000 per ton on 1st October. The price of that chemical further rose to ₹ 12,000 per ton on 20th October. Y decided not to rescind the contract on 1st October and to wait till 20th October. On 19th October, the entire chemical in the factory was destroyed by fire without the fault of either party.



**Solution:**

**Case (a):** Section to which the given problem relates: Section Sec 56, para 2

Impossibility of performance is, as a rule, not an excuse from performance. A contract is not discharged by the supervening impossibility on the grounds of strikes, lockouts and civil disturbances unless otherwise agreed by the parties to the contract. (**Budget V Bennington; Jacobs V Credit Lyonnais**).

This difficulty in performance cannot be considered as supervening impossibility attracting Section 56 (Para 2) and hence X is liable to Y for non-performance of contract and Y can claim damages of ₹ 40,000 @ ₹ 4000 per ton [i.e. ₹ 12,000 – ₹ 8,000].

**Case (b):** Section to which the given problem relates: Section Sec 56, para 2

As per Sec. 56 (Para 2) of the Indian Contract Act, 1872 when the performance of a contract becomes impossible subsequent to its formation, the contract becomes void. Hence, this contract is discharged by the supervening impossibility since the subject matter of the contract was destroyed after the formation of the contract without any fault of either party.

Hence, X is not liable to Y for non-performance of contract and Y can not claim any damages.

**Case (c),(d) & (e):** Section to which the given problem relates: Section 39

The stated problem is a case of 'Anticipatory breach of Contract' as per Sec. 39 of the Indian Contract Act, 1872.

The case law applicable here is **Frost vs. Knight**.

The answer to the problem is that

**Case (c):** Y can claim damages of ₹ 20,000 @ ₹ 2000 per ton [i.e. ₹ 10,000 – ₹ 8,000].

**Case (d):** Y can claim damages of ₹ 40,000 @ ₹ 4000 per ton [i.e. ₹ 12,000 – ₹ 8,000].

**Case (e):** Y had lost his right to sue X for damage since the contract had become void on the ground of supervening impossibility. [Sec 56, para 2]. As per Sec. 56 (Para 2) of the Indian Contract Act, 1872 when the performance of a contract becomes impossible or unlawful subsequent to its formation, the contract becomes void, this is termed as 'supervening impossibility' (i.e. impossibility which does not exist at the time of making the contract, but which arises subsequently).

**PROBLEM 14**

'X' entered into a contract with 'Y' to supply him 1,000 water bottles @ ₹ 10.00 per water bottle, to be delivered at a specified time. Thereafter, 'X' contracts with 'Z' for the purchase of 1,000 water bottles @ ₹ 9 per water bottle. 'Z' failed to perform his contract in due course and market price of each water bottle on that day was ₹ 10.50 per water bottle. Consequently, 'X' could not procure any water bottle and 'Y' rescinded the contract. What would be the amount of damages which 'X' could claim from 'Z'?

- (a) if 'Z' had not informed about the 'Y's contract?
- (b) if 'Z' had informed about the 'Y's contract?

**Solution:** Section to which the given problem relates: Section 73.

**Decision and Reason:**

- (a) If 'X' had not informed 'Z' of 'Y's contract, then X is entitled to recover **only the ordinary damages** which are equal to the difference between the contract price (₹ 9) and the market price (₹ 10.50) on the day of default. In other words, the amount of damages would be ₹ 1500 (i.e. 1000 water bottles x ₹ 1.50).
- (b) If 'X' had intimated to 'Z' that he was purchasing water bottles from him for the purpose of performing his contract with 'Y', then X is entitled to recover **the special damages being** the amount of profit 'X' which would have made by the performance of his contract with 'Y'. Which are equal to the difference between the procuring price of water bottles and contracted selling price to 'Y' since the special circumstances under which the contract was actually made were communicated by X to 'Z'. Therefore, 'X' is entitled to claim from 'Z' ₹ 1000 at (i.e. 1000 water bottles x ₹ 1) '. [Leading case: **Hadley v. Baxendale**]

## IMPORTANT POINTS TO REMEMBER

### 1.0 Meaning and Modes of Breach of Contract

<b>Meaning</b>	A breach of contract occurs if any party refuses or fails to perform his part of the contract or by his act makes it impossible to perform his obligation under the contract.
<b>Modes</b>	A breach of contract may arise in two ways: (a) anticipatory breach and (b) actual breach.

### 2.0 Anticipatory Breach of Contract

<b>Meaning</b>	Anticipatory breach occurs when the party declares his intention of not performing the contract before the performance is due.
<b>Modes</b>	A party may declare his intention of not performing the contract in the following two ways: (a) When a party to a contract has refused to perform his promise. (b) When a party to a contract has disabled himself from performing his promise in its entirety.
<b>Two Options</b>	(a) He can rescind the contract and claim damages for breach of contract without waiting until the due date for performance, or (b) He may treat the contract as operative and wait till the due date for performance and claim damages if the promise still remains unperformed.

<b>Consequences of Treating Contract as Operative</b>	<p>(a) The promisor may perform his promise on or before the due date of performance and the promisee will be bound to accept the performance.</p> <p>(b) The promisor may take advantage of the discharge by supervening impossibility arising between the date of breach and the due date of the performance and in such a case, the promisee shall lose his right to sue for damages.</p>
<b>Option exercised</b>	<b>Amount of Damages</b>
<b>I. When the aggrieved party rescinds the contract at the date of breach</b>	I. Difference between the price prevailing on the date of breach and the contract price.
<b>II. When the aggrieved party does not rescind the contract at the date of breach</b>	II. Difference between the price prevailing on the due date of performance and the contract price.

### 3.0 Actual Breach of Contract

<b>Two Ways of Actual Breach of Contract</b>	<p>Actual breach of contract may take place in any of the following two ways:</p> <p>(a) Actual Breach on due Date of Performance</p> <p>(b) Actual Breach during the Course of Performance</p>	
<b>Consequences of Actual Breach of Contract</b>	<b><i>Where time is the essence of a contract</i></b>	<b><i>Where time is not the essence of a contract</i></b>
<b>1. Whether the Contract becomes voidable at the option of the promisee.</b>	Yes	No
<b>2. Whether the Promisee is entitled to claim the compensation for any loss occasioned to him by the non-performance of the promise at the stipulated time</b>		
<b>(a) <i>Where performance beyond the stipulated time is not accepted</i></b>	Yes	Yes

(b) <i>Where performance beyond the stipulated time is accepted</i>	No, unless the promisee gives notice to the promisor of his intention to do so.	No, unless the promisee gives notice to the promisor of his intention to do so.
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#### 4.0 Remedies for Breach of Contract

<b>Meaning of Remedy</b>	A remedy is the course of action available to an aggrieved party (i.e. the party not at default) for the enforcement of a right under a contract.
<b>Remedies for Breach of Contract</b>	<b>1. Rescission of Contract [Section 39]</b> Rescission means a right not to perform obligation.
	<b>2. Suit for Damages</b>
	(a) Such damages which naturally arose in the usual course of things from such breach. This relates to ordinary damages arising in the usual course of things.
	(b) Such damages which the parties knew, when they made the contract, to be likely to result from the breach. This relates to special damages.
	(c) The aforesaid compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach, and
	<b>3. Suit for Specific Performance</b> i.e. demanding the court's direction to the defaulting party to carry out the promise according to the terms of the contract.
	<b>4. Suit for Injunction</b> i.e. demanding court's stay order. Injunction means an order of the court which prohibits a person to do a particular act.
	<b>5. Suit for Quantum Meruit</b> Quantum Meruit means as much as is earned. Right to Quantum Meruit means a right to claim the compensation for the work already done.

#### 5.0 Types of Damages

<b>Ordinary Damages</b>	<ol style="list-style-type: none"> <li>1. The aggrieved party must suffer by breach of contract, and</li> <li>2. The damages must be proximate (i.e. direct) consequence of the breach of contract and not the indirect consequence.</li> </ol>
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<b>Special Damages</b>	Aggrieved party may claim the special damages if the special circumstances resulting in a special loss are communicated to the promisor.
<b>Exemplary or Punitive or Vindictive Damages</b>	Exemplary damages are those which are in the nature of punishment.  The court may award these damages in case of: 1. A breach of promise to marry, where damages shall be calculated on the basis of mental injury sustained by the aggrieved party, 2. Wrongful dishonour of a cheque by a banker.
<b>Nominal Damages</b>	Where there is only a technical violation of a legal right but the aggrieved party has not in fact suffered any loss because of breach of contract. ( <i>say, one rupee</i> )
<b>Damages for Inconvenience and Discomfort suffered</b>	If a party has suffered physical inconvenience and discomfort due to breach of contract, that party can recover the damages for such inconvenience and discomfort.

## 6.0 Liquidated Damages and Penalty

<b>Liquidated Damages</b>	The specified sum payable by the party responsible for breach which represents a fair and genuine pre estimate of the damages likely to result due to breach is called liquidated damages.
<b>Penalty</b>	The specified sum payable by the party responsible for breach which is disproportionate to the damages likely to result due to breach.
<b>Position in India</b>	In India, there is no distinction between penalty and liquidated damages. The Courts in India allow only reasonable compensation not exceeding the specified sum [Section 74].
<b>Position in English Law</b>	Under English law, liquidated damages are enforceable and not penalty.

## 7.0 Stipulation for Interest

<i>Stipulation</i>	<i>Whether the stipulation is in the nature of a penalty or not</i>
<b>1. For payment of interest in case of default</b>	It is not in the nature of a penalty if the interest is reasonable.

<b>2. For payment of increased interest from the date of the contract</b>	It is always in the nature of a penalty.
<b>3. For payment of increased interest from the date of default only</b>	It may or may not be in the nature of a penalty depending on the terms and circumstances of the case.
<b>4. For payment of compound interest on default at the same rate as simple interest</b>	It is not in the nature of a penalty.
<b>5. For payment of compound interest on default at the rate higher than that of simple interest</b>	It is in the nature of a penalty.
<b>6. For payment of interest at a rate lower than that of original rate if interest is paid on due date</b>	It is not in the nature of a penalty.

### 8.0 Forfeiture of Security Deposit (or Earnest Money)

A clause in a contract which provides for forfeiture of security deposit in the event of failure to perform is in the nature of a penalty. In such cases, the court may award reasonable compensation only.

## TRUE OR FALSE QUESTIONS

**State with reasons whether the following statements are True or False:**

1. Anticipatory breach of a contract takes place at the time when the performance is due.
2. Actual breach of a contract may take place during the performance of the contract.
3. In case of anticipatory breach of contract, the aggrieved party must rescind the contract and sue for damages for breach of contract at the time of such breach.
4. In case of anticipatory breach of contract, if the promisee decides not to rescind the contract, the contract shall remain alive for the benefit of both the parties.
5. In case of actual breach of a contract, the contract becomes void if the time is the essence of the contract.
6. In case of actual breach of a contract, if performance beyond stipulated time is accepted, the promisee can claim the compensation for any loss occasioned by the non-performance of the promise at the stipulated time if he gives notice of his intention to do so.
7. The aggrieved party has a right to refuse to accept monetary compensation and insist on specific performance of a contract by the promisor.
8. Specific performance can be granted in case of contract to marry.
9. Suit for specific performance can be filed where a party does something which he promised not to do.

10. Suit upon quantum meruit can be filed in case of incomplete and indivisible contract.
11. Ordinary damages are available only when the contract provides therefor.
12. Special damages are available as a matter of statutory right.
13. Special damages can be claimed whether or not the special circumstances are communicated to the promisor.
14. Exemplary damages are available only in case of a breach of promise to marry.
15. In case of wrongful dishonour of a cheque, the rule is smaller the amount, smaller will be the amount of damages and vice versa.
16. The damages which are awarded in case of breach of contract whereby no loss is caused, are called "punitive damages".
17. Liquidated damages need not be specified at the time of formation of contract.
18. Liquidated damages is a sum which is disproportionate to the damages likely to occur.
19. Penalty payable by party guilty of breach cannot be decided at the time of formation of contract.
20. Penalty is not enforceable in India.
21. Penalty is a fair and genuine pre-estimate of the damages likely to result due to breach.
22. The aggrieved party is entitled to claim the highest of the amount of penalty or actual compensation.

### ANSWERS

1. False 2. True 3. False 4. True 5. False 6. True 7. False 8. False 9. False  
 10. False 11. False 12. False 13. False 14. False 15. False 16. False 17. False  
 18. False 19. False 20. False 21. False 22. False

### VERY SHORT ANSWER TYPE QUESTIONS

1. What is a breach of contract?
2. What is an actual breach of contract?
3. When does an actual breach of contract take place?
4. What is meant by 'remedy'?
5. What is 'rescission of contract'?
6. What are 'ordinary damages'?
7. How are 'ordinary damages measured'?
8. What are 'special damages'?
9. What are 'exemplary damages'?
10. Explain 'nominal damages'?
11. What are 'liquidated damages'?
12. What is 'penalty'?

13. Is the distinction between 'liquidated damages' and 'penalty' recognised in India?
14. Is stipulation for payment of interest in case of default a penalty?
15. Is stipulation for payment of interest at a higher rate from the date of contract in case of default, a penalty?
16. Is stipulation for payment of interest at a higher rate from the date of default, a penalty?
17. Is stipulation for payment of compound interest in case of default at the same rate than that of simple interest, a penalty?
18. Is stipulation for payment of compound interest in case of default at a higher rate than that of simple interest a penalty?
19. Is stipulation for payment of interest in case of no default at a rate lower than that originally agreed, a penalty?
20. Is a clause in a contract providing for forfeiture of earnest money in the event of failure to perform a penalty?
21. What is specific performance?
22. What is an injunction?
23. What is quantum meruit?

### SHORT ANSWER TYPE QUESTIONS

1. State the options available to a promisee in case of an anticipatory breach of contract.
2. State the consequences of not rescinding a contract at the time of anticipatory breach of contract.
3. State the consequences of actual breach of a contract.
4. State the importance of time in case of actual breach of a contract.
5. Enumerate the remedies for breach of a contract.
6. Comment on the following:
  - (a) Damages for breach of contract are granted by way of compensation and not by way of punishment.
  - (b) If a contract is broken, the law will endeavour, so far as money can do it, to place the injured party in the same position as if the contract had been performed.
7. Distinguish between the following:
  - (a) Ordinary damages and liquidated damages
  - (b) Liquidated damages and penalty
  - (c) Actual breach of contract and anticipatory breach of contract
8. Write short notes on the following:
  - (a) Liquidated damages
  - (b) Exemplary damages
  - (c) Penalty
  - (d) Nominal damages



- (e) Special damages
- (f) Specific performance.

### LONG ANSWER TYPE QUESTIONS

1. (a) What is a breach of contract?  
(b) What do you understand by an anticipatory breach of contract?  
(c) State the rights of the promisee in case of anticipatory breach.
2. State the principles on which damages are assessed for breach of contract.
3. What remedies are available to an aggrieved party on the breach of contract?
4. State the circumstances under which a party is not entitled to specific performance.
5. State briefly whether all stipulations for payment of interest are in the nature of a penalty. Give examples also.
6. Examine critically the rule in *Hadley v. Baxendale* and indicate to what extent the said rule is applicable in India.
7. Explain special damages, exemplary damages, nominal damages, liquidated damages, specific performance, injunction, quantum meruit, penalty.





# Quasi-Contracts

## 1.0 WHAT IS THE MEANING OF QUASI-CONTRACTS?

1. A Quasi-contract is not a contract at all because one or the other essentials for the formation of a contract are absent.
2. It is an obligation imposed by law upon a person for the benefit of another even in the absence of a contract.
3. It is based on the principle of equity, which means no person shall be allowed to unjustly enrich himself at the expense of another.
4. Such obligations are called quasi-contracts or implied contracts because the outcome of such obligations resemble those created by a contract.

## 2.0 WHAT ARE THE FEATURES OF A QUASI-CONTRACT

The salient features of a quasi contract are as under:

- (a) It is imposed by law and does not arise from any agreement.
- (b) The duty of a party and not the promise of any party is the basis of such contract.
- (c) The right under it is always a right to money and generally, though not always, to a liquidated sum of money.
- (d) The right under it is available against specific person(s) and not against the world.
- (e) A suit for its breach may be filed in the same way as in case of a complete contract.

## 3.0 DISTINCTION BETWEEN QUASI-CONTRACTS AND CONTRACTS

Quasi-contracts differ from other contracts in the following respects:

Basis of distinction	Quasi-contract	Contract
1. Essential for the formation of a valid contract	The essentials for the formation of a valid contract are absent.	The essentials for the formation of a valid contract are present.
2. Obligation	Obligation is imposed by law.	Obligation is created by the consent of the parties.

## 4.0 SIMILARITY BETWEEN QUASI-CONTRACTS AND CONTRACTS?

The outcome of quasi-contracts resemble that created by a contract. So far as claim for

damages are concerned, there is a similarity between a Quasi-contracts and contract because in case of breach of a quasi-contract, Section 73 provides for the same remedies as provided in case of breach of a contract.

## 5.0 WHAT ARE THE KINDS OF QUASI-CONTRACTS

The various kinds of Quasi-contracts are discussed below:

### RIGHT TO RECOVER THE PRICE OF NECESSARIES SUPPLIED [SECTION 68]

The person who has supplied the necessities to a person who is incompetent to contract or anyone who is dependent on such incompetent person, is entitled to claim their price from the property of such incapable person.

**Example I** *A supplies B, a lunatic, with necessities suitable to his condition in life. A is entitled to be reimbursed from B's property.*

**Example II** *A supplies the wife and children of B, a lunatic, with necessities suitable to their condition in life. A is entitled to be reimbursed from B's property.*

#### Notes:

1. If money has been advanced in like circumstances for the purchase of necessities, its reimbursement can also be claimed u/s 68.
2. Necessities mean necessities suitable to the conditions in the life of the person to whom such necessities are supplied.

### RIGHT TO RECOVER MONEY PAID FOR ANOTHER PERSON [SECTION 69]

A person who is interested in the payment of money for which another person is legally bound to pay, and who therefore pays it, is entitled to recover the payment made from the person who was legally bound to pay.

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

**Example II** *The goods belonging to A were wrongfully attached in order to realise arrears of Government revenue due by G. A paid the amount to save the goods from sale. It was held that A was entitled to recover the amount from G. [Abid Hussain v. Ganga Sahai]*

### RIGHT TO RECOVER FOR NON-GRATUITOUS ACT [SECTION 70]

Such right to recover arises if the following three conditions are satisfied:

- (i) The thing must have been done or delivered lawfully;
- (ii) The person who has done or delivered the thing, must not have intended to do so gratuitously; and
- (iii) The person for whom the act is done/to whom thing is delivered must have enjoyed the benefit of the act done/thing delivered.

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

**Example II** *A saves B's property from fire. A is not entitled to compensation from B, if the circumstances show that he intended to act gratuitously.*

### RESPONSIBILITY OF FINDER OF GOODS [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.

**Example X** *a guest found a diamond ring at a birthday party of Y. X told Y and other guests about it. He has performed his duty to find the owner. If he is not able to find the owner he can retain the ring as bailee.*

### RIGHT TO RECOVER FROM A PERSON TO WHOM MONEY IS PAID OR THING IS DELIVERED, BY MISTAKE OR UNDER COERCION [SECTION 72]

A person to whom money has been paid, or anything delivered by mistake or under coercion, must repay or return it.

**Example I** *A and B jointly owe ₹ 100 to C. A alone pays the amount to C, and B, not knowing this fact, pays ₹ 100 over again to C. C is bound to repay the amount to B.*

**Example II** *A railway company refuses to deliver up certain goods to the consignee, except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.*

#### Notes:

- (i) Section 72 is wide enough to cover not only a mistake of fact but also a mistake of law. [Sales Tax Officer v. Kanhaiya Lal Mukand Lal]
- (ii) The expression 'coercion' occurring in Section 72 is not governed by the definition of this term given u/s 15. It is to be interpreted in its popular sense to mean oppression, extortion or such other means. [Seth Kanhaiya Lal v. National Bank of India]

### 6.0 COMPENSATION FOR FAILURE TO DISCHARGE OBLIGATION CREATED BY QUASI-CONTRACTS [SECTION 73]

When an obligation created by a Quasi-contract is not discharged, the injured party is entitled to receive the same compensation from the party in default as if such person had contracted to discharge it and had broken his contract.

### 7.0 QUANTUM MERUIT

#### MEANING OF QUANTUM MERUIT

The term 'quantum meruit' means as much as merited or 'as much as earned'. In other words, it means payment in proportion to the amount of work done. Generally, one cannot claim performance from another unless one has performed his obligation in full but in certain

cases, a person who has performed some work under a contract can claim remuneration for the work which he has already done. The right to claim on 'quantum meruit' does not arise out of a contract as the right to damages does. It is a claim on the quasi contractual obligations which is implied by the circumstances. The claim for quantum meruit arises only when the original contract is discharged.

### CASES IN WHICH THE CLAIM OF QUANTUM MERUIT ARISE

The various cases in which the claim of quantum meruit arise are discussed below:

- (a) **In Case of Void Agreement, or Contract that becomes Void [Section 65]** When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it.

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

**Example II** *A contracts with B to deliver to him 250 tons of rice before the 1st of May. A delivers 130 tons only before that day, and none after. B retains the 130 tons after the first of May. He is bound to pay A for them.*

**Example III** *A, a singer contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her ₹ 100 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence rescinds the contract. B must pay A for the five nights on which she had sung.*

**Example IV** *A contracts to sing for B for ₹ 1,000 which are paid in advance. A is too ill to sing. A is not bound to make compensation to B for the loss of the profits which B would have made if A had been able to sing, but must refund to B ₹ 1,000 paid in advance.*

- (b) **In Case of Non-gratuitous Act [Section 70]** The obligation to pay arises if the following three conditions are satisfied:
- (i) The thing must have been done or delivered lawfully;
  - (ii) The person who had done or delivered the thing must not have intended to do so gratuitously; and
  - (iii) The person for whom the act is done must have enjoyed the benefit of the Act.

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

- (c) **In Case of Act Preventing the Completion of Contract** If a party does not complete the contract or prevents the other party to complete the contract, the aggrieved party can sue on quantum meruit.

**Example** *C an owner of a magazine engaged P to write a book to be published as series in his magazine. After a few series were published, the publication of the magazine was stopped. It was held that P could claim payment on quantum meruit for the part already published. [Planche v. Calburn]*

**(d) In Case of Divisible Contract** The party at default may sue on a quantum meruit if the following conditions are satisfied:

- (i) If the contract is divisible; and
- (ii) If the party not at default has enjoyed benefits of the part performance.

**Example** *S agreed to construct a house for H for ₹ 965 but he abandoned this contract after having done the work worth ₹ 333. Afterwards, H got the work completed. It was held that S could not recover anything for the work done because he was entitled to the payment only on the completion of the work.*

**(e) In Case of Indivisible Contract Performed Completely but Badly** The party at default may claim the lumpsum less deduction for bad work if the following conditions are satisfied:

- (i) If the contract is indivisible;
- (ii) If the contract is for lumpsum;
- (iii) If the contract is completely performed; and
- (iv) If the contract is performed badly.

**Example** *X agreed to decorate Y's flat for a lumpsum of ₹ 20,000. X did the complete work but Y complained of faulty workmanship. It costs Y another ₹ 3,000 to remedy the defect. It was held that X could recover only ₹ 17,000 from Y. [Hoenig v. Issacs (1952)]*

## PRACTICAL PROBLEMS

### PROBLEM 1

X supplied rice and wheat worth ₹ 20,000. Y supplied a mobile phone worth ₹ 30,000 and Z lent ₹ 50,000 for the purchase of necessities to the wife and children of M, a minor. M had assets worth ₹ 1,00,000. Can X, Y and Z recover anything from M?

**Solution:** Section to which the given problem relates: Section 68.

**Decision and Reason:** X and Z can recover from the Z's assets because X supplied necessities and Z lent for the purchase of necessities but Y cannot recover anything because he has not supplied necessities.

### PROBLEM 2

P left his carriage on D's premises and D's landlord seized the carriage for non-payment of the rent. P paid the rent to obtain the release of his carriage. Could P recover the amount from D?

**Solution:** Section to which the given problem relates: Section 69.

**Decision and Reason:** P could recover the amount from D because he made the payment which D was bound by law to pay.

**[Leading case:** Exall v. Patridge]

### PROBLEM 3

X saved Y's house from fire. Can X claim compensation from Y on the ground that Y enjoyed the benefit of X's act?

**Solution:** Section to which the given problem relates: Section 70.

**Decision and Reason:** Y cannot claim compensation from Y unless the circumstances show that he did not intend the act gratuitously.

### PROBLEM 4

X picked up a diamond from the floor of Y's shop and handed it over to Y to keep it till owner is found, Y did his best to find out the owner but true owner could not be found. After sometime, X offered Y the lawful charges incurred by Y for finding out the true owner and asked him to return the diamond to him. Y refused to do so. Discuss the legal position.

**Solution:** Section to which the given problem relates: Sections 71 and 168.

**Decision and Reason:** Y must return the diamond to X because X was entitled to retain it against the whole world except the true owner.

### PROBLEM 5

X owes Baburam and pays to Rambabu by mistake. Discuss the rights of X and Baburam.

**Solution:** Section to which the given problem relates: Section 72.

**Decision and Reason:** Rambabu must repay the money to X because money was paid by mistake. Baburam cannot recover from Rambabu because there is no privity of contract between Baburam and Rambabu.

### PROBLEM 6

X engaged Y to write a book to be published as series in a magazine. The magazine was abandoned after a few issues. Can Y recover anything from X.

**Solution:** Y can recover compensation for the work done by him on quantum meruit basis. [Planche v. Colburn]

### PROBLEM 7

X is employed as a managing director in a company. After he rendered service for sometime, it is found that the Board of Directors was not competent to appoint him as such. Can X recover anything from the company?

**Solution:** X can recover compensation for the work done by him on quantum meruit basis. [Craven Ellis v. Canons Ltd.]

### PROBLEM 8

X agreed to construct a house for Y for ₹ 1,00,000 but after having done three fourth of the work, he abandons the contract. Y, afterwards, completed the house. Can X recover anything from Y?



**Solution:** X cannot recover anything from Y because the contract is indivisible. [Sumpter v. Hedges]

### PROBLEM 9

X decorated Y's house for a lumpsum of ₹ 20,000. The work is done but Y complains of faulty workmanship. Y spent ₹ 5,000 to remedy the defect. Can X recover anything from Y?

**Solution:** X can recover only ₹ 15,000 (i.e. ₹ 20,000 less ₹ 5,000) from Y because the contract is indivisible but has been completely performed.

## IMPORTANT POINTS TO REMEMBER

### 1.0 Meaning and kinds of Quasi-Contracts

<b>Meaning</b>	A Quasi-contract is an obligation imposed by law upon a person for the benefit of another even in the absence of a contract. It is based on the principle of equity.
<b>Features</b>	<ul style="list-style-type: none"> <li>(a) It is imposed by law and does not arise from any agreement.</li> <li>(b) The duty of a party and not the promise of any party is the basis of such contract.</li> <li>(c) The right under it is always a right to money and generally, though not always, to a liquidated sum of money.</li> <li>(d) The right under it is available against specific person(s) and not against the world.</li> <li>(e) A suit for its breach may be filed in the same way as in case of a complete contract.</li> </ul>
<b>Similarity</b>	The outcome of quasi-contracts resemble that created by a contract. So far as claim for damages are concerned, there is a similarity between a Quasi-contracts and contract because in case of breach of a quasi-contract, Section 73 provides for the same remedies as provided in case of breach of a contract.
<b>Kinds</b>	<ol style="list-style-type: none"> <li>1. <b>Right to Recover the Price of Necessaries Supplied</b> to a person who is incapable of contracting or anyone whom such incapable person is legally bound to support, from the property of such incapable person.</li> <li>2. <b>Right to Recover Money Paid for Another Person</b></li> <li>3. <b>Right to Recover for Non-Gratuitous Act</b></li> <li>4. <b>Responsibility of Finder of Goods as Bailee</b></li> <li>5. <b>Right to Recover from a Person to whom Money is Paid or thing is Delivered, by Mistake or Under Coercion</b></li> </ol>
<b>Right of Injured Party</b>	When an obligation created by a Quasi-contract is not discharged, the injured

	party is entitled to receive the same compensation from the party in default as if such person had contracted to discharge it and had broken his contract.
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## 2.0 Quantum Meruit

<b>Meaning</b>	The term ' <i>quantum meruit</i> ' means as much as merited or 'as much as earned'. In other words, it means payment in proportion to the amount of work done. The right to claim on ' <i>quantum meruit</i> ' does not arise out of a contract as the right to damages does. It is a claim on the quasi contractual obligations which is implied by the circumstances. The claim for <i>quantum meruit</i> arises only when the original contract is discharged.
<b>Cases</b>	1. In case of void agreement or contract that becomes void
	2. In case of non-gratuitous act
	3. In case of act preventing the completion of contract
	4. In case of divisible contract
	5. In case of indivisible contract performed completely but badly

## TRUE OR FALSE QUESTIONS

**State whether the following statements are True or False:**

1. In quasi-contracts, the promise to pay is based on express agreement.
2. A minor is personally responsible for necessities supplied to his dependent.
3. The essentials for the formation of a valid contract are present in quasi-contracts.
4. An agreement void ab-initio cannot be a quasi-contract.
5. A finder of lost goods is just like a bailee.
6. A finder of goods is the next best owner to the real owner.
7. The finder of goods may sue the true owner for expenses incurred by him in respect of the goods.
8. The finder of goods may sue the owner for a specific award (if any) offered by owner.
9. A person cannot recover from another an amount paid under a mistake of law.
10. When an indivisible contract is partly performed in accordance with the terms of contract, the party at default can claim compensation on quantum meruit basis.
11. When an indivisible contract is completely performed but badly, the party at default cannot recover anything.
12. The right to claim quantum meruit arises out of the contract.
13. The right to claim on quantum meruit arises only in case of quasi-contracts.

**ANSWERS**

1. False 2. False 3. False 4. True 5. True 6. True 7. True 8. True 9. False  
 10. False 11. False 12. False 13. False

**VERY SHORT ANSWER TYPE QUESTIONS**

1. What are Quasi-contracts?
2. Are Quasi-contracts outcome of contracts?
3. What do you understand by 'Quantum Meruit'?
4. Does the right to claim on Quantum Meruit arise out of the contract?

**SHORT ANSWER TYPE QUESTIONS**

1. Enumerate the quasi-contracts dealt with under the Indian Contract Act, 1872.
2. Enumerate the cases in which the claim on the Quantum Meruit basis arises.

**LONG ANSWER TYPE QUESTIONS**

1. (a) What are the Quasi-contracts?  
 (b) Discuss the Quasi-contracts dealt with under the Indian Contract Act, 1872.
2. (a) Who is finder of lost goods?  
 (b) What are the obligations of a finder of goods?  
 (c) What are the rights of a finder of goods?  
 (d) When can a finder sell the goods?
3. (a) What is meant by 'Quantum Meruit'?  
 (b) Explain the cases in which the claim on quantum meruit basis arises.





# The Sale of Goods Act, 1930

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## 1.0 INTRODUCTION

1. Till 1930, transactions relating to sale and purchase of goods were regulated by the Indian Contract Act, 1872.
2. In 1930, Sections 76 to 123 of the Indian Contract Act, 1872 were repealed and a separate Act called 'The Indian Sale of Goods Act, 1930' was passed.
3. It came into force on 1st July 1930. With effect from 22nd September, 1963, the word 'Indian' was also removed. Now, the present Act is called 'The Sale of Goods Act, 1930'.

4. **What is the territory to which this Act applies ?**

This Act extends to the whole of India except the State of Jammu and Kashmir.

5. **Do the provisions of the Indian Contract Act, 1872 still apply to contracts for Sale of Goods ?**

*According to Section 3, "the provisions of the Indian Contract Act, 1872 still continue to apply to contracts for the sale of goods except where 'The Sale of Goods Act', 1930 provides for the contrary".*

## 2.0 WHAT IS THE SCOPE OF THE ACT?

1. The Sale of Goods Act deals with 'sale' but not with 'mortgage' (which is dealt with under the Transfer of Property Act, 1882) or 'pledge' (which is dealt with under the Indian Contract Act, 1872).
2. This Act deals with 'goods' but not with other movable property, e.g., actionable claims and money.
3. In other words, this Act does not deal with movable property other than goods, and immovable property.

## 3.0 WHAT IS THE MEANING OF CONTRACT OF SALE ?

1. *According to Section 4(1) of the Sale of Goods Act, 1930, "contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price."*
2. 'Contract of Sale' is a generic term which includes both a sale as well as an agreement to sell.

#### 4.0 WHAT ARE THE ESSENTIAL ELEMENTS OF CONTRACT OF SALE?

The aforesaid definition clearly indicates the following essential elements

<p><b>1. Seller and Buyer</b></p>	<p>There must be a seller as well as a buyer. 'Buyer' means a person who buys or agrees to buy goods [Section 2(1)]. 'Seller' means a person who sells or agrees to sell goods [Section 2(13)]. A person cannot be a seller as well as a buyer as a person cannot buy his own goods. That is why distribution of goods among partners on account of dissolution of a firm does not amount to a sale of goods because the partners are joint owners and they cannot be both sellers and buyers [State of Gujarat v. Raman Lal &amp; Co.]. However, one part owner may be a seller and another part owner may be buyer. Where a person's goods are sold under an execution of decree, a bankrupt may also buy back his own goods from his trustee. [King v. England]</p>
<p><b>2. Goods</b></p>	<p>There must be some goods. 'Goods' means every kind of movable property other than actionable claims and money and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale [Section 2(7)]. It may be noted that the contract relating to actionable claims, immovable property and services are not covered by this Act.</p> <p><b>Notes:</b></p> <ul style="list-style-type: none"> <li>(i) The 'actionable claims' mean a claim which can be enforced through the courts of Law, e.g. a debt due from one person to another is an actionable claim.</li> <li>(ii) The 'money' here means the legal tender (i.e. currency of the country) and not old coins.</li> </ul>
<p><b>3. Transfer of Property</b></p>	<p>Property means the general property in goods, and not merely a special property [Section 2(11)]. General property in goods means ownership of the goods. Special property in goods means possession of goods. Thus, there must be either a transfer of ownership of goods or an agreement to transfer the ownership of goods. The ownership may transfer either immediately on completion of sale or sometime in future in agreement to sell.</p>
<p><b>4. Price</b></p>	<p>There must be a price. Price here means the money consideration for a sale of goods [Section 2(10)]. When the consideration is only goods, it amounts to a 'barter' and not sale. When there is no consideration, it amounts to gift and not sale. However, the consideration may be partly in money and partly in goods because the law does not prohibit as such. [Shelden v. Cox]</p>

<b>5. Essential Elements of a Valid Contract</b>	In addition to the aforesaid specific essential elements, all the essential elements of a valid contract as specified under Section 10 of Indian Contract Act, 1872 must also be present since a contract of sale is a special type of a contract. For example, an agreement to sell smuggled gold is not valid because its object is unlawful. [Refer to Practical Problem 1]
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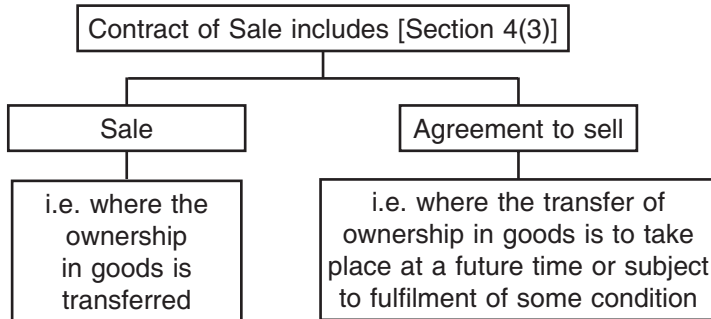
## 5.0 WHAT ARE THE FORMALITIES OF A CONTRACT OF SALE ? [SECTION 5]

In connection with the formalities of a contract of sale, the provisions of Section 5 specifically provide only for the following three matters:

<b>1. Offer and Acceptance</b>	A contract of sale is made by an offer to buy or sell the goods for a price and acceptance of such offer.		
<b>2. Delivery and Payment</b>	The contract of sale may provide for any of the following combinations:		
	<b>Option</b>	<b>Delivery</b>	<b>Payment</b>
	I	Immediate	Immediate
	II	Immediate	By Instalments
	III	Immediate	At some future date
	IV	By instalments	By Instalments
	V	By instalments	Immediate
	VI	By instalments	At some future date
	VII	At some future date	At some future date
	VIII	At some future date	Immediate
	IX	At some future date	By Instalments
<b>3. Express or Implied</b>	<p>A contract of sale may be implied from the conduct of parties or express (i.e. written or oral or partly written or oral)</p> <p>It may be noted that an offer by word of mouth may be accepted in writing and an offer in writing may be accepted by word of mouth.</p>		

## 6.0 WHAT DOES 'CONTRACT OF SALE' INCLUDE ?

The term 'Contract of Sale' includes both a 'sale' and 'agreement to sell' as shown below:



## 7.0 WHEN DOES AGREEMENT TO SELL BECOME SALE ?

An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the ownership in the goods, is to be transferred.

## 8.0 DISTINCTION BETWEEN SALE AND AGREEMENT TO SELL

A 'Sale' and an 'Agreement to Sell' can be distinguished as follows:

Basis of distinction	Sale	Agreement to sell
<b>1. Transfer of ownership</b>	Transfer of ownership of goods takes place immediately.	Transfer of ownership of goods is to take place at a future time or subject to fulfilment of some condition.
<b>2. Executed Contract or Executory Contract</b>	It is an executed contract because nothing remains to be done.	It is an executory contract because something remains to be done.
<b>3. Conveyance of property</b>	Buyer gets a right to enjoy the goods against the whole world including seller. Therefore, a sale creates jus in rem (Right against property).	Buyer does not get such right to enjoy the goods. It only creates jus in personam (Right against the person).
<b>4. Transfer of Risk</b>	Transfer of risk of loss of goods takes place immediately because ownership is transferred. As a result, in case of destruction of goods, the loss shall be borne by the buyer even though the goods are in the possession of the seller.	Transfer of risk of loss of goods does not take place because ownership is not transferred. As a result, in case of destruction of goods, the loss shall be borne by the seller even though the goods are in the possession of the buyer.



<b>5. Rights of seller against the buyer's breach</b>	Seller can sue the buyer for the price even though the goods are in his possession.	Seller can sue the buyer for damages even though the goods are in the possession of the buyer.
<b>6. Rights of buyer against the seller's breach</b>	Buyer can sue the seller for damages and can sue the third party who bought those goods, for goods.	Buyer can sue the seller for damages only.
<b>7. Effect of insolvency of seller having possession of goods</b>	Buyer can claim the goods from the official receiver or assignee because the ownership of goods has transferred to the buyer.	Buyer cannot claim the goods even when he has paid the price because the ownership has not transferred to the buyer. The buyer who has paid the price can only claim rateable dividend.
<b>8. Effect of insolvency of the buyer before paying the price</b>	Seller must deliver the goods to the official receiver or assignee because the ownership of goods has transferred to the buyer. He can only claim rateable dividend for the unpaid price.	Seller can refuse to deliver the goods unless he is paid full price of the goods because the ownership has not transferred to the buyer.

## 9.0 DISTINCTION BETWEEN SALE AND HIRE-PURCHASE AGREEMENT

### MEANING OF HIRE-PURCHASE AGREEMENT

Hire-purchase agreement means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes the agreement under which:

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

### TRUE TEST OF HIRE-PURCHASE AGREEMENT

If in an agreement the person taking the goods has an option to terminate the agreement at any time before the transfer of ownership of goods, it will be an agreement of hire purchase. If, in an agreement, the person taking the goods has no option to terminate the agreement, it will be a contract of sale even if the price is payable in instalments. [Lee v. Butler]

**Example** *X takes the delivery of a furniture from Y under an agreement which provides for (a) an immediate down payment of ₹ 300, (b) the balance by way of 12 monthly installments of ₹ 100 each, (c) transfer of ownership on the payment of last installment, (d) Y's right to or possess the goods in case of non-payment of incitements due. Before the 12th installment was paid, X sold the furniture to Z. Can Y recover the furniture from Z ? State your answer in each of the following cases:*

Case (a): If the agreement does not provide for any other stipulation.

Case (b): If the agreement also provides that X can return the goods.

**Solution:**

Case (a): Y cannot recover the furniture from Z because it was a contract of sale (as X was not having any option to return but was under compulsion to buy) and not hire-purchase agreement.

Case (b): Y can recover the furniture from Z because it was a hire-purchase agreement (as X was having an option to return) and hence, X was not having any title to it.

**DISTINCTION BETWEEN A SALE AND HIRE-PURCHASE AGREEMENT**

A 'Sale' can be distinguished from a hire-purchase agreement as under:

Basis of Distinction	Sale	Hire-purchase agreement
1. Regulating Law	All contracts of sale are governed by Sale of Goods Act, 1930.	The Hire-purchase agreements are governed by Hire Purchase Act, 1972.
2. Nature of Contract	It is contract of sale.	It is an agreement of hiring and hence an agreement to sell.
3. Possession of goods	Possession of goods need not necessarily be transferred immediately.	Possession of goods is necessarily transferred immediately.
4. Transfer of ownership of goods	Ownership of goods is transferred immediately.	Ownership of goods is transferred on the payment of the last instalment when the option to purchase is exercised.
5. Right to terminate	The buyer has no right to terminate the contract of sale.	The hirer has right to terminate the agreement at any time before the ownership is transferred.
6. Right to repossess the goods	The seller has no right to repossess the goods. He can sue for price.	The hire-vendor has a right to repossess the goods if the hirer defaults.

<b>7. Transfer of good title to third party</b>	The buyer can transfer a good title to third party because ownership of goods has been transferred.	The hirer cannot transfer a good title to third party because ownership of goods has not been transferred.
<b>8. Compulsion as to be in writing</b>	A contract of sale need not necessarily be in writing.	The hire-purchase agreement must be in writing.
<b>9. Benefits of implied conditions and warranties under the Sale of Goods Act</b>	The benefits of implied conditions and warranties are available.	The benefits of implied conditions and warranties are not available.
<b>10. Goods &amp; Services Tax (GST)</b>	In case of sale of taxable goods, GST is levied.	In case of hire of even taxable goods, GST is not levied.
<b>11. Treatment of payment made by instalment</b>	The payment made by the buyer is treated as payment towards the price of goods.	The payment made by the hire purchases is treated as hire charges for the use of goods till the option to purchase the goods is exercised.

## 10.0 DISTINCTION BETWEEN SALE AND CONTRACT FOR WORK AND LABOUR

In a contract for work and labour, the rendering of the service and exercise of skill is the essence of contract even though there may be delivery of goods. In a contract of sale, the delivery of goods is the essence of the contract although some labour on the part of the seller might also have been exercised. It may be noted that the Sale of Goods Act does not apply to contracts for skill and labour.

**Example I** *X engaged an artist to paint a portrait and supplied canvas, paint and other necessary articles. It was a contract for work and labour and not a contract of sale because the substance of the contract was the artist's skill and not the delivery of material. [Robinson v. Graves]*

**Example II** *X purchased a portrait painted by a famous artist. It was a contract of sale and not a contract for work and labour because the substance of the contract was the delivery of portrait.*

**Example III** *A restaurant provides food and drinks to its customers in the restaurant. It is essentially in the nature of service and not a transaction of sale because the customers come there not to buy the food and drinks but to find bodily satisfaction that service of food in the setting of a restaurant can afford to give. [Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi].*

**Example IV** *A customer takes home a supply of certain food and drinks from the restaurant. It is a contract of sale and not a contract of work and labour because the substance of*

*the contract is the delivery of foods and drinks.*

**Example V** *The contract for the construction of coaches on the underframes supplied by the Railways was held to be a contract for work and labour and not for sale. [State of Gujarat v. Variety Body Builders (1976) S.C. 2108]*

**Example VI** *A dentist agreed to supply an artificial denture to fit the mouth of a patient, material being wholly supplied by the Dentist. Held, it was a contract of sale. (Lee v. Griffin)*

## 11.0 MEANING AND TYPES OF GOODS

### MEANING OF GOODS [SECTION 2(7)]

Goods means every kind of movable property other than actionable claims and money, and includes the following:

- (a) Stock and shares
- (b) Growing crops, grass and thing attached to or forming part of the land which are agreed to be served before sale or under the Contract of Sale.

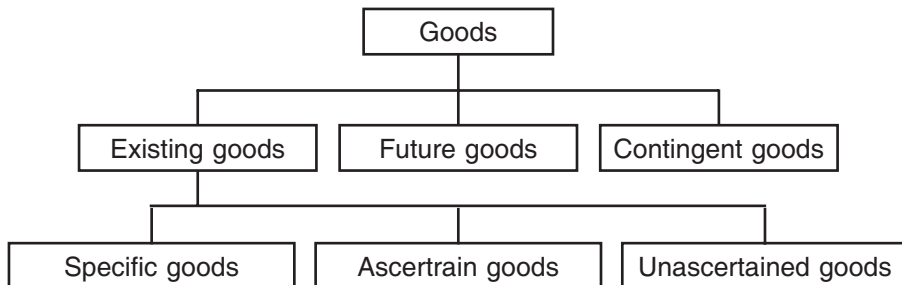
**Examples of Goods:** Old rare coins, stock, shares, debentures, goodwill, patents, trademark, copyright, water, gas, electricity, grass, growing crops, trees to be cut and their log wood delivered etc.

**Things excluded from the term 'goods':** The term 'goods' does not include the following:

- (a) Actionable claim, which means a claim to any debt or any beneficial interest in movable property not in possession. Such claims cannot be sold or purchased like goods, they can only be assigned, e.g., a debt due from one person to another;
- (b) Money, which means the legal tender and not the old rare coins;
- (c) Immovable property.

### TYPES OF GOODS [SECTION 6]

The goods which form the subject of a contract of sale may be classified into following categories as shown on next page:



Let us discuss these types of goods one by one:

- (a) **Existing Goods** Existing goods mean the goods which are either owned or possessed by the seller at the time of contract of sale. The existing goods may be specific or ascertained or unascertained as follows:

- (i) **Specific Goods [Section 2(14)]:** These are the goods which are identified and agreed upon at the time when a contract of sale is made-For example, a specified TV, VCR, Car, Ring.
- (ii) **Ascertained Goods:** Goods are said to be ascertained when out of a mass of unascertained goods, the quantity extracted for is identified and set aside for a given contract. Thus, when part of the goods lying in bulk are identified and earmarked for sale, such goods are termed as ascertained goods.
- (iii) **Unascertained Goods:** These are the goods which are not identified and agreed upon at the time when a contract of sale is made. e.g. goods in stock or lying in lots.

**Example** *X goes to a Maruti car showroom where 10 Maruti cars have been displayed. X agrees to buy one Maruti car 800 and the seller agrees to sell. Here, 10 cars will be classified as under:*

- I. 10 cars are unascertained goods before the identification of a particular car to be sold.
- II. 9 cars are unascertained goods after the identification of 1 particular car to be sold. Such one particular car to be sold is an ascertained goods.
- III. 1 particular car identified and agreed upon at the time when the contract of sale is made is specific goods and other 9 cars are unascertained goods.

- (b) **Future Goods [Section 2(6)]** Future goods mean goods to be manufactured or produced or acquired by the seller after the making of the contract of sale. There can be an agreement to sell only. There can be no sale in respect of future goods because one cannot sell what he does not possess.

**Example** *X agrees to sell to Y all the crops to be grown at his farm in Haryana during the year 2,000 season for a sum of ₹ 1,00,000. This is an agreement to sell future goods and not a sale.*

**Notes:**

- (i) The contracting parties are not discharged on non-acquisition or non-production of future goods.
  - (ii) The future goods are neither in existence nor in possession of the seller at the time of contract of sale whereas the unascertained goods are in existence and in possession of the seller at the time of contract of sale.
- (c) **Contingent Goods [Section 6(2)]** These are the goods the acquisition of which by the seller depends upon a contingency which may or may not happen.

**Example** *X agrees to sell to Y all the crops to be grown at Z's farm in Haryana during the year 2,000 season for a sum of ₹ 1,00,000 if Z sells the same to X. This is an agreement to sell contingent goods because the availability of crops depends on its sale by Z.*

**Note:** The contracting parties are discharged on non-acquisition of contingent goods.

## 12.0 WHAT IS THE EFFECT OF DESTRUCTION OF GOODS?

The effect of destruction of goods can be discussed under the following two heads:

### IN CASE OF CONTRACT OF SALE [SECTION 7]

The contract of sale is void if the following three conditions are satisfied:

- (i) There must be a contract of sale for specific goods.
- (ii) The goods must have perished or become so damaged as no longer to answer to their description in the contract, before making of the contract.
- (iii) The seller must not be aware about the destruction of goods.

The aforesaid provision is based on the principle of impossibility of performance of the contract.

**Example** *X sold to Y all 700 bags of cement lying in his Delhi's godown. State the legal position (I) if unknown to X, all bags had been stolen before the contract was made, (II) if unknown to X, the cement had becomes stone as a result of heavy rainfall, (III) if unknown to X, 109 bags had been stolen at the time of making the contract.*

**Solution:**

**Case I:** The contract, is void because the goods have perished before making of the contract.

**Case II:** The contract is void because the goods became so damaged as no longer to answer to their description.

**Case III:** The contract has become void and Y cannot be compelled to accept 591 bags because the contract was indivisible. [*Barrow Lane & Ballard Ltd v. Phillips & Co*]

### IN CASE OF AN 'AGREEMENT TO SELL' [SECTION 8]

An agreement to sell becomes void if the following four conditions are satisfied:

- (i) There must be an agreement to sell specific goods;
- (ii) The goods must have perished or become so damaged as no longer to answer to their description in the agreement;
- (iii) There must not be any fault of seller or buyer;
- (iv) The risk must not have passed to the buyer, i.e. the goods must have perished before the agreement to sell becomes sale.

**Example I** *X agrees to sell a particular horse to Y on the expiry of 8 days. The horse was delivered on trial for 8 days. However, the horse died on the third day, without any fault of either seller or buyer. This agreement became void and X could not recover the price from Y. [Elphick v. Barnes]*

**Example II** *X agrees to sell some specific goods to Y on the expiry of 8 days. However, the goods were requisitioned by the Government on the third day. This agreement becomes void.*

**Example III** *X agreed to sell to Y 10 tons of potatoes to be grown on his land. X sowed sufficient land to grow more than 10 tons of potatoes. But without any fault on X's part, a disease attacked the crop and only about eight tons of potatoes could be grown. It was held that the agreement to sell has become void. [Howell v. Coupland]*

**Note:** The provision of Sections 7 and 8 are applicable only in case of specific goods and not in case of unascertained goods. If unascertained goods are destroyed either before or after making the agreement, the contract shall not become void. An agreement to sell certain unascertained goods shall not become void even if the entire stock of unascertained stock is destroyed. For example, X agrees to sell 100 bags of cement out of 700 bags lying in his godown. The entire cement had become stone. The contract is not void because the contract was for unascertained goods and not for specific goods. Hence, X must deliver 100 bags of cement or pay damages for the breach.

### 13.0 PRICE OF GOODS

<b>Meaning of Price Modes of Determining Price</b>	Price means the money consideration for a sale of goods. There are three modes of determining the price as under: (a) It may be fixed by the contract; or (b) It may be left to be fixed in an agreed manner, or (c) It may be determined by the course of dealing between the parties. Thus, the price need not necessarily be fixed at the time of sale.
<b>Consequences of not Determining the Price</b>	Where the price is not determined in accordance with Section 9(1), the buyer must pay the seller a reasonable price. What is a reasonable price is a question of fact dependent on the circumstances of each particular case. It may be noted that a reasonable price need not be market price.
<b>Consequences of not Fixing Price by Third Party</b>	The agreement to sell goods becomes void if the following two conditions are fulfilled. (a) If such agreement provides that the price is to be fixed by the valuation of a third party, and (b) If such third party cannot or does not make such valuation.
<b>Duty of Buyer</b>	A buyer who has received and appropriated the goods, must pay a reasonable price therefor.
<b>Right of Party not at Fault</b>	Where such a third party is prevented from making the valuation by fault of the seller or buyer, the party not at fault may maintain a suit for damages against the party in fault.  <b>Example</b> <i>X agrees to sell 100 bags of cement to Y at a price to be fixed by Z and to be delivered in 4 equal installments. Y receives a delivery of 25 cement bags. State the legal position (a) if Z refuses to value the goods and fix the price, (b) if Z is prevented from fixing the price by the fault of X, (c) if Z is prevented for fixing the price by the fault of Y.</i>

	<p><b>Solution:</b></p> <p>Case (a): The agreement to sell becomes void. But Y must pay a reasonable price for 25 cement bags.</p> <p>Case (b): The agreement to sell becomes void. But Y must pay a reasonable price for 25 cement bags. However, Y may maintain a suit for damages against X.</p> <p>Case (c): The agreement to sell becomes void. But Y must pay a reasonable price for 25 cement bags. However, X may maintain a suit for damages against Y.</p>
<b>Earnest v. Advance Payment</b>	<p>Earnest means security for the due performance of the contract. Advance payment means the payment of the price of the goods in advance which is to be adjusted against the ultimate total price of the goods. If the contract is not or cannot be performed by the fault of the buyer, the seller may forfeit the earnest and not the advance payment. The party not at fault may maintain a suit for damages against the party in fault.</p>

#### 14.0 IS STIPULATION AS TO TIME AN ESSENCE OF CONTRACT ?

Stipulation as to time of payment is not deemed to be an essence of a contract of sale unless a different intention appears from the terms of the contract. [Section 11]

**Other Stipulation as to Time** Whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract.

#### 15.0 CONDITIONS AND WARRANTIES

It is usual for both seller and buyer to make representations to each other at the time of entering into a contract of sale. Some of these representations are mere opinions which do not form a part of contract of sale. Whereas some of them may become a part of contract of sale. Representations which become a part of contract of sale are termed as stipulations which may rank as condition and warranty e.g. a mere commendation of his goods by the seller doesn't become a stipulation and gives no right of action to the buyer against the seller as such representations are mere opinion on the part of the seller. But where the seller assumes to assert a fact of which the buyer is ignorant, it will amount to a stipulation forming an essential part of the contract of sale.

<b>Meaning of Stipulation</b>	A stipulation in a contract of sale of goods may be a condition or warranty [Section 12(1)].
<b>Meaning of Condition</b>	<p>A condition is a stipulation-</p> <p>(a) which is essential to the main purpose of the contract, and</p> <p>(b) the breach of which gives the aggrieved party a right to terminate the contract. [Section 12(2)].</p>



	<b>Example</b> X asked a car dealer to suggest him a car suitable for touring purposes. The dealer suggested a 'Bugatti Car'. Accordingly, X purchased it but found it unsuitable for touring purpose. In this case, suitability of car for touring purpose was a condition of contract. X was, therefore entitled to reject the car and have refund of the price paid. [Baldry v. Marshall]
<b>Meaning of Warranty</b>	A warranty is a stipulation- (a) which is collateral to the main purpose of the contract, and (b) the breach of which gives the aggrieved party a right to claim damages but not a right to reject goods and to terminate the contract. [Section 12(3)].  <b>Example</b> X asked a car dealer to suggest him a good car and while suggesting the car, the dealer said that it could run for 20 km per litre of petrol. But the car could run only 15 kms per litre of petrol. In this case, the statement made by the seller was a warranty. X was, therefore not entitled to reject the car but he was entitled to claim the damages.
<b>How to Determine</b>	Whether stipulation in a contract of sale is condition or a warranty depends in each case on the construction of the contract. Stipulation may be a condition though called a warranty in the contract.

### DISTINCTION BETWEEN CONDITION AND WARRANTY

A condition can be distinguished from a warranty as under:

Basis of Distinction	Condition	Warranty
<b>1. Essential vs. Collateral</b>	It is a stipulation which is essential to the main purpose of the contract.	It is a stipulation which is only collateral to the main purpose of the contract.
<b>2. Right in case of breach</b>	The aggrieved party can terminate the contract.	The aggrieved party can claim damages but cannot terminate contract.
<b>3. Treatment</b>	A breach of condition can be treated as a breach of warranty. For example, a buyer may like to retain the goods and claim only damages.	A breach of warranty cannot be treated as a breach of condition.

### WHEN CONDITION TO BE TREATED AS WARRANTY ? [SECTION 13]

In the following three cases, a breach of a condition is treated as a breach of a warranty:

- (a) where the buyer waives a condition; once the buyer waives a condition, he cannot insist on its fulfillment e.g. accepting defective goods or beyond the stipulated time amounts to waiving a condition.

- (b) where the buyer elects to treat breach of the condition as a breach of warranty; e.g. where he claims damages instead of repudiating the contract.
- (c) where the contract is not severable and the buyer has accepted the goods or part thereof, the breach of any condition by the seller can only be treated as a breach of warranty. It can not be treated as a ground for rejecting the goods unless otherwise specified in the contract. Thus, where the buyer after purchasing the goods finds that some condition is not fulfilled, he cannot reject the goods. He has to retain the goods entitling him to claim damages.

## 16.0 EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES

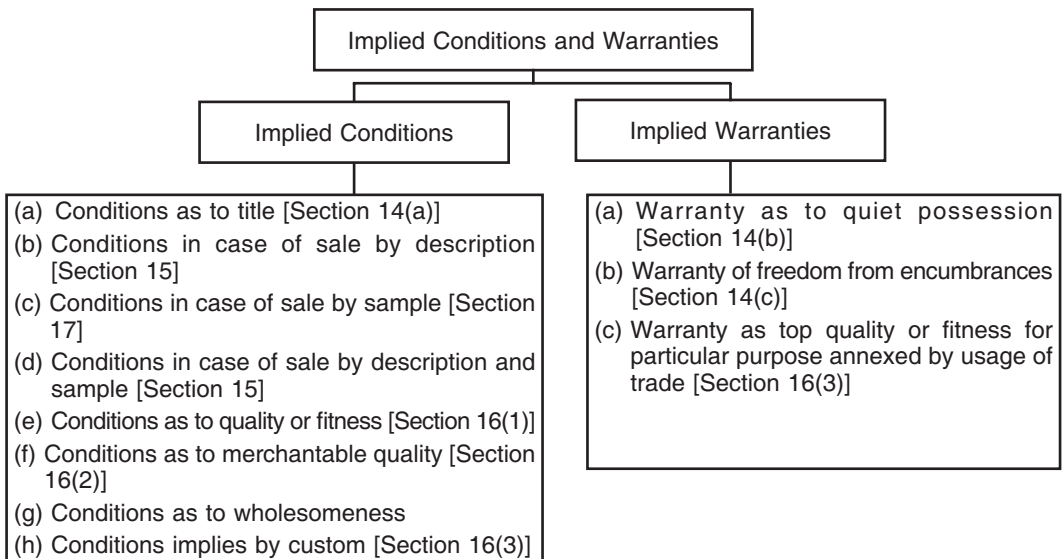
In a contract of sale of goods, conditions and warranties may be express or implied.

### EXPRESS CONDITIONS AND WARRANTIES

These are expressly provided in the contract. **For example**, a buyer desires to buy a SONY TV Model No. 2062. Here, model no. is an express condition. In an advertisement for Khaitan fans, guarantee for 5 years is an express warranty.

### IMPLIED CONDITIONS AND WARRANTIES

These are implied by law in every contract of sale of goods unless a contrary intention appears from the terms of the contract. The various implied conditions and warranties have been shown below.



## 17.0 WHAT ARE THE IMPLIED CONDITIONS ?

### CONDITION AS TO TITLE [SECTION 14(A)]

There is an implied condition on the part of the seller that (i) in the case of a sale, he has a right to sell the goods, and (ii) in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass.

**Note:** The term 'right to sell' is wider than 'right to pass ownership'.

**Example I** *X purchased a car from Y. After 6 months Z, the true owner of car, demanded it from X. X had to return it to its true owner. X was entitled to recover the full price even though several months had passed. [Rowland v. Divall]*

**Example II** *X purchased from Y tins of condensed milk bearing the label 'N BRAND.' It is proved that there was an infringement of trademark. X had to remove the labels and sold the tin at a loss. X was entitled to sue Y for breach of implied condition that Y had the right to sell. [Niblett Ltd. v. Confectioner's Materials Co.]*

**Example III** *X (a buyer in Chor Bazaar) purchased some stolen goods from Y, a thief. Z, the true owner of stolen goods, demanded it from X. X had to return it to its true owner. X is not entitled to sue Y because the knowledge of the buyer has negated the implied condition as to title.*

### SALE BY DESCRIPTION [SECTION 15]

Where there is a contract of sale of goods by description, there is an implied condition that the goods shall correspond with description. The main idea is that the goods supplied must be same as were described by the seller. Sale of goods by description include many situations as under:

- (i) Where the buyer has never seen the goods and buys them only on the basis of description given by the seller.

**Example** *X bought a reaping machine from Y who described it to be one year old and used only to cut 50 to 60 acres but X found that the machine extremely old. X was entitled to reject the machine because machine did not correspond with the description given by the seller. [Varley v. Whipp.]*

- (ii) Where the buyer has seen the goods but he buys them only on the basis of description given by the seller.

**Example** *The buyer bought after seeing certain goods which were described by the seller as "dating from seventeenth century" but he found them of eighteenth century. The buyer was entitled to reject the goods because goods did not correspond with the description given by the seller. [Nicholson and Venn v. Smith Marriott]*

- (iii) Where the method of packing has been described.

**Example** *X purchased from Y 5000 tins of canned fruit to be packed in cases each containing 50 tins but Y supplied cases containing 25 tins. X was entitled to reject the goods because the goods were not packed according to the description. [Moore & Co. v. Landauer & Co.]*

**Note:** If the goods do not correspond with the description but such goods are fit for buyer's purpose, even then the buyer may reject the goods and the seller cannot take the defence by saying that the goods will serve the buyer's purpose. [*Arcos v. Ranaason & Sons*]

### SALE BY SAMPLE [SECTION 17]

A contract of sale is a contract for sale by sample when there is a term in the contract, express or implied, to that effect. Such sale by sample is subject to the following three conditions:

- (i) The goods must correspond with the sample in quality.
- (ii) The buyer must have a reasonable opportunity of comparing the bulk with the sample.
- (iii) The goods must be free from any defect which renders them unmerchantable and which would not be apparent on reasonable examination of the sample. Such defects are called latent defects and are discovered when the goods are put to use. It may be noted that the seller cannot be held liable for apparent or visible defects which could be easily discovered by an ordinary prudent person.

**Example** *X bought from Y certain quantity of worsted coating equal to sample. The coating was equal to sample but due to a latent defect, the cloth was found to be unfit for making coats. The buyer was entitled to reject the goods because the defect contained in the sample was not apparent on reasonable examination of the sample. [Drummond & Sons v. Van Ingen]*

### SALE BY SAMPLE AS WELL AS BY DESCRIPTION [SECTION 15]

If the sale is by sample as well as by description, the goods must correspond with the sample as well as the description.

**Example** *X bought from Y foreign refined rapeseed oil which was warranted to be equal to sample. The oil supplied was equal to the sample. The sample was actually a mixture of rapeseed oil and hemp oil. X was entitled to reject the goods because the goods supplied did not correspond with the description. [Nichol v. Godts]*

### CONDITION AS TO QUALITY OR FITNESS [SECTION 16(1)]

There is no implied condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale. In other words, the buyer must satisfy himself about the quality as well as the suitability of the goods. This is expressed by the maxim *caveat emptor* (let the buyer beware).

**Exception to this Rule:** There is an implied condition that the goods shall be reasonably fit for a particular purpose described if the following three conditions are satisfied:

- (i) The particular purpose for which goods are required must have been disclosed (expressly or impliedly) by the buyer to the seller.

**Note:** This condition need not be fulfilled if the goods can be used only for a particular purpose.

- (ii) The buyer must have relied upon the seller's skill or judgement.
- (iii) The seller's business must be to sell such goods.

**Note:** This condition cannot be invoked against a casual seller.

**Example I** *X purchased a hot water bottle from Y, retail chemist. X asked Y if it would stand boiling water. The Chemist told him that the bottle was meant to hold hot water. The bottle burst when water was poured into it and injured his wife. The chemist is liable to refund the price and pay damages because bottle was unfit for the purpose for which it was purchased. [Priest v. Last]*

**Example II** *X asked a car dealer to suggest him car suitable for touring purposes. The dealer suggested a 'Buggati Car.' Accordingly, X purchased it but found it unsuitable for touring purpose. The car dealer is liable for breach of condition as to fitness because X who relied upon his skill and judgement is entitled to reject the car and have refund of the price paid. [Baldry v. Marshall]*

**Example III** *X bought a refrigerator without asking the dealer whether it is fit to make ice. Refrigerator failed to make ice. The dealer is liable to refund the price because refrigerator was unfit for the purpose for which it was meant for and the buyer was not required to disclose this particular purpose. [Evens v. Stelle Benjamin]*

**Example IV** *X bought a set of false teeth from Y a Dentist. But the set was not fit for X's mouth. X rejected the set of teeth and claimed the refund of price. It was held that X was entitled to do so as the only purpose for which he wanted the set of teeth was not fulfilled. [Dr. Baretto v. T.R. Pruce]*

**Circumstances under which Condition as to Fitness not Applicable [Provision to Section 16(1)]:**

- (i) **Where the buyer fails to disclose to the seller any abnormal circumstances.**

**Example** *X bought tweed coat and found unfit for her abnormally sensitive skin. The seller was not liable because the cloth was fir for anyone with a normal skin and she did not inform the seller about her abnormally sensitive skin. [Griffiths v. Peter Conway Ltd.]*

- (ii) **Where the buyer buys a specified article under its patent or other trade name and does not rely upon the skill and judgement of the seller.**

**Example** *X asks a chemist to supply 'Bournvita' as health drink. He found no improvement in his health in spite of its prolonged use. He is not entitled to claim any compensation because there was no condition as to fitness because goods are bought under patent name.*

**Tutorial Note:** *The implied condition as to fitness for a particular purpose applies to goods whether or not the buyer has examined the goods.*

### **CONDITION AS TO MERCHANTABLE QUALITY [SECTION 16(2)]**

Where the goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition

that the goods shall be of merchantable quality. The expression 'merchantable quality' means that the quality and condition of the goods must be such that a man of ordinary prudence would accept them as the goods of that description. Goods must be free from any latent or hidden defects.

**Example I** *X bought from a dealer a bottle of wine. While opening its cork in the normal manner, the bottle broke off and injured X's hands. X was entitled to claim damages because the bottle was not of merchantable quality. [Morelli v. Fitch & Gibbons]*

**Example II** *X a dealer sold a plastic catapult to B. While using the catapult in the usual manner, it broke due to the fact that the materials used in its manufacture were unsuitable. As a result the boy who was using was blinded in one eye. The seller was liable because the goods were not of merchantable quality. [Godley v. Perry]*

**Example III** *X bought some cooking coal from Y a coal dealer for his domestic use. However, the coal contained an explosive substance which exploded and caused injury to X. It was held that the coal was not of merchantable quality as it was not fit for using as cooking coal. X was entitled to claim damages from Y. [Wilson v. Rickett Cackerrel & Co.]*

**Circumstances under which Condition as to Merchantable Quality not Applicable [Provision to Section 16(2)]:** There shall be no implied conditions as regards defects which the buyer could have discovered if the buyer has examined the goods.

**Example** *X purchased glue from Y. The glue was packed in barrels and every facility was given to X for its examination but X did not examine the contents. X could not reject the goods by saying that they are not merchantable because opportunity of examining the goods was given to X but he did not examine. [Thornett & Fehs v. Beers & Sons]*

**Notes:**

- (i) The implied condition as to merchantable quality applies to goods whether or not the goods are sold under a patent or trade name.
- (ii) The implied condition as to merchantable quality applies to goods whether or not the buyer relies on the skill and judgement of the seller.

**CONDITION AS TO WHOLESOMENESS**

In case of eatables or provisions or foodstuffs, there is an implied condition as to wholesomeness. Condition as to wholesomeness means that the goods shall be fit for human consumption.

**Example** *X bought milk from Y's dairy. The milk contained typhoid terms. X's wife consumed milk, became infected and died. Y was liable for damages because the milk was not fit for human consumption [Frost v. Aylesbury Dairy Co. Ltd.].*

**CONDITION IMPLIED BY CUSTOM [SECTION 16(3)]**

Condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

**Example** *X sold certain drugs by auction to Y. In case of sale by auction, there was a trade custom to declare any sea damage in the goods. But the goods were sold without such declaration. Such goods were found to be sea damaged. It was held Y could reject the goods and claim the refund of the price because the sale without such declaration meant that the goods were free from any sea damage. [Jones v. Bowden]*

## 18.0 WHAT ARE THE IMPLIED WARRANTIES ?

### WARRANTY AS TO QUIET POSSESSION [SECTION 14(B)]

There is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. The reach of this warranty gives buyer a right to claim damages from the seller.

**Example** *X sold a second hand Radio to Y who spent ₹ 100 on the repairs of this radio. This radio was seized by the police as it was a stolen one. Y filed a suit against X for the recovery of damages for breach of warranty of quite possession including the cost of repairs. It was held that Y was entitled to recover the same. [Mason v. Birmingham]*

### WARRANTY OF FREEDOM FROM ENCUMBRANCES [SECTION 14(C)]

There is an implied warranty that the goods are free from any charge or encumbrance in favour of any third person if the buyer is not aware of such charge or encumbrance. The breach of this warranty gives buyer a right to claim damages from the seller.

**Example** *X borrowed ₹ 500 from Y and hypothecated his radio with Y as security. Later on X sold this radio to Z who bought in good faith. Here, Z can claim damages from X because his possession is disturbed by Y having a charge.*

### WARRANTY AS TO QUALITY OR FITNESS FOR A PARTICULAR PURPOSE WHICH MAY BE ANNEXED BY THE USAGE OF TRADE [SECTION 16(3)]

#### WARRANTY TO DISCLOSE DANGEROUS NATURE OF GOODS

In case of goods of dangerous nature the seller must disclose or warn the buyer of the probable danger. If the seller fails to do so, the buyer may make him liable for breach of implied warranty.

**Example** *X purchased a tin of disinfectant powder which required to be opened with special care. X's wife while opening the tin was injured as the powder flew into her eyes. Held, the seller was liable for the injury sustained by X's wife because of breach of warranty. [Clarke v. Army and Navy Cooperative Society Ltd. (1903) 1 KB 155]*

## 19.0 MEANING AND EXCEPTION TO THE DOCTRINE OF CAVEAT EMPTOR

<b>Meaning</b>	The expression ' <b>Caveat Emptor</b> ' means 'let the buyer beware.' The doctrine of caveat emptor has been given in the first para of Section 16 which reads as under:
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	<p><i>"Subject to the provisions of this Act and any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale".</i></p> <p>In other words, it is not part of the seller's duty to point out defects of the goods which he offers for sale, rather it is the duty of the buyer to satisfy himself about the quality as well as the suitability of the goods.</p> <p><b>Example</b> <i>Pigs were sold subject to all faults and the seller knew that the pigs were suffering from swine-fever but he did not inform the buyer about this defect. The seller was not liable for damages because there was no implied warranty. [Ward v. Hobbs]</i></p>
<b>Exceptions</b>	<p>The doctrine of <b>Caveat Emptor</b> is subject to the following exceptions:</p> <ul style="list-style-type: none"> <li>(a) <b>In Case of Misrepresentation by the Seller</b> Where the seller makes a misrepresentation and the buyer relies on that representation.</li> <li>(b) <b>In Case of Concealment of Latent Defect</b> Where the seller knowingly conceals a defect which would not be discovered on a reasonable examination.</li> <li>(c) <b>In Case of Sale by Description [Section 15]</b> Where the goods are sold by description and the goods supplied by the seller do not correspond to the description.</li> <li>(d) <b>In Case of Sale by Sample [Section 17]</b> Where the goods are sold by sample and the goods supplied by the seller do not correspond with the sample.</li> <li>(e) <b>In Case of Sale by Sample as well as Description [Section 15]</b> Where the goods are sold by sample as well as description and the goods supplied do not correspond with sample as well as description.</li> <li>(f) <b>Fitness for a Particular Purpose [Section 16(1)]</b> Where the seller or a manufacturer is a dealer of the type of goods sold by him and the buyer has disclosed the purpose for which goods are required and relied upon the seller's skill or judgement.</li> <li>(g) <b>Merchantable Quality [Section 16(2)]</b> Where the goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that goods shall be of merchantable quality.</li> </ul>
<b>Relevance</b>	<p>The rule of <b>Caveat Emptor</b> appeared to play an important role in the past when trade was conducted on local scale and the buyer had every opportunity to examine the goods before buying. However, in the modern context, the rigours of the rule have been mitigated because of global dimensions of trade, government legislations on consumer protection, professional management, intense competition and consumer awareness. In fact, the rule of caveat emptor should be replaced by the rule of '<b>caveat vendor</b>' (Let the seller beware).</p>



## 20.0 WHAT IS THE MEANING AND SIGNIFICANCE OF PASSING OF PROPERTY ?

### MEANING OF PASSING OF PROPERTY

Passing of property implies transfer of ownership and not the physical possession of goods. For example, where a principal sends goods to his agent, he merely transfers the physical possession and not the ownership of goods. Here, the principal is the owner of the goods but is not having possession of goods and the agent is having possession of goods but is not the owner.

### SIGNIFICANCE OF PASSING OF PROPERTY

The time of transfer of ownership of goods decides various rights and liabilities of the seller and the buyer. Thus, it becomes very important to know the exact time of transfer of ownership of goods from seller to buyer to answer the following questions:

- Q.1. *Who shall bear the risk:*** It is the owner who has to bear the risk and not the person who merely has the possession.
- Q.2. *Who can take action against third party:*** It is the owner who can take action and not the person who merely has the possession.
- Q.3. *Whether a seller can sue for price:*** The seller can sue for the price only if the ownership of goods has been transferred to the buyer.
- Q.4. *In case of insolvency of a buyer whether the official receiver or assignee can take the possession of goods from seller:*** The Official Receiver or Assignee can take the possession of goods from seller only if the ownership of goods has been transferred to the buyer.
- Q.6. *In case of insolvency of a seller whether the official receiver or assignee can take the possession of goods from buyer:*** The official receiver or assignee can take the possession of goods from buyer only if the ownership of goods has not been transferred to the buyer.

## 21.0 WHAT ARE THE RULES RELATING TO THE TRANSFER OF OWNERSHIP OF SPECIFIC GOODS OR ASCERTAINED GOODS ?

### MEANING OF SPECIFIC GOODS [SECTION 2(14)]

Specific goods mean goods identified and agreed upon at the time when a contract of sale is made.

### GENERAL RULE [SECTION 19(1)]

The ownership of specific goods or ascertained goods is transferred to the buyer at such time as the parties intend it to be transferred.

### ASCERTAINMENT OF THE INTENTION [SECTIONS 19(2), 19(3), 20, 21, 22, 23]

For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case [Section 19(2)]. Unless a different intention appears, the following rules are applicable [Section 19(3)]:

Case	Time when the ownership is transferred
<b>I. Where there is an unconditional contract for sale of specific goods in a deliverable state [Section 20]</b>  <b>Notes:</b> (i) <i>Unconditional contract means a contract containing no condition regarding the transfer of ownership.</i> (ii) <i>Deliverable state means such state that the buyer would be bound to take delivery of the goods under the contract.</i> (iii) <i>It is immaterial whether the time of payment of the price or the delivery of goods, or both is postponed.</i>	When the contract is made. [Refer to Example I]
<b>II. Where there is a contract for sale of specific goods not in a deliverable state [Section 21]</b>	When the goods are put into a deliverable state and the buyer has notice thereof. [Refer to Example II]  <b>Note:</b> Where the seller undertakes to put the goods on rail or any other means of transportation, the ownership shall remain with the seller till the goods are loaded. [Underwood Ltd. v. Burgh]
<b>III. Where there is a contract for sale of specific goods in a deliverable state but the seller has to do some act to ascertain the price [Section 22]</b>	When the seller has done that act to ascertain the price and the buyer has notice thereof. [Refer to Example III]

**Example I** X bought from Y a heap of wheat the weight of which is 1,000 kg at the rate of ₹ 8 per kg, and agrees to pay the price on the first day of the next month and the wheat is to be delivered at X's godown on the following day. A fire broke out and the entire quantity of wheat was destroyed. In this case X is liable to pay the price because the ownership of wheat has transferred from Y to X on making the contract even though the price has not been paid and the goods have not been delivered.

**Example II** X bought from Y a heap of wheat (weight 100 kg) at the rate of ₹ 8 per kg, and Y had to put the wheat in bags to deliver it to X. Y filled some bags in X's presence, but before the remainder could be filled, a fire broke out and the entire quantity of wheat was destroyed. In this case, X is liable to pay the price for the wheat which was put into bags because the ownership in respect of these goods has passed when Y has put the wheat in bags and the buyer has notice thereof. [Rugg v. Minett]

**Example III** X bought from Y a heap of wheat at a rate of ₹ 8 per kg and Y had to weigh the wheat. Before weighing was completed, the wheat was destroyed by fire. In this case, X is not liable to pay the price because the ownership of goods has not passed from Y to X. [Zagury v. Furnell]

## 22.0 WHAT ARE THE RULES RELATING TO THE TRANSFER OF OWNERSHIP OF UNASCERTAINED GOODS AND FUTURE GOODS?

### MEANING OF UNASCERTAINED GOODS

Unascertained goods means goods which have not been identified and agreed upon at the time when contract of sale is made.

### MEANING OF FUTURE GOODS [SECTION 2(6)]

Future goods means goods to be manufactured or produced or acquired by the seller after the making of the contract of sale.

### RULES RELATING TO THE TRANSFER OF OWNERSHIP [SECTIONS 18 AND 23]

The ownership of unascertained goods is transferred to the buyer when the following two conditions are fulfilled:

- (a) the goods must have been ascertained.  
**Note:** Ascertainment is the process of identifying the goods to be sold to the buyer. It is an unilateral act and is usually done by the seller alone.
- (b) the goods must have been unconditionally appropriated by the seller or the buyer with the consent of the other.

#### Notes:

- (i) Appropriation means an act involving the selection of goods with the intention of using the goods in performance of the contract.
- (ii) The consent of the seller or the buyer as to appropriation may be express or implied and may be given before or after the appropriation is made.
- (iii) Where the seller delivers the goods to the buyer or to a carrier or other bailee (whether named by the buyer or not) for the purpose of transmission to the buyer and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract.
- (iv) The contract to sell unascertained goods is not a complete sale. It is merely an agreement to sell.

**Example I** *X agreed to sell 100 bags of wheat to Y out of his stock of 500 bags. A fire broke out and the entire quantity of wheat was destroyed. State who shall bear the loss and why in each of the following alternative cases?*

- (a) If no bag had been separated before fire for the purposes of delivery to Y;
- (b) If 100 bags had been separated before fire with Y's consent.

#### Solution:

**Case (a):** X shall bear the loss because the ownership has not transferred to Y as the goods were not ascertained.

**Case (b):** Y shall bear the loss because the ownership has transferred to Y as the goods were ascertained.

**Example II** *X agreed to sell to Y the oil to be produced by him. The oil was filled by X into the bottles supplied by Y. Here, the ownership passed when the oil was filled into the bottles because the buyer gave his consent to the appropriation by supplying the bottles.*  
*[Langton v. Higgins]*

## 23.0 WHAT ARE THE RULES RELATING TO THE TRANSFER OF OWNERSHIP OF GOODS SENT 'ON APPROVAL' OR 'ON SALE OR RETURN' BASIS ?

### MEANING OF GOODS SENT 'ON APPROVAL'

Goods sent 'on approval' or 'on sale or return' basis mean those goods in respect of which the buyer has option either to return or retain.

### RULES RELATING TO THE TRANSFER OF OWNERSHIP

The various rules relating to the transfer of ownership of such goods have been given below.

Case	Time when the ownership is transferred
(a) When the buyer signifies his approval or acceptance	When the approval or acceptance is communicated to the seller.
(b) When the buyer does some act adopting the transaction	When the act of adoption is done.
(c) When the buyer fails to return the goods	
(i) If a time has been fixed for the return of goods	On the expiry of fixed time.
(ii) If no time has been fixed for the return of goods	On the expiry of the reasonable time.  <b>Note:</b> What is a reasonable time is a question of fact depending upon the facts and circumstances of each case.

**Example I** *X delivers some goods to Y on "Sale or return" for 7 days. State the legal position in each of the following alternative cases:*

- Case (a) such goods are destroyed by fire on the third day itself without any fault of Y.
- Case (b) Y informs X on telephone on the third day itself that he has accepted the goods and immediately after the receiver is put off, the goods are destroyed by fire.
- Case (c) such goods are further delivered by Y on the third day itself to Z and then by Z to A on similar terms. The goods are stolen while in the custody of A.
- Case (d) Y neither returns nor gives notice of rejection even after the expiry of 7 days. Goods are destroyed by fire on the eighth day.
- Case (e) Y retains the goods but gives the notice of rejection on the expiry of 7 days. Goods are destroyed by fire on the eighth day.

**Solution:**

Case (a): X shall bear the loss because the ownership has not yet passed to the buyer. [Elphick v. Barnes]

Case (b): Y shall bear the loss because the ownership has passed to the buyer.

Case (c): X can recover the loss from Y because the ownership passed to Y as Y has adopted the transaction by delivering the goods to Z. Y can recover the loss from Z because the ownership has passed to Z as Z has adopted the transaction by delivering the goods to A. Z cannot recover the loss from A because the ownership has not yet passed. [Genn v. Winkel]

Case (d): Y shall bear the loss because the ownership has passed to the buyer.

Case (e): X shall bear the loss because the ownership has not yet passed.

**Example II** *X delivered some jewellery to Y on 'sale or return' without specifying any time for its return in case of non-acceptance. State the legal position in each of the following alternative cases:*

Case (a) If Y pledges the jewellery with Z.

Case (b) If X makes it clear that the goods are to remain his property until paid for. Before Y pays the price, he pledges the jewellery with Z.

Case (c) If Y neither accepts nor rejects within one month and after a month a burglary takes place in Y 's house and the jewellery is stolen.

**Solution:**

Case (a): X can recover the price of the jewellery from Y because ownership has passed to Y as Y had adopted the transaction by pledging the jewellery with Z. But X cannot recover the jewellery from Z. [Kirkham v. Attenborough]

Case (b): X can recover the jewellery from Z because the pledge was not valid as the ownership has not yet transferred to Y. [Weiner v. Smith]

Case (c): X can sue Y for the price of the jewellery because a reasonable time to reject has expired. As such, the ownership has transferred to Y. [Hooghly Chinsurah Municipality v. Spence Ltd.]

**24.0 RESERVATION OF RIGHT OF DISPOSAL****CAN A SELLER RESERVE THE RIGHT OF DISPOSAL OF THE GOODS ? [SECTION 25(1)]**

Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may reserve the right of disposal of the goods until certain conditions are fulfilled.

### **WHEN OWNERSHIP IS TRANSFERRED IN CASE OF RESERVATION OF RIGHT OF DISPOSAL ? [SECTION 25(1)]**

In such a case, the ownership of goods will not be transferred to the buyer until the conditions imposed by the seller are fulfilled even if the goods have already been delivered to the buyer or to a carrier or other bailee for the purpose of transmitting the same to the buyer.

### **WHAT ARE THE MODES OF RESERVATION?**

The seller may reserve the right of disposal of goods either expressly or by implication. In the following two cases, the seller is deemed to have reserved the right of disposal to himself.

**1. In case of Goods Deliverable to the Order of Seller or his Agent [Section 25(2)]**

Where the goods are shipped or delivered to a railway administration for carriage and by the bill of lading or railway receipt, as the case may be, they are deliverable to the order of seller or his agent.

**Example** *X sold some goods to Y with the terms that the goods shall be sent by railway. The goods were destroyed in the course of journey. State the legal position (i) if railway receipt is taken in the name of X, (ii) if railway receipt is taken in the name of Y but is sent through Bank, (iii) if railway receipt is taken in the name of Y and is sent to him.*

**Solution:**

Cases (i) and (ii): X will have to bear the loss because the ownership has not yet been transferred. [*General Papers Ltd. v. P. Mohideen & Sons*]

Case (iii): Y will have to bear the loss because the ownership has already been transferred.

**2. In case of Drawing a Bill of Exchange [Section 25(3)]** Where the seller of goods draws on the buyer for the price of the goods and sends the bill of exchange together with the bill of lading or railway receipt, the ownership of goods will not be transferred to the buyer until the buyer honours the bill of exchange. The buyer must return the bill of lading or the railway receipt if he does not honour the bill of exchange, and if he wrongfully retains the bill of lading or the railway receipt, the ownership of goods will not be transferred.

**Example** *X sold some goods to Y, took the bill of lading in Y's name and drew a Bill of Exchange on Y and delivered bill of lading and Bill of exchange to his banker with the instruction to deliver the bill of lading to Y on his accepting and paying the amount of the bill. Initially, Y refused to accept the offer and sold the goods to Z. It was held that the banker was liable to Y for making the wrongful sale to Z because the ownership was transferred to Y when he offered to pay the amount. [*Mirabita v. Imperial Ottoman Bank*]*

**25.0 DOES RISK PRIMA FACIE PASS WITH PROPERTY****MEANING OF GENERAL RULE**

Risk means the liability to bear the loss if the goods are lost or damaged. The general rule is that the risk follows ownership. In other words, risk and ownership go together. This general rule implies that it is the owner of the goods who has to bear the loss and not the person who merely has the possession of goods. Thus, this general rule can be summarised as under:

Case	Party who has to bear the loss
<b>(a) If the ownership has not been transferred to the buyer.</b>	The seller has to bear the loss because he is the owner at the time of loss.
<b>(b) If the ownership has been transferred to the buyer</b>	The buyer has to bear the loss because he is the owner at the time of loss. It is immaterial whether delivery has been made or not.

**Example I** *X selects some books from Y's books shop and agrees to pay the price after 20 days and the books are to be delivered at X's house on the following day. These books were destroyed as a result of fire in the shop. The loss is to be borne by X because at the time of loss of books, he had become the owner of the books even if the delivery has not been made and the price has not been paid.*

**Example II** *X selects some books from Y's book shop and asks the seller whether he can return after 2 days if he does not like. The seller agrees but asks the buyer to deposit the price of those books. The buyer agrees thereto. On the very same day, the books were destroyed as result of fire in X's house. The loss is to be born by Y because at the time of loss of books, he was the owner of the books even if the delivery has been made.*

**EXCEPTIONS TO THE GENERAL RULE 'RISK FOLLOWS OWNERSHIP'**

The general rule that the risk follows the ownership is subject to the following two exceptions:

- (a) Agreement to the Contrary** Where the parties have made an agreement to the contrary.

**Example** *X sold goods to Y with the term that the goods shall be sent by railway and during the transit the goods shall be the property of the seller but they shall be at the risk of the buyer. During the transit the goods were destroyed by an accident. Here Y will have to bear the loss though the ownership of the goods is with X. [M. Champalal v. C.P. Shah]*

- (b) Delayed Delivery** Where the delivery has been delayed through the fault of either buyer or seller, the party in fault has to bear the loss which might not have occurred but for such fault.

**Example** *X contracted to sell 100 tons of apple juice to Y. X crushes the apples, puts juice in corks and keeps them ready for delivery. Y took the delivery of part*

*of the juice but made a default to accept the remaining juice. The juice became unfit for consumption. Y will have to bear the loss. [Demby Hamilton & Co. Ltd. v. Barden]*

(c) **Usage of Trade** Risk and ownership may be separated by usage of trade.

### NO EFFECT ON DUTIES AS A BAILEE

This general rule shall not affect the duties or liabilities of the seller or the buyer as bailee of goods for the other party even when the risk has passed.

## 26.0 IS SALE BY NON-OWNERS VALID?

### MEANING OF GENERAL RULE

The general rule is expressed by the latin maxim "Nemo dat quod non habet," which means that "no one can give what he does not himself possess." If the seller's title to the goods is defective, the buyer's title will also be defective because the buyer acquires his title to the goods from the seller. Hence, the seller cannot give a better title to the buyer than he himself has.

**Example** *X stole a TV and delivered it to Y, an auctioneer. Y sold the TV to Z at auction. It was held that Z obtained no title to the TV because X had no title to it. [Leo v. Byes]*

### EXCEPTIONS TO THE GENERAL RULE 'NAMO DAT QUOD NON HABET'

The circumstances under which a seller can give a better title than what he himself has are discussed below:

#### 1. Sale by a Mercantile Agent [Section 27]

- (i) The agent must be in possession of goods or a document title (e.g., Railway receipt, Bill of Lading) to the goods with the consent of the owner.
- (ii) The agent must have sold the goods in the ordinary course of business as a mercantile agent.
- (iii) The buyer must have acted in good faith.
- (iv) The buyer must have no knowledge that the seller had no authority to sell.

**Example** *P, the owner of the car instructed an agent A to sell his car at not less than ₹ 50,000. But A sold the car to B for ₹ 40,000 and misappropriated the money. B acted in good faith and without notice of the above instruction to agent. Here, B got a good title to the car and the real owner P cannot recover the car from B. [Folkes v. King]*

#### 2. Sale by one of the Joint Owners [Section 28]

- (i) The joint owner must be in the sole possession of goods with the consent of other co-owners.
- (ii) The buyer must have bought the goods in good faith.
- (iii) The buyer must have no knowledge that the seller had no authority to sell.



**Example** *X, Y and Z were the co-owners of some goods. X was in the possession of those goods with the consent of Y and Z. X sold those goods to B who bought them in good faith and without notice that X had no authority to sell. In this case, B got a good title to the goods and Y and Z cannot recover the goods from B.*

### 3. Sale by a Person in possession under voidable contract

- (i) The seller must be in possession of goods under a contract voidable u/s 19 or 19A of Indian Contract Act, 1872 on ground of coercion, undue influence, misrepresentation or fraud.
- (ii) The goods must have been sold before the contract is rescinded.
- (iii) The buyer must have bought the goods in good faith.
- (iv) The buyer must have no knowledge that the seller's title is defective.

**Example** *X, by fraud obtained the possession of a diamond ring from Y. X sold the ring to B before Y rescinded the contract. B bought the ring in good faith and without notice of X's defective title. B got a good title and Y cannot recover the ring from B. [Phillips v. Brooks]*

### 4. Sale by a Seller in possession after sale [Section 30(1)]

- (i) The seller must be in possession of goods or of a document of title to the goods, in the capacity of a seller and not in any other capacity such as bailee.
- (ii) The buyer must have bought the goods in good faith.
- (iii) The buyer must have no knowledge about the previous sale.

**Example** *X sold two TV sets to Y with the terms that one to be delivered immediately and another to be delivered after 2 days. Later on, Y delivered the first TV to X for some minor repair. X resold the first TV to P and the second to Q. Both P and Q bought in good faith and without notice of the previous sale.*

*Here, Q got a good title to the TV but P did not get good title because X was in the possession of TV in the capacity of a bailee and not in the capacity of a seller.*

### 5. Sale by a Buyer in possession before the transfer of ownership [Section 30(2)]

- (i) The buyer must be in possession of the goods or a document of title to the goods, with the consent of the original seller and must have bought or agreed to buy the goods.
- (ii) The new buyer must have bought the goods in good faith.
- (iii) The new buyer must have no knowledge about any lien or other right of the original seller in respect of goods.

**Example** *X takes the delivery of a furniture from Y under an agreement which provides for (a) an immediate down payment of ₹ 300, (b) the balance by way of 12 monthly instalments of ₹ 100 each, (c) transfer of ownership on the payment of last instalment, (d) Y's right to repossess the goods in case of non-payment of instalments due. Before the 12th instalment was paid, X sold the furniture to Z. Can Y recover the furniture from Z? State your answer in each of following cases.*

Case (a): If the agreement does not provide for any other stipulation.

Case (b): If the agreement also provides that X can return the goods.

**Solution:**

Case (a): Y cannot recover the furniture from Z because it was a contract of sale (as X was not having any option to return but was under compulsion to buy) and not hire-purchase agreement.

Case (b): Y can recover the furniture from Z because it was a hire-purchase agreement (as X was having an option to return) and hence, X was not having any title to it.

**Note:** A buyer (being hirer in case of a hire purchase agreement) cannot transfer a valid title to the new buyer because an 'option to buy' does not amount to an 'agreement to buy'.

**6. Sale by an Unpaid Seller [Section 54(3)]**

An unpaid seller must have exercised his right of lien or stoppage in transit.

**7. Sale by a Finder of Goods [Section 169 of Indian Contract Act 1872]**

- (i) The owner cannot be found with reasonable diligence; or
- (ii) The owner, if found, refuses to pay the lawful charges of finder; or
- (iii) If the goods are in danger of perishing or of losing the greater part of its value; or
- (iv) If the lawful charges of the finder in respect of the thing found amount to two-thirds of its value.

**8. Sale by a Pawnee or Pledgee**

- (i) The pawnor or pledger must have made a default in the payment of the debt or the performance of the promise at the stipulated time.
- (ii) The pawnee or pledgee must have given a reasonable notice to the pawnor or pledger.

**9. Sale by Official Receiver or Assignee or Liquidator**

The involuntarily person must be the owner of goods.

**10. Sale by Owner by Estoppel**

The owner of the goods by his statement or conduct must have led the buyer to believe that the seller has the authority to sell.

**Example** X told Y, a buyer in the presence of Z that he (X) is the owner of the TV. But Z remained silent though the TV belonged to him. Y bought the TV from X. Here, Y will get a valid title to the TV even though X had no title to the TV because Z by his own conduct is prevented from denying X's authority to sell the TV.

## 27.0 DELIVERY

### MEANING OF DELIVERY [SECTION 2(2)]

Delivery means the voluntary transfer of possession from one person to another.

**MODE OF DELIVERY [SECTION 33]**

Delivery of goods may be made—

- (a) by doing anything which the parties agree shall be treated as delivery, or
- (b) by doing anything which has the effect of putting the goods into the buyer's or his authorised agent's possession.

**THREE TYPES OF DELIVERY**

The delivery of goods may be of the following three types:

<b>1. Actual Delivery</b>	Delivery is said to be actual where the goods are physically handed over to the buyer or his authorised agent.  <b>For example</b> , X sells to Y 100 bags of wheat lying in Z's warehouse. X orders Z to deliver the wheat to Y. Z delivers to Y. In this case there is an actual delivery of goods.
<b>2. Symbolic Delivery</b>	Delivery is said to be symbolic where some symbol of the real possession or control over the goods is handed over to buyer. <b>For example</b> , X sells to Y 100 bags of wheat lying in Z's warehouse and hands over the key of Z's warehouse to Y. In this case, there is symbolic delivery of goods.
<b>3. Constructive Delivery</b>	Delivery is said to be constructive where a person who is in possession of the goods, acknowledges to hold the goods on behalf of the buyer. <b>For example</b> , X sells to Y 100 bags of wheat lying in Z's warehouse. Y orders Z to deliver the wheat to Y. Z agrees to hold the 100 bags of wheat on behalf of Y and makes the necessary entry in his books. In this case, there is constructive delivery of goods.

**RULES AS TO DELIVERY [SECTIONS 32 TO 39]**

The various rules as to delivery have been discussed below:

- 1. Payment and Delivery to be Concurrent [Section 32]** Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller must be ready and willing to give possession of the goods to the buyer and the buyer must be ready and willing to pay the price.
- 2. Mode of Delivery [Section 33]** Delivery must have the effect of putting the goods into the buyer's or his authorised agent's possession.
- 3. Effect of Part Delivery [Section 34]** A delivery of part of goods with an intention of giving the delivery of the whole amounts to the delivery of the whole for the purpose of transfer of ownership of goods, but a delivery of part of goods with an intention of separating it from the whole lot does not amount to the delivery of the whole of the goods.
- 4. Buyer to Apply for Delivery [Section 35]** Unless otherwise agreed, the seller of the goods is not bound to deliver them until the buyer applies for delivery.

5. **Place of Delivery [Section 36(1)]** The various rules as to the place of delivery are summarised as under:

Case	Place at which goods are to be delivered
1. Where there is a contract as to the place of delivery	At the agreed place.
2. Where there is no contract as to the place of delivery	
(a) In case of sale	At the place at which the goods are at the time of sale.
(b) In case of an agreement to sell	
(i) in respect of existing goods	At the place at which the goods are at the time of agreement to sell.
(ii) in respect of future goods	At the place at which the goods are manufactured or produced.

6. **Time of Delivery [Section 36(2)]** The various rules as to the time of delivery are summarised as under:

Case	Time within which goods are to be delivered
(a) Where there is a contract as to the time of delivery	Within the time agreed.
(b) Where there is no contract as to the time of delivery	Within the reasonable time. <b>Note:</b> What is a reasonable time is a question of fact depending upon the facts and circumstances of each case.

7. **Delivery when the Goods are in Possession of a Third Party [Section 36(3)]**  
Where the goods at the time of sale are in the possession of a third person, there is no delivery by seller unless and until such third person acknowledges to the buyer that he holds the goods on his behalf. However, this provision shall not affect the operation of the issue or transfer of any document of title to goods.
8. **Demand of Delivery to be Treated as Ineffectual [Section 36(4)]** Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour. What is a reasonable hour is a question of fact.
9. **Expenses of Delivery [Section 36(5)]** Unless otherwise agreed, the expenses of putting the goods into a deliverable state shall be borne by the seller.
10. **Delivery of Wrong Quantity [Section 37]** Subject to any usage of trade, special agreement or course of dealing between the parties, the rules as to the delivery of wrong quantity are summarised below:

Case	Rights available to the buyer
<b>I. Short delivery, i.e., where the seller delivers a quantity of goods less than contracted for</b>	(a) The buyer may accept the goods so delivered, or (b) The buyer may reject the goods.
<b>II. Excess delivery, i.e., where the seller delivers a quantity of goods larger than contracted for</b>	(a) The buyer may accept the goods so delivered, (b) The buyer may reject the whole, or (c) The buyer may accept the contracted quantity and reject the excess.
<b>III. Mixed delivery, i.e., where the seller delivers the goods contracted for mixed with goods of different description</b>  <b>Note:</b> <i>The mixing of goods with inferior quality does not amount to mixing of goods of different description. [Harnarain v. M/s Radha Krishan Naraindas]</i>	(a) The buyer may reject the whole, or (b) The buyer may accept the goods which are in accordance with the contract and reject the rest.

**Notes:**

- (i) The buyer may not be allowed to reject the goods in case of negligible short or excess delivery.
  - (ii) In case of short or excess delivery if the buyer rejects the whole quantity, the contract is not treated as cancelled. The seller still has the right to tender again the quantity of goods as per contract and the buyer is bound to accept the same. [*Vilas Udyog Ltd. v. Prag Vanaspati Products*]
- 11. Delivery by Instalments [Section 38]** Unless otherwise agreed, the buyer of goods is not bound to accept delivery by instalments.
- The question whether the aggrieved party can repudiate the whole contract or not depends upon the terms of the contract and the circumstances of each case where-
- (i) The goods are to be delivered in instalments;
  - (ii) The instalments are to be separately paid for;
  - (iii) The seller makes no delivery or defective delivery in respect of one or more instalments, or the buyer neglects or refuses to take delivery of or pay for one or more instalments.
- 12. Delivery to Carrier or Wharfinger [Section 39]** Where the seller is authorised or required to send the goods to the buyer, delivery of the goods to carrier (whether named by the buyer, or not) for the purpose of transmission to the buyer, or delivery of the goods to wharfinger custody, is prima facie deemed to be a delivery of the goods to the buyer [Section 39(1)]. The seller is further required to perform the following two duties also.

- (a) **To make a reasonable contract with the carrier or wharfinger:** Unless otherwise authorised by the buyer, the seller shall make a reasonable contract with the carrier or wharfinger on behalf of the buyer. If the seller omits to do so, and the goods are lost or damaged in course of transit or whilst in the custody of the wharfinger, the buyer may decline to treat the delivery to the carrier or wharfinger as a delivery to himself, or may hold the seller irresponsible for damages [Section 39(2)].
- (b) **To give notice to the buyer to enable him to insure the goods:** Unless otherwise agreed, where goods are sent by the seller to the buyer by a route involving sea transit, in circumstances in which it is usual to insure, the seller must inform the buyer to enable him to insure them during their sea transit, and if the seller fails to do so, the goods shall be deemed to be at his risk during such transit [Section 39(3)].

**Example** X agrees to sell 100 tons of 'Basmati' rice to Y at ₹ 40,000 per ton. State the legal position in each of the following alternative cases:

Case (a) If X delivers 8 tons of Basmati rice.

Case (b) If X delivers 12 tons of Basmati rice.

Case (c) If X delivers 10 tons of Basmati rice and 2 tons of Dehraduni rice.

Case (d) If X delivers 10 tons of Basmati rice of which 2 tons of inferior quality.

Case (e) If X delivers 8 tons of Basmati rice in April and the remaining 2 tons in the first week of May.

Case (f) If X delivers 10 tons of Basmati rice at Y's godown. Y refuses to accept them and neither returns nor informs the seller that he refused to accept the goods.

Case (g) If X delivers 10 tons of Basmati rice at Y's godown. Y refuses to accept them and inform the seller about his intention but does not return the goods.

Case (h) If X is ready to deliver but Y refuses to take delivery and repudiates the contract.

Case (i) If X delivers 10 tons of Basmati rice and Y resells the rice to Z. When the rice are delivered to Y, he inspected a sample of it and sends it to Z. Z rejects it as not having according to sample. Y rejects the goods.

Case (j) If X delivers 10 tons 1 kg of Basmati rice and does not charge the buyer with excess quantity.

**Solution:**

Case (a): Y has two options: (i) he can reject the goods or (ii) he can accept the goods. [Beck etc. v. Synzmanoski]

Case (b): Y has three options, (i) he can reject the whole, (ii) he can accept the whole, or (iii) he can accept 10 tons and can reject 2 tons. If he accepted 12 tons, he must pay for them at the contract rate. [Cunliffe v. Harrison]

Case (c): Y has two options: (i) he can reject the whole or (ii) he can accept 10 tons of Basmati rice and can reject 2 tons of Dehraduni rice. [London Plywood Ltd. v. Nasik Oak Ltd.]

Case (d): Y has two options: (i) he can accept the whole, or (ii) he can accept 8 tons of Basmati rice of superior quality and can reject 2 tons of Basmati rice of interior quality.

It may be noted that Y cannot reject the whole because mixing of goods with inferior quality does not amount to mixing of goods of different description.

*[Hamarain v. M/s Radha Krishan Naraindas]*

Case (e): Y can reject the whole lot of 10 tons because he is not bound to accept delivery in instalments. *[Renter v. Sala]*

Case (f): Y is deemed to have accepted the goods after a lapse of reasonable time

Case (g): Y is not deemed to have accepted the goods because he has informed the seller about his intention.

Case (h): X can sue Y for price and for damages.

Case (i): Y's act in inspecting the sample and then sending the rice to Z was an acceptance and he could not afterwards reject it. *[Perkins v. Bell]*

Case (j): Y is not entitled to reject the whole quantity of what because the excess delivery of 1 kg was so trivial as to be wholly insignificant. *[Shipton Anderson & Co. v. Weil Brothers & Co. Ltd.]*

### **ACCEPTANCE OF DELIVERY [SECTION 42]**

Delivery does not amount to acceptance of goods. Acceptance is something more than mere receipt of goods by the buyer. It means the final assent by the buyer that he has received the goods under, and in performance of the contract of sale. The buyer is deemed to have accepted the goods under the following circumstances:

- (a) When he intimates to the seller that he has accepted the goods, or
- (b) When the goods have been delivered to him and he does any act in relation to them which shows that he has accepted them (for example resale or pledge of goods by buyer), or
- (c) When he does not inform the seller that he has rejected the goods and retains the goods beyond a reasonable time.

### **DUTIES AND LIABILITIES OF BUYER [SECTIONS 43 AND 44]**

The duties and liabilities of buyer in various cases are as under:

Case	Duties and liabilities of buyer
<b>(a) Where the goods are delivered to the buyer and he refuses to accept them</b>	The buyer must inform the seller that he refuses to accept them.
<b>(b) Where the seller is ready and willing to deliver the goods and requests the buyer to take delivery and the buyer does not, take delivery of goods within a reasonable time after such request.</b>	The buyer is liable to the seller for—

## 28.0 WHAT IS THE MEANING OF AN UNPAID SELLER?

The seller of goods is deemed to be 'unpaid seller'-

- (a) When the whole of the price has not been paid or tendered.
- (b) When a bill of exchange or other negotiable instrument (such as cheque) has been received as conditional payment, and it has been dishonoured [Section 45(1)].

The term 'seller' includes any person who is in the position of a seller (for instance, an agent of the seller to whom the bill of lading has been endorsed, or a consignor or agent who has himself paid, or is directly responsible for the price) [Section 45(2)].

### Notes:

- (i) The seller shall be called an unpaid seller even when only a small portion of the price remains to be paid.
- (ii) It is for the non-payment of the price and not for other expenses, that a seller is termed as an unpaid seller.
- (iii) Where the goods have been sold on credit, the seller cannot be called as an unpaid seller during the credit period unless the buyer becomes insolvent. On the expiry of credit period if the price remains unpaid, then only the seller will become an unpaid seller.
- (iv) Where the full price has been tendered by the buyer and the seller has refused to accept it, the seller cannot be called as unpaid seller.

**Example** *State whether the seller is an unpaid seller or not in each of the following alternative cases:*

- Case (a) X sold some goods to Y for ₹ 10,000. Y paid ₹ 9,900 but failed to pay the balance.
- Case (b) X sold some goods to Y for ₹ 10,000 and received a cheque for the full price as conditional payment. On presentment, the cheque was dishonoured by the Bank.
- Case (c) X sold some goods to Y for ₹ 10,000 on a credit of one month. One month has not yet expired.
- Case (d) X sold some goods to Y for ₹ 10,000 on a credit of one month and one month has expired and the price remains unpaid.
- Case (e) X sold some goods to Y for ₹ 10,000 on a credit of one month. Y became insolvent during the period of credit.

### Solution:

- Case (a) X is an unpaid seller because the full price has not been paid.
- Case (b) X is an unpaid seller because the cheque received as conditional payment has been dishonoured.
- Case (c) X is not an unpaid seller because the credit period has not yet expired and the buyer has not yet become insolvent.



Case (d) X is an unpaid seller because the price remains unpaid even after the expiry of credit period.

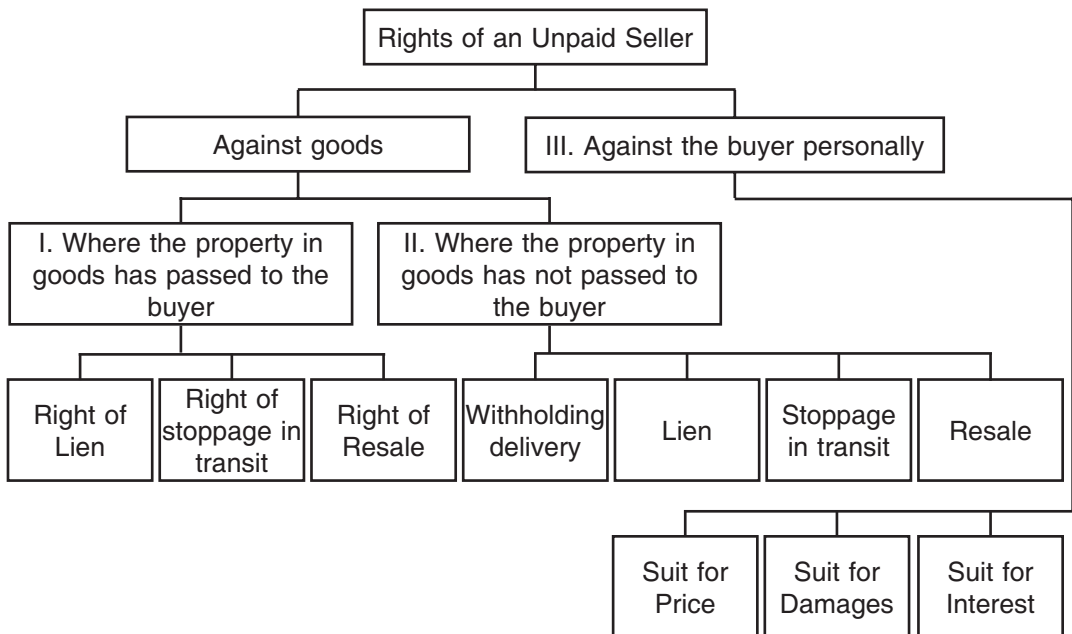
Case (e) X is an unpaid seller because the buyer has become insolvent.

### **RIGHTS OF AN UNPAID SELLER [SECTIONS 46-52, 54-56, 60-61]**

The rights of an unpaid seller can broadly be classified under the following two categories:

- I. Rights against the goods
- II. Rights against the buyer personally

The various rights of an unpaid seller have been shown.



## **29.0 RIGHT OF LIEN**

### **MEANING OF RIGHT OF LIEN**

The right of lien means the right to retain the possession of the goods until the full price is received.

### **THREE CIRCUMSTANCES UNDER WHICH RIGHT OF LIEN CAN BE EXERCISED [SEC. 47(1)]**

The unpaid seller of goods who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases, namely:

- (i) Where the goods have been sold without any stipulation to credit;
- (ii) Where the goods have been sold on credit, but the term of credit has expired; and
- (iii) Where the buyer becomes insolvent.

**OTHER PROVISIONS REGARDING RIGHT OF LIEN [SECTIONS 47(2), 48, 49(2)]**

- (i) The seller may exercise his right of lien, even if he possesses the goods as agent or bailee for buyer [Section 47(2)].
- (ii) Where an unpaid seller has made part delivery of the goods, he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstances as to show an agreement to waive the lien [Section 48]. In other words, in case of part delivery, this right of lien can be exercised only where part delivery is not intended as delivery of the whole.
- (iii) The seller may exercise his right of lien even though he has obtained a decree for the price of the goods [Section 49(2)].

**CIRCUMSTANCES UNDER WHICH RIGHT OF LIEN IS LOST  
[SECTIONS 49(1) AND 53(1)]**

The unpaid seller loses his right of lien in the following cases:

- (i) When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods [Section 49(1)(a)].
- (ii) When the buyer or his agent lawfully obtains possession of the goods [Section 49(1)(b)].
- (iii) When the seller waives his right of lien [Section 49(1)(c)].
- (iv) When the buyer disposes of the goods by sale or in any other manner with the consent of the seller [Section 53(1)].
- (v) Where document of title to goods has been issued or lawfully transferred to any person as buyer or owner of the goods and that person transfers the document by way of sale, to a person who takes the document in good faith and for consideration. [Proviso to Section 53(1)].

**Example** *State whether a right of lien can be exercised in each of the following alternative cases:*

- Case (a) X sold goods to Y for ₹ 10,000 without any stipulation as to credit and the price remains unpaid.
- Case (b) X sold goods to Y for ₹ 10,000 on a credit of 1 month and the period of credit has expired.
- Case (c) X sold goods to Y for ₹ 10,000 on a credit of 1 month and Y became insolvent during the period of credit.
- Case (d) X of Delhi, sold goods to Y of Mumbai for ₹ 10,000 and delivered the same to the railway for the purpose of transmission to the buyer. The railway receipt was taken in the name of Y and sent to Y.
- Case (e) X sold goods to Y for ₹ 10,000 and Y's agent lawfully took the delivery of goods.
- Case (f) X sold goods to Y for ₹ 10,000 and expressly waived his right of lien.

- Case (g) X sold 10 tons of wheat to Y for ₹ 1,00,000 and Y resold 8 tons of wheat out of 10 tons to Z. Y instructed X to deliver 8 tons of wheat to Z. Y then became insolvent.
- Case (h) X of Delhi sold some goods to Y of Mumbai and took the railway receipt in his own name and sent the railway receipt to his agent.
- Case (i) X of Delhi sold some goods to Y of Mumbai and took the railway receipt in the name of Y and it was sent by X to his agent.

**Solution:**

- Case (a): Yes, because the price has not been paid.
- Case (b): Yes, because the term of credit has expired and the price remains unpaid.
- Case (c): Yes, because the buyer has become insolvent.
- Case (d): No, because the delivery to the carrier prima facie amounts to the delivery to the buyer himself and the right of disposal of the goods has not been reserved as the railway receipt has been sent to buyer [Section 49(1)(a)].
- Case (e): No, because buyer's agent has lawfully taken the delivery of the goods [Section 49(1)(b)].
- Case (f): No, because seller has waived his right of lien [Section 49(1)(c)].
- Case (g): X can exercise his right of lien only against 2 tons of wheat and not against 8 tons of wheat.
- Case (h): Yes, because the seller is deemed to have reserved the right of disposal of the goods by sending the railway receipt to his own agent.
- Case (i): Yes, because the seller is deemed to have reserved the right of disposal by sending the railway receipt to his own agent.

**30.0 RIGHT OF STOPPAGE OF GOODS IN TRANSIT****MEANING OF RIGHT OF STOPPAGE OF GOODS IN TRANSIT**

The right of stoppage in transit means the right of stopping the goods while they are in transit, to regain possession and to retain them till the full price is paid. Lord Cairns LJ in case of *Schotsmans v. Lances and Yorks Rly.* had made the following observation in this regard:

"The essential feature of stoppage in transit is that the goods should be in the possession of a middleman or some other person intervening between the vendor who has parted with and the purchaser who has not received them."

**CONDITIONS UNDER WHICH RIGHT OF STOPPAGE IN TRANSIT CAN BE EXERCISED [SECTION 50]**

The unpaid seller can exercise the right of stoppage in transit only if the following conditions are fulfilled:

- (i) The seller must have parted with the possession of goods, i.e., the goods must not be in the possession of seller.
- (ii) The goods must be in the course of transit.
- (iii) The buyer must have become insolvent.

**Note:** The buyer is said to be insolvent when he has ceased to pay his debts in ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not.

**Note:** The seller's right of stoppage in transit is based on the principle that one man's goods shall not be applied to the payment of other man's debt. [*Lord Reading in Booth Steamship Co Ltd. v. Cargo Fleet Iran Co.*]

### **DURATION OF TRANSIT [SECTION 51(1)]**

Goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent in that behalf takes delivery of them from such carrier or other bailee.

**Note:** The carrier must hold the goods in the capacity of an independent person and not in the capacity of an agent for the seller or buyer. If the carrier holds the goods as an agent for the seller, there is no question of exercising the right of stoppage in transit because the seller can exercise his right of lien. If the carrier holds the goods as an agent for the buyer, the seller cannot exercise the right of stoppage in transit because the delivery to the carrier amounts to delivery to buyer.

### **CIRCUMSTANCES UNDER WHICH RIGHT OF STOPPAGE IS LOST [SECTIONS 51 AND 53(1)]**

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

- (i) If the buyer or his agent in that behalf obtains delivery of the goods before their arrival at the appointed destination [Section 51(2)].
- (ii) If, after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on his behalf and continues in possession of them as bailee for the buyer or his agent, even if a further destination for the goods may have been indicated by the buyer [Section 51(3)].
- (iii) When goods are delivered to a ship chartered by the buyer, it is a question depending on the circumstances of the particular case, whether goods are in the possession of the master as a carrier or as agent of the buyer [Section 51(5)].
- (iv) Where the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent in that behalf [Section 51(6)].
- (v) Where part delivery of the goods has been made to the buyer or his agent in that behalf, the remainder of the goods may be stopped in transit and such part delivery has not been given in such circumstances as to show an agreement to give up possession of the whole of the goods [Section 51(7)].

- (vi) Where the sub-sale or other disposition by the buyer has been done with seller's consent [Section 53(1)].
- (vii) Where a document of title to goods (e.g., bill of lading or railway receipt) has been issued or lawfully transferred to any person as buyer and that person transfers the document by way of sale to a person who takes the document in good faith and for consideration [Provision to Section 53(1)].

### **HOW TO EXERCISE RIGHT OF STOPPAGE IN TRANSIT [SECTION 52(1)]**

The unpaid seller may exercise his right of stoppage in transit in anyone of the following two ways:

- (i) by taking actual possession of the goods, or
- (ii) by giving notice of his claim to the carrier or other bailee who possesses the goods.

Such notice may be given either to the person in actual possession of the goods or to his principal. In the latter case, the notice to be effectual shall be given at such time and in such circumstances that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time to prevent a delivery to the buyer.

### **DUTY OF CARRIER [SECTION 51(2)]**

When notice of stoppage in transit is given by the seller to the carrier or other bailee in possession of the goods, he shall redeliver the goods to or according to the directions of the seller. The expenses of such redelivery shall be borne by the seller.

### **31.0 DISTINCTION BETWEEN RIGHT OF LIEN AND RIGHT OF STOPPAGE IN TRANSIT**

<b>Basis of Distinction</b>	<b>Right of Lien</b>	<b>Right of Stoppage in transit</b>
<b>1. Possession of goods</b>	The goods must be in actual possession of the seller.	The goods must be in the possession of a carrier or other bailee who is acting as an independent person.
<b>2. Solvency</b>	The right can be exercised even when the buyer is solvent but refuses to pay the price.	This right can be exercised only when the buyer has become insolvent.
<b>3. End vs. Commencement on delivery to carrier</b>	This right comes to an end when the seller delivers the goods to a carrier.	This right commences only when the seller delivers the goods to a carrier.
<b>4. Purpose</b>	The purpose of right is to retain possession of the goods.	The purpose of this right is to regain the possession of the goods.
<b>5. Mode of exercising the right</b>	This right can be exercised by the seller himself.	This right can be exercised by the seller through the carrier or the other bailee.

**Right of Stoppage in Transit as an Extension of the Right of Lien:** The right of stoppage in transit is an extension of the right of lien in the sense that the right of stoppage in transit begins when the right of lien ends and the purpose of the right of stoppage in transit is to regain possession of the goods.

## 32.0 EFFECT OF SUB-SALE OR PLEDGE BY BUYER

### GENERAL RULE

The unpaid seller's right of lien or stoppage in transit is not affected by any sale or other disposition of the goods by the buyer [Section 52(1)].

**Example** *X sold 10 tons of wheat to Y for ₹ 1,00,000. Y resold 8 tons of wheat out of 10 tons to Z and instructed X to deliver 8 tons of wheat to Z. X delivered 5 tons of wheat to Z. Later on when Y did not pay the price, X refused to make further deliveries to Z. It was held that X was entitled to refuse further delivery of oil to Z. [Mordaunt Bros. v. The British Oil & Cake Mills Ltd.]*

### EXCEPTIONS TO THE GENERAL RULE

There are two exceptions to the aforesaid rule as under:

1. Where the sub-sale or other disposition by the buyer has been done with the consent of the seller;
2. Where a document of title to goods (e.g., bill of lading or railway receipt) has been issued or lawfully transferred to any person as buyer and that person transfers the document by way of sale to a person who takes the document in good faith and for consideration.

## 33.0 RIGHTS OF UNPAID SELLER IN CASE OF TRANSFER OF DOCUMENT BY WAY OF PLEDGE

- (i) Where the transfer was by way of pledge or other disposition for value, the unpaid seller's right of lien or stoppage in transit can only be exercised subject to rights of the transferee.
- (ii) Where the transfer is by way of pledge, the unpaid seller may require the pledgee to have the amount secured by the pledge satisfied in the first instance, as far as possible, out of any other goods or securities of the buyer in the hands of the pledgee and available against the buyer.

**Example** *X of Delhi sold some goods to Y of Mumbai and took the railway receipt in the name of Y and sent to Y. State whether a right of stoppage in transit can be exercised in each of the following alternative cases:*

Case (a) Before the goods reach Mumbai, Y became insolvent.

Case (b) When the goods reached Mumbai, Y asked the railways to carry them to Calcutta. In the meantime Y became insolvent.

Case (c) When the goods reached Mumbai, the railway officials inform Y that the goods are lying at the station at Y's risk. Y became insolvent in the meantime.

Case (d) Y handed over railway receipt to Z in return for a loan. Z took the railway receipt in good faith and for consideration. Before the goods reach Mumbai, Y became insolvent.

Case (e) Before the goods reach Mumbai, Y became insolvent. Y assigned the railway receipt for ₹ 10,000 to Z who knew about the Y's insolvency.

Case (f) Y assigned the railway receipt to Z to borrow ₹ 10,000 on the security of railway receipt. Before the goods reach Mumbai, Y became insolvent.

**Solution:**

Case (a): Yes, because the goods are still in transit [Section 50].

Case (b): No, because the transit came to an end when Y asked the railways to carry the goods to Kolkata [Section 51(2)].

Case (c): No, because the transit came to end when the railway official informed Y that the goods are lying at Y's risk [Section 51(3)].

Case (d): No, because the transfer was by way of sale and Z took the railway receipt in good faith and for valuable consideration and hence, Z got a good title [Section 53(1)].

Case (e): Yes, because Z has not acted in good faith and hence, Z did not get a good title [Section 53(1)].

Case (f): Yes, but subject to rights of Z. In other words, X can get back the railway receipt after paying ₹ 10,000 to Z [Section 53(2)].

### **34.0 RIGHT OF RESALE [SECTIONS 46(1) AND 54]**

#### **WHAT ARE CIRCUMSTANCES UNDER WHICH AN UNPAID SELLER CAN RESELL THE GOODS?**

An unpaid seller can resell the goods under the following three circumstances:

- (i) Where the goods are of a perishable nature.
- (ii) Where the seller expressly reserves a right of resale if the buyer commits a default in making the payment.

**Note:** As a result of this resale, the original contract will be terminated but the seller will have a right to claim damages [Section 54(4)].

- (iii) Where the unpaid seller who has exercised his right of lien or stoppage in transit gives a notice to the buyer about his intention to resell and buyer does not pay or tender within a reasonable time.

#### **EFFECTS OF RESALE WITH OR WITHOUT NOTICE [SECTIONS 54(2) AND (3)]**

The effects of resale with or without notice are summarised as under:

Rights	In case of resale after notice	In case of resale without notice
I. Unpaid seller's right to recover the loss on the sale	Available	Not available
II. Original buyer's right to recover the profit on resale	Not available	Available
III. New buyer's (who buys in resale) right to acquire a good title	Available	Available

**Example** X sold 10 tons of rice to Y at a rate of ₹ 40,000 per ton on a credit of one month. One month expired but Y did not pay. State the legal position in each of the following alternative cases:

- Case (a) If X resold 10 tons of rice to Z at a rate of ₹ 50,000 per ton after giving a notice of resale to Y.
- Case (b) If X resold 10 tons of rice to Z at a rate of ₹ 30,000 per ton after giving a notice of resale to Y.
- Case (c) If X resold 10 tons of rice to Z at a rate of ₹ 50,000 per ton without giving a notice of resale to Y.
- Case (d) If X resold 10 tons of rice to Z at a rate of ₹ 30,000 without giving a notice of resale to Y.

**Solution:**

- Case (a): X is entitled to keep the profit of ₹ 1,00,000 with himself because the buyer cannot be allowed to take advantage of his own wrong i.e., breach of contract [Section 54(2)]. Z shall get a good title against Y [Section 54(3)].
- Case (b): X is entitled to recover the loss of ₹ 1,00,000 from Y [Section 54(2)]. Z shall get a good title against Y [Section 54(3)].
- Case (c): Y is entitled to the profit of ₹ 1,00,000 [Section 54(2)]. However, Z shall get a good title against Y [Section 54(3)].
- Case (d): X is not entitled to recover the loss of ₹ 1,00,000 [Section 54(2)]. However, Z shall get a good title against Y [Section 54(3)].

### 35.0 RIGHTS AGAINST THE GOODS WHERE THE PROPERTY IN THE GOODS HAS NOT PASSED TO THE BUYER

Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit where the property has passed to the buyer [Section 46(2)].



**36.0 RIGHTS AGAINST THE BUYER PERSONALLY**

In addition to the rights against the goods, unpaid seller has the following rights against the buyer personally:

<b>1. Suit for Price [Sec. 55(1)]</b>	Where under a contract of sale, the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of goods.  Where under a contract of sale the price is payable on a certain day irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may sue him for the price although the property in the goods has not passed and the goods have not been appropriated to the contract.
<b>2. Suit for Damages for Non-acceptance [Sec. 56]</b>	Where the buyer wrongfully neglects or refuses to accept the goods and pay for the goods, the seller may sue him for damages for non-acceptance of the goods.
<b>3. Suit for Damages for Repudiation of the Contract [Sec. 60]</b>	Where buyer repudiates the contract before the due date of delivery, the seller may either treat the contract as subsisting and wait till the due date of delivery or he may treat the contract as rescinded and sue for damages for the breach.
<b>4. Suit for Interest [Sec. 61(2)]</b>	In case of breach of contract on the part of the buyer, while filing a suit for the price, the seller may sue the buyer for interest from the date of the tender of the goods or from the date on which the price was payable.

**37.0 RIGHTS OF BUYER**

The following rights are available to the buyer:

<b>1. Suit for Damages for Non-delivery [Sec. 57]</b>	Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.
<b>2. Suit for Specific Performance [Sec. 58]</b>	In any suit for breach of contract to deliver specific or ascertained goods, the court may direct that the contract shall be performed specifically.
<b>3. Suit for Breach of Warranty [Sec. 59]</b>	Where there is a breach of warranty by the seller, or where the buyer elects or is compelled to treat any breach of a condition on the part of the seller as a breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods, but he may-

	<p>(i) set up against the seller the breach of warranty in diminution or extinction of the price; or</p> <p>(ii) sue the seller for damages for breach of warranty.</p> <p><b>Note:</b> The fact that a buyer has set up a breach of warranty in diminution or extinction of the price does not prevent him from suing for the same breach of warranty if he suffered further damage. [Section 59(2)]</p> <p><b>Example</b> <i>X sold a second hand Radio to Y who spent ₹ 100 on the repair of this radio. This radio was seized by the police as it was a stolen one. Y filed a suit against X for recovery of damages for breach of warranty of quite possession including the cost of repairs. It was held that Y was entitled to recover the same. [Mason v. Birmingham]</i></p>
<b>4. Right to Treat the Contract as Rescinded or Operative in Case of Repudiation of Contract by Seller before due Date [Sec. 60]</b>	Where seller repudiates the contract before the date of delivery, the buyer may either treat the contract as subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach.
<b>5. Suit for Interest [Sec. 61(2)]</b>	In case of breach of the contract on the part of the seller, the buyer may sue the seller for interest from the date on which the payment was made.

### 38.0 AUCTION SALE [SECTION 64]

#### MEANING OF AUCTION SALE

Auction sale means a public sale where intending buyer assemble at one place and offer the price at which they are ready to buy the goods. The offer of the price is known as 'bid' and the person making the bid is known as the 'bidder.' The owner of the goods may himself sell them by auction or appoint a person to sell the goods by auction on his behalf. The person so appointed is known as 'auctioneer.' The relationship between the owner of the goods and the auctioneer is that of the principal and agent. In an auction the goods are sold to the highest bidder. It may be noted that an advertisement to sell the goods by auction is simply an invitation to the public to make offers and not an offer to sell. That is why the intending buyers have no right to sue the auctioneer if auctioneer cancels or postpones the sale by auction.

#### RULES REGARDING SALE BY AUCTION [SECTION 64]

The various rules regarding sale by auction are given as follows:

<b>Separate Contract</b>	Where goods are put up for sale in lots, each lot is prima facie deemed to be the subject of a separate contract of sale [Section 64(1)].
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<b>Completion of Sale</b>	A sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner. For example, by saying one, two and three, or by shouting going, going, gone etc. [Section 64(2)].
<b>Right to Withdraw bid</b>	Until the announcement of completion of sale is made, any bidder may withdraw his bid [Section 64(2)].
<b>Seller's Right to bid</b>	A right to bid may be reserved expressly by or on behalf of the seller and, where such right is expressly so reserved, the seller or anyone person on his behalf may bid at the auction [Section 64(3)].
<b>Fraudulent Sale</b>	Where a sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person, and any sale contravening the rule may be treated as fraudulent by the buyer [Section 64(4)].
<b>Reserve Price</b>	A sale may be notified to be subject to a reserve or upset price [Section 64(5)]. The term 'reserve' or 'upset' price may be defined as the minimum price below which the auctioneer will not sell the goods put up for auction sale.
<b>Voidable Sale</b>	If a seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer [Section 64(6)].

**Notes:**

- (i) An auctioneer can refuse to accept even the highest bid because 'bid' is only an offer which may or may not be accepted by the auctioneer.
- (ii) An agreement between the bidders not to bid against each other is called the knock-out agreement. Under such agreement, it is agreed that only one person will bid and anything obtained by him shall be shared by all privately. Such agreements are lawful unless the intention of the parties to the agreement is to defraud a third party.
- (iii) Damping, which is intended to discourage the bidders from bidding is an unlawful act.
- (iv) Puffers (also known as By-bidders or White Bonnets or Decoy Ducks) are persons who are appointed by the seller for the purpose of raising the price. The seller can appoint only one puffer.

**Example** *At an auction sale, C made the highest bid for an article of P. State the legal position in each of the following alternative cases:*

*Case (a)* If C withdrew the bid before the fall of the hammer though he knew that one of the condition of the sale was 'bid once made cannot be withdrawn'.

*Case (b)* If P refused to accept the highest bid. The sale was not notified subject to a reserve price.

Case (c) If P appointed two persons A and B, to bid on his behalf. The sale was notified subject to a right to bid.

Case (d) If C was allowed to take it away on (i) giving a cheque for the price (ii) signing an agreement that ownership should not pass to him until the cheque was cleared. The cheque was dishonoured but in the meantime C sold the article to Z.

Case (e) If the sale was notified subject to a reserve price and the auctioneer by mistake accepted the C's highest bid (which was lower than the reserve price) by striking the hammer. Later, auctioneer refused to deliver the goods.

**Solution:**

Case (a): C's bid was an offer to buy and he was entitled to withdraw his bid before the sale is completed as per express provision of Section 64(2) [Payne v. Cave]. Such a condition in an auction sale was inoperative because it was against the provisions of the law. [Champa Lal v. Jaigopal]

Case (b): C's bid was an offer to buy which may or may not be accepted by the auctioneer. Hence, P could refuse to accept the highest bid. [Fenwick v. Macdonald]

Case (c): It amounts to fraud and sale is voidable at the option of the buyer because the seller could appoint only one person to bid on his behalf. [Section 64(3) and Section 64(6)]. Here intention of the seller was not to protect his interest but to raise the price. [Thornett v. Haines]

Case (d): Z had a good title because the property passed to C on the fall of the hammer [Dennant v. Skinner]. The ownership of specific goods in a deliverable state passes on the completion of contract of sale.

Case (e): The sale was not valid and C was not entitled to goods. It was held that the auctioneer could not effectively accept such a bid (which was lower than reserve price) because he could not make a contract so as to bind his principal to accept less than the reserve price. [Manas v. Fortesque]

**WHAT ARE THE LIABILITIES OF AN AUCTIONEER?**

On the basis of various decisions taken by the court, it can be said that an auctioneer is liable for damages in the following cases:

- (a) If the auctioneer had no authority to sell the goods. [Anderson v. Creall & Sons Ltd.]
- (b) If there is a defect in principal's title. [Benton v. Campbell Parker & Co.]
- (c) If the auctioneer refuses to give the possession on the payment of the price.
- (d) If the buyer's possession is disturbed by his principal or himself.

## PRACTICAL PROBLEMS

### PROBLEM 1

State whether each of the following transaction is a contract of sale under the Sale of Goods Act, 1930.

- (a) A partner agreed to sell his goods to the firm.
- (b) A partner agreed to buy goods from the firm.
- (c) X is the owner of some goods, but he is not aware of this fact. Y pretends to be the owner of these goods and sells them to X.
- (d) X, Y and Z are joint owners of some furniture and with the consent of Y and Z, the furniture was kept in possession of X. X buys Y's share from him.
- (e) X agreed to sell a set containing 100 new currency notes of ₹ 500 each for ₹ 50,000 to Y.
- (f) X agreed to sell 100 silver coins for ₹ 10,000 to Y.
- (g) X agreed to sell 100 shares for ₹ 10,000 to Y.
- (h) X agreed to sell his building for ₹ 1,00,000 to Y.
- (i) X agreed to sell the goodwill of his proprietorship firm for ₹ 1,00,000 to Y.
- (j) X agreed to transfer some jewellery to his prospective wife Mrs. Kajol on account of love and affection.
- (k) X agreed to exchange with Y 100 kg of rice (valued at ₹ 20 per kg) for 200 kg of wheat (valued at ₹ 10 per kg).
- (l) X agreed to exchange with Y 100 kg of rice (valued at ₹ 20 per kg) for 200 kg of wheat (valued at ₹ 12 per kg and pay the difference in cash).
- (m) X agreed to pledge his goods valued at ₹ 1,00,000 with Y.
- (n) X engaged an artist to paint a portrait, canvas and other materials were to be supplied by A to painter.
- (o) X agreed to buy a painting from an artist.
- (p) Supply of wagons or coaches on the under frame supplied by the Railways.
- (q) X delivered a manuscript to Y for printing. Y agreed to use his own ink and paper for printing the book.
- (r) X supplied a piece of cloth to a tailor to make a suit for him. The tailor agreed to supply the lining material and buttons.
- (s) Supply of food by a hotel company to its resident customers, where no rebate is allowed if food is not taken by the customers.
- (t) X sold a car to Y, on the payment of ₹ 6,000 per month for 36 months at the end of which the ownership of the car will be transferred to Y. It was agreed that X can recover the car if Y makes a fault.

**Solution:** Section to which the given problem relates: Section 4.

**DECISION AND REASON.**

<b>Case</b>	<b>Decision</b>	<b>Reason</b>
<b>(a)</b>	Yes	because there are two distinct parties-the firm being buyer and the partner being seller.
<b>(b)</b>	Yes	because there are two distinct parties-the firm being seller and the partner being buyer.
<b>(c)</b>	No	because there are not two distinct parties-buyer and seller. A person cannot buy his own goods. [Leading case: Bell v. Lever Bros Ltd.]
<b>(d)</b>	Yes	because a part-owner may sell to another part-owner as per the express provision of Section 4.
<b>(e)</b>	No	because money has been specifically excluded from the definition of 'goods'. Hence, the new currency notes cannot be the subject-matter of the contract of sale.
<b>(f)</b>	Yes	because old rare coins can be the subject-matter of the contract of sale. The term 'goods' excludes money which means current money and not old rare coins.
<b>(g)</b>	Yes	because shares can be the subject-matter of the contract of sale. The term 'goods' specifically includes stock and shares.
<b>(h)</b>	No	because immovable property cannot be the subject-matter of the contract of sale of goods. The immovable property does not fall in the definition of the term 'goods'.
<b>(i)</b>	Yes	because goodwill can be the subject-matter of the contract of sale. The term 'goods' includes goodwill as well.
<b>(j)</b>	No	because the consideration is not money but love and affection. Thus, it amounts to a gift and not sale.
<b>(k)</b>	No	because the consideration is not money but goods. Thus, it amounts to a barter and not sale.
<b>(l)</b>	Yes	because there is nothing in law to prevent the consideration from being partly in money and partly in goods. [Leading case: Shelden v. Cox]
<b>(m)</b>	No	because the property involved in this case is a special property and not general property.
<b>(n)</b>	No	because it is a contract for work and labour and not contract of sale. In this case rendering of service and exercise of skill is the essence of contract and the delivery of the goods is merely ancillary to the contract. [Leading case: Robinson v. Graves]

<b>(o)</b>	Yes	because it is contract of sale. In this case, delivery of the goods is the essence of contract.
<b>(p)</b>	No	because it is a contract of work and labour and not a contract of sale. In this case, rendering of service and exercise of skill is the essence of contract and the delivery of the goods is merely ancillary to the contract.
<b>(q)</b>	No	because it is contract of work and labour and not a contract of sale. In this case, rendering of service and exercise of skill is the essence of contract and the delivery of the goods is merely ancillary to the contract.
<b>(r)</b>	No	because it is contract of work and labour and not a contract of sale. In this case rendering of service and exercise of skill is the essence of contract and the delivery of the goods is merely ancillary to the contract.
<b>(s)</b>	No	because supply of food is essentially in the nature of service and not a transaction of sale because there is an indivisible contract of multiple services. [Leading case: Associated Hotels of India v. Excise and Taxation officer]
<b>(t)</b>	Yes	because X did not have any option to return, but was under compulsion to buy. Hence, it is not a hire purchase agreement. [Leading case: Lee v. Butler]

**PROBLEM 2**

State whether the following contracts of sale amount to sale or an 'agreement to sell'.

Case (a): X entered into a contract for sale of the entire crop of rice that would yield on his farm.

Case (b): A railway administration entered into a contract for sale of coal-ash that might accumulate during the period of contract.

Case (c): X entered into a contract for sale of some goods in a particular ship to be delivered on the arrival of the ship.

Case (d): X entered into a contract for sale of a painting only if Z, its present owner, sells it to him.

**Solution:**

	<b>Cases (a) and (b)</b>	<b>Cases (c) and (d)</b>
<b>Relevant Section</b>	Section 6(3)	Section 6(2)
<b>Decision and Reason</b>	The contract amounted to an agreement to sell because the subject matter of the contract is future goods which can be the subject-matter of an agreement to sell only.	The contract amounted to an agreement to sell because the subject matter of the contract is contingent goods which can be the subject-matter of an agreement to sell only.

### PROBLEM 3

X agreed to sell to Y a parcel of 700 bags of groundnuts lying in his godown. Unknown to X, 109 bags had been stolen at the time of contract. X tendered delivery of 591 bags. Y declined to accept. State the legal position.

**Solution:**

<b>Relevant Section</b>	Section 7
<b>Decision</b>	The contract of sale has become void and thus, Y cannot be compelled to accept 591 bags.
<b>Reason</b>	There was a contract for sale of an indivisible lot of specific goods and some goods are destroyed at the time when the contract was made without the knowledge of the seller. [Leading case: Barrow Lane & Ballard Ltd. v. Phillips & Co.]

### PROBLEM 4

X agreed to sell a horse to Y on condition that Y will keep it for 10 days on trial basis and have the option to return on the expiry of 10 days, if he does not find it suitable. However, the horse dies on the third day, without any fault of either the seller or buyer. State the legal position.

**Solution:**

<b>Relevant Section</b>	Section 8
<b>Decision</b>	The agreement to sell has become void and thus, the seller could not recover the price from the buyer.
<b>Reason</b>	There was an agreement to sell specific goods which are destroyed before it becomes a sale without any fault of seller or buyer.

### PROBLEM 5

X entered into on a contract for the sale of 100 bags of wheat out of 1,000 bags lying in his godown. Unknown to X, the entire stock was destroyed by fire. X declined to deliver. State the legal position.

**Solution:**

<b>Relevant Section</b>	Section 7
<b>Decision</b>	X must deliver 100 bags of wheat or pay damages for the breach.
<b>Reason</b>	There was a contract for the sale of unascertained goods and not specific goods and hence the contract did not become void.



## IMPORTANT POINTS TO REMEMBER

### 1.0 THE SALE OF GOODS ACT, 1930

<b>Effective Date</b>	It came into force on 1st July, 1930.
<b>Territory</b>	It extends to the Whole of India except the State of Jammu and Kashmir.
<b>Scope</b>	<p>(a) It deals with sale and not with mortgage <i>or</i> pledge <i>or</i> hypothecation.</p> <p>(b) It deals with goods but not with other movable property (e.g., actionable claims &amp; money) <i>or</i> immovable property.</p>
<b>Not Applicable</b>	<p>(a) It does not apply to Hire Purchase Agreement where possession of goods is transferred immediately but ownership of goods is transferred on the payment of last instalment and the hirer has right to terminate the agreement at any time before the transfer of ownership.</p> <p>(b) It does not apply to Contracts for skill and labour where the rendering of the service and exercise of skill is the essence of contract even though there may be delivery of goods.</p>

### 2.0 CONTRACT OF SALE

<b>Meaning</b>	Contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.
<b>Essential Elements</b>	<p>1. There must be Seller as well as Buyer.</p> <p><b>Note:</b> <i>Distribution of goods among partners on account of dissolution of a firm does not amount to a sale of goods by a firm to partners.</i></p>
	<p>2. There must be some goods.</p> <p>3. There must be <i>either</i> a transfer of general property (i.e. ownership) of goods <i>or</i> an agreement to transfer the general property (i.e. ownership) of goods.</p> <p>4. There must be a price (i.e. money consideration)</p> <p><b>Note:</b> <i>The consideration for the contract of sale can be partly in money and partly in goods.</i></p> <p>5. There must exist all essential elements of a valid contract.</p>
<b>Formation</b>	A Contract of Sale may be implied from the conduct of parties or express (i.e. written or oral or partly written and partly oral)

<b>Includes</b>	A Contract of Sale includes: (a) Sale (i.e. where the transfer of ownership of goods takes place immediately) (b) Agreement to Sell (i.e. where the transfer of ownership of goods is to take place at a future time or subject to fulfillment of same condition)
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### 3.0 DISTINCTION BETWEEN SALE AND AGREEMENT TO SELL

A 'Sale' and an 'Agreement to Sell' can be distinguished as follows:

<b><i>Basis of Distinction</i></b>	<b><i>Sale</i></b>	<b><i>Agreement to Sell</i></b>
<b>1. Transfer of Owner-ship</b>	Transfer of ownership of goods takes place <b><i>immediately</i></b> .	Transfer of ownership of goods is to take place at a <b><i>future time</i></b> or subject to fulfillment of some condition.
<b>2. Executed Contract or Executory Contract</b>	It is an <b><i>executed</i></b> contract because nothing remains to be done.	It is an <b><i>executory</i></b> contract because something remains to be done.
<b>3. Conveyance of Property</b>	Buyer <b><i>gets a right to enjoy</i></b> the goods against the whole world including seller. There-fore, a sale creates <b><i>jus in rem</i></b> (Right against property).	Buyer does <b><i>not get such right</i></b> to enjoy the goods. It only creates <b><i>jus in personam</i></b> (Right against the person).
<b>4. Transfer of risk</b>	Transfer of <b><i>risk of loss of goods takes place immediately</i></b> because ownership is transferred. As a result, in case of destruction of goods, the	Transfer of risk of loss of goods <b><i>does not take place</i></b> because ownership is not transferred. As a result, in case of destruction of goods, the loss shall be
	loss shall be borne by the buyer even though the goods are in the possession of the seller.	borne by the seller even though the goods are in the possession of the buyer.
<b>5. Rights of Seller against the Buyer's breach</b>	Seller can <b><i>sue</i></b> the buyer for the <b><i>price</i></b> even though the goods are in his possession.	Seller can <b><i>sue</i></b> the buyer for <b><i>damages</i></b> even though the goods are in the possession of the buyer.

### 4.0 MEANING AND TYPES OF GOODS

<b>Meaning</b>	The term 'Goods' mean every kind of movable property
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	<b>...and Includes</b>	<b>...but Excludes</b>
	(a) Stock and Shares (b) Growing crops, Grass & things agreed to be severed under contract of sale	(a) Actionable claims (b) Money ( <i>i.e.</i> , legal tender) but not old rare coins
<b>1. Existing Goods</b>		
<b>(a) Specific Goods</b>	Which are identified and agreed upon at the time when a contract of sale is made.	
<b>(b) Ascertained Goods</b>	Which are identified and set aside for a given contract out of a mass of unascertained goods.	
<b>(c) Unascertained Goods</b>	Which are not identified and agreed upon at the time when a contract of sale is made	
<b>2. Future Goods</b>	Which are to be produced or acquired by the seller after making of the contract of sale.	
<b>3. Contingent Goods</b>	The acquisition of which by the seller depends upon a contingency which may or may not happen.	

## 5.0 SALE/AGREEMENT TO SELL

<b>Sale/Agreement to sell</b>	(a) There can be Sale or Agreement to sell in respect of existing goods. (b) There can only be an agreement to sell in respect of future goods and contingent goods.
<b>Discharge of Contracting Parties</b>	(a) The contracting parties are not discharged on non-acquisition or non-production of future goods. (b) The contracting parties are discharged on non-acquisition of contingent goods.
<b>Effect of Destruction of Goods</b>	(a) The contract of sale <i>or</i> an agreement to sell specific goods becomes void. (b) The contract of sale <i>or</i> an agreement to sell unascertained goods does not become void even if the entire stock of unascertained goods is destroyed <i>either</i> before <i>or</i> after making agreement.

## 6.0 PRICE

<b>Fixation Not Necessary at Time of Sale</b>	Price need not necessarily be fixed at the time of sale.
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<b>Fixation by 3rd Party</b>	Price may be fixed by a third party.
<b>Reasonable Price</b>	Where the price is not determined in any manner, the buyer must pay the seller a reasonable price.
<b>Void Agreement</b>	Agreement to sell becomes void if price is to be determined by third party & third party cannot or does not make such valuation.
<b>Sue for Damages</b>	Party not at fault may sue for damages where a third party is prevented from making valuation.
<b>Forfeiture</b>	If the contract is not or cannot be performed by buyer's fault, the seller may forfeit earnest money and not advance payment.
<b>Stipulation as to Time</b>	<b>Stipulation as to time of payment is not deemed to be as essence of a contract of sale unless a different intention appears from the terms of the contract.</b>

## 7.0 CONDITION

<b>Meaning</b>	A condition is a stipulation: (a) which is essential to the main purpose of the contract, and (b) the breach of which gives the aggrieved party a right to terminate the contract.
<b>Form</b>	It may be express or implied in a contract of sale.
<b>When treated as Warranty</b>	A breach of condition is treated as breach of warranty in the following 3 cases: (a) when buyer waives a condition (b) when buyer elects to treat breach of condition as breach of warranty (c) where the contract is not several and the buyer has accepted the goods or part thereof.

## 8.0 WARRANTY

<b>Meaning</b>	A warranty is a stipulation: (a) which is collateral to the main purpose of the contract, and (b) the breach of which gives the aggrieved party a right to claim damages but not a right to reject goods and to terminate the contract
<b>Form</b>	It may be express or implied.

## 9.0 IMPLIED CONDITIONS

1. Condition as to Title	Seller must have right to sell.
2. Condition as to Sale by Description	Goods must correspond with description. Whether or not seen by buyer.
3. Condition as to Sale by Sample	Goods must correspond with the sample.
4. Condition as to Sale by Sample and Description	Goods must correspond with the sample and description.
5. Condition as to Quality or Fitness	<p>Goods must be reasonable fit for a particular purpose if the buyer has disclosed the purpose for which goods are required and relied upon the seller's skill or judgement and the seller's business is to sell such goods. (whether or not buyer has examined the goods)</p> <p><b>Note:</b> <i>An implied condition as to quality or fitness does not apply:</i></p> <ul style="list-style-type: none"> <li>(a) If the seller is a casual seller and not a dealer.</li> <li>(b) If buyer fails to disclose any abnormal circumstances</li> <li>(c) If buyer does not rely upon the seller's skill or judgement.</li> <li>(d) If buyer buys a specified article under its patent or other trade name.</li> </ul>
6. Condition as to Merchantable Quality	<p>Goods must of merchantable quality (<i>i.e.</i> free from any latent or hidden defects) if goods are bought by description from a seller who deals in goods of that description (whether he is manufacturer or not)</p> <p><b>Note:</b> <i>An implied condition as to Merchantable Quality does not apply for defects which the buyer could have discovered if he had examined the goods.</i></p>
7. Condition as to Wholesomeness	<p>Goods must be fit for human consumption.</p> <p><b>Note:</b> <i>An implied condition as to merchantable quality applies to goods</i></p> <ul style="list-style-type: none"> <li>(a) <i>whether or not goods are sold under a patent or trade name</i></li> <li>(b) <i>whether or not buyer relies on the skill/judgement of the seller.</i></li> </ul>

**10.0 CAVEAT EMPTOR**

<b>Meaning</b>	It means let the buyer beware.
<b>No Seller's Duty</b>	A seller need not disclose the defects of his goods.
<b>Buyer's Duty</b>	It is buyer's duty to satisfy himself about the quality as well as the suitability of the goods.
<b>Not Applicable</b>	The rule of caveat emptor does not apply where the buyer has disclosed the purpose for which the goods are required and relied upon the seller's skills or judgement.

**11.0 PASSING OF PROPERTY OR TRANSFER OF OWNERSHIP**

<b>Case</b>	<b>Time when Ownership passes...</b>
<b>1. Specific Goods</b>	
(a) <i>Where there is an unconditional contract for sale of specific goods in a deliverable state</i>	When the contract is made
(b) <i>Where there is a contract for sale of specific goods not in a deliverable state</i>	(i) When the goods are put into a deliverable state, and (ii) The buyer has notice thereof.
(c) <i>Where there is a contract for sale of specific goods in a deliverable state but the seller has to do some act to ascertain the price</i>	(i) When the seller has done that act to ascertain the price, and (ii) The buyer has notice thereof.
<b>2. Unascertained Goods</b>	When goods are (a) ascertained and (b) unconditionally appropriated by the seller/buyer with the consent of the other  <b>Note:</b> <i>Such consent may be before or after appropriation.</i>
<b>3. Goods sent on approval</b>	
(a) <i>When the buyer signifies his approval or acceptance</i>	When the approval or acceptance is communicated to the seller.
(b) <i>When the buyer does some act adopting the transaction (e.g., pledging of such goods)</i>	When the act of adoption is done.
(c) <i>When the buyer fails to return the goods</i>	
(i) <i>If a time has been fixed for the return of goods</i>	On the expiry of fixed time.

(ii) <i>If no time has been fixed for the return of goods</i>	On the expiry of the reasonable time
<b>4. Sale of Standing Trees</b>	When trees are felled and ascertained.
<b>5. Where the seller has reserved the right of disposal of goods (e.g., B/E sent with document of title)</b>	When the conditions imposed by the seller are fulfilled (e.g., when B/E is honoured)

## 12.0 RESERVATION OF RIGHT OF DISPOSAL

<b>Mode</b>	<p>(a) In case of goods deliverable to the order of seller or his agent (e.g., Railway receipt/Bill of lading/Lorry receipt taken in the name of seller or in the name of buyer but sent through bank).</p> <p>(b) In case of drawing of a Bill of Exchange for the price of goods and sending B/E with R/R, L/R or B/L.</p>
<b>T/F of Ownership</b>	The ownership of goods will not be transferred to the buyer until the conditions imposed by the seller are fulfilled.

## 13.0 PASSING OF RISK

<b>When Passes</b>	Risk passes with property or follows ownership.
<b>Who has to Bear</b>	The person whosoever be the owner at the time of occurrence of loss has to bear the loss whether delivery has been made or not.

## 14.0 SALE BY NON-OWNERS

**Exceptions to** The rule “No seller of goods can transfer better title to the buyer of the goods than he himself possesses”

<b>1. Sale by a Mercantile Agent</b>	<p>(a) Possession of Goods/Document of title to goods with the consent of owner</p> <p>(b) Sold in ordinary course of business</p> <p>(c) Buyer must have bought in good faith</p> <p>(d) Buyer must have no knowledge that seller had no authority to sell</p>
<b>2. Sale by One of Joint Owners</b>	<p>(a) Sole Possession with consent of other co owners</p> <p>(b) Same as (c) above in 1</p> <p>(c) Same as (d) above in 1</p>
<b>3. Sale by Person in possession under Voidable Contract</b>	<p>(a) Possession of goods under voidable contract</p> <p>(b) Sold before contract is rescinded</p> <p>(c) Same as (c) in 1</p> <p>(d) Same as (d) in 1</p>

<b>4. Sale by Seller in Possession after Sale</b>	(a) Possession of goods/documents of title to goods as seller not as bailee (b) same as (c) in 1 (c) same as (d) in 1
<b>5. Sale by a Buyer in Possession before transfer of Ownership</b>	(a) Possession of Goods/Document of title with the consent of original seller (b) same as (c) in 1 (c) same as (d) in 1
<b>6. Sale by an Unpaid Seller</b>	On exercising right of lien or stoppage in transit
<b>7. Sale by Finder of Goods</b>	(a) Owner could not be found or (b) Owner refuses to pay (c) Goods of perishable nature (d) Lawful charges – 2/3 of value
<b>8. Sale by a Pawnee/ Pledgee</b>	
<b>9. Sale by a Official Receiver/ Assignee</b>	
<b>10. Sale by Owner by Estopple</b>	

## 15.0 DELIVERY

<b>Meaning</b>	Delivery means voluntary transfer of possession from one person to another.
<b>Types</b>	<p>(a) <b>Actual delivery</b> – Where goods are physically handed over to the buyer or his authorised agent.</p> <p>(b) <b>Symbolic Delivery</b> – Where some symbol of real possession or control over goods is handed to buyer or his authorised agent e.g., delivery of key of a warehouse.</p> <p>(c) <b>Constructive Delivery</b> – Where a person in possession of goods acknowledges to hold the goods on behalf of the buyer.</p>
<b>Place</b>	Where there is no contract as to the <b>place of delivery</b> , the goods are to be delivered at the <b>place at which goods are at the time of sale/agreement to sell</b> (in case of <b>existing goods</b> ) or at the <b>manufacturing place</b> (in case of <b>future goods</b> )
<b>Time</b>	Where there is no contract as to the <b>time of delivery</b> , the goods are to be delivered within <b>reasonable time</b> .



<b>Wrong Qty</b>	<p>(a) Where the seller delivers a quantity of goods larger than contracted for, the buyer may accept/reject the whole or accept the contracted and reject the excess.</p> <p>(b) The buyer may not be allowed to reject the whole goods in case of negligible short or excess delivery.</p> <p>(c) In case of short or excess delivery if the buyer rejects the whole quantity, the contract is not treated as cancelled. The seller still has the right to tender again the quantity of goods as per contract and the buyer is bound to accept the same.</p>
<b>Expenses</b>	The expenses of putting the goods into a deliverable state shall be borne by the seller.
<b>Buyer to Apply</b>	Unless otherwise agreed the buyer must apply for delivery
<b>Payment and Delivery</b>	Unless otherwise agreed there must be simultaneous payment of price and delivery of goods.
<b>Delivery by Instalments</b>	Unless otherwise agreed the buyer is not bound to accept delivery by installments.
<b>Part Delivery</b>	Delivery of part of goods with an intention of giving the delivery of the whole amounts to the delivery of the whole of the goods.
<b>Delivery to Carrier</b>	<p>Delivery of the goods to carrier (whether named by the buyer or not) for the purpose of transmission to the buyer, or delivery of the goods to wharfinger custody, is prime facie deemed to be a delivery of the goods to the buyer. The seller is further required to perform the following 2 duties also:</p> <ol style="list-style-type: none"> <li>1. To make a reasonable contract with the carrier or wharfinger:</li> <li>2. To give notice to the buyer to enable him to insure goods during sea transit</li> </ol>
<b>Acceptance</b>	<p><b>Three Circumstances under which Buyer is deemed to have accepted the goods:</b></p> <ol style="list-style-type: none"> <li>1. When he intimates to the seller that he has accepted the goods,</li> <li>2. When the goods have been delivered to him and he does any act in relation to them which shows that he has accepted them (for example resale or pledge of goods by buyer),</li> <li>3. When he does not inform the seller that he has rejected the goods and retains the goods beyond a reasonable time.</li> </ol>

## 16.0 MEANING OF UNPAID SELLER

The seller of goods is deemed to be an 'unpaid seller':

<b>Whole Price Not Paid</b>	When the whole of the price (not other expenses) has not been paid or tendered
<b>Dishonour</b>	When a bill of exchange or other negotiable instrument (such as cheque) has been received as conditional payment, and it has been dishonoured.
<b>Buyer's Insolvency</b>	When the buyer becomes insolvent during the credit period allowed.

## 17.0 RIGHT OF LIEN

<b>Meaning</b>	The right of lien means the right to retain the possession of the goods until the full price is received.
<b>Circumstances</b>	<b>Three Circumstances under which Right of Lien can be exercised:</b> <ol style="list-style-type: none"> <li>1. Where the goods have been sold without any stipulation to credit,</li> <li>2. Where the goods have been sold on credit, but the term of credit has expired,</li> <li>3. Where the buyer becomes insolvent.</li> </ol>
<b>Possession as Agent</b>	The seller may exercise his right of lien, even if he possesses the goods as agent or bailee for buyer.
<b>Part Delivery</b>	In case of part delivery, this right of lien can be exercised only where part delivery is not intended as delivery of the whole.
<b>Decree for Price</b>	The seller may exercise his right of lien even though he has obtained a decree for the price of the goods.

## 18.0 RIGHT OF STOPPAGE OF GOODS IN TRANSIT

<b>Meaning</b>	The right of stoppage in transit means the right of stopping the goods while they are in transit, to regain possession and to retain them till the full price is paid. Right of stoppage in transit is an extension of the right of lien.
<b>Conditions</b>	<b>Three conditions under which Right of Stoppage in Transit can be exercised:</b> <ol style="list-style-type: none"> <li>1. The seller must have parted with the possession of goods, i.e., the goods must not be in the possession of seller.</li> <li>2. The goods must be in the course of transit.</li> <li>3. The buyer must have become insolvent.</li> </ol>

<b>Duration of Transit</b>	<p>Goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent in that behalf takes delivery of them from such carrier or other bailee.</p> <p><b>Note:</b> The carrier must hold the goods in the capacity of an independent person and not in the capacity of an agent for the seller or buyer.</p>
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## 19.0 EFFECT OF SUB-SALE OR PLEDGE BY BUYER

<b>General Rule</b>	The unpaid seller's right of lien or stoppage in transit is not affected by any sale or other disposition of the goods by the buyer.
<b>Exceptions</b>	<p>There are <b>2 exceptions</b> to the aforesaid rule as under:</p> <ol style="list-style-type: none"> <li>1. Where the sub-sale or other disposition by the buyer has been done with the consent of the seller;</li> <li>2. Where a document of title to goods (e.g., bill of lading or railway receipt) has been issued or lawfully transferred to any person as buyer and that person transfers the document by way of sale to a person who takes the document in good faith and for consideration,.</li> </ol>

## 20.0 RIGHT OF RESALE

<b>Circumstances</b>	<p><b>Three circumstances under which an unpaid seller can resell the goods:</b></p> <ol style="list-style-type: none"> <li>1. Where the goods are of perishable nature,</li> <li>2. Where the seller expressly reserves a right of resale if the buyer commits a default in making the payment,</li> </ol> <p><b>Note:</b> As a result of this resale, the original contract will be terminated but the seller will have a right to claim damages.</p> <ol style="list-style-type: none"> <li>3. Where the unpaid seller who has exercised his right of lien or stoppage in transit gives a notice to the buyer about his intention to resell and buyer does not pay or tender within a reasonable time.</li> </ol>	
<b>Rights in Case of Resale</b>	<b>In Case of Resale after notice</b>	<b>In Case of Resale without notice</b>
<b>1. Unpaid Seller's right to recover the Loss</b>	Available	Not available
<b>2. Original Buyer's right to recover the Profit</b>	Not Available	Available
<b>3. New Buyer's (who buys in resale) right to acquire a good title</b>	Available	Available

**21.0 RIGHTS OF SELLER AND BUYER**

<b>Rights of Unpaid Seller against Buyer</b>	<ol style="list-style-type: none"> <li>1. Suit for Price</li> <li>2. Suit for Interest</li> <li>3. Suit for Damages for Non-Acceptance of Goods</li> <li>4. Suit for Damages for Repudiation of the Contract</li> </ol>
<b>Rights of buyer against Seller</b>	<ol style="list-style-type: none"> <li>1. Suit for Damages for non-delivery of goods</li> <li>2. Suit for Specific Performance</li> <li>3. Suit for Breach of Warranty</li> <li>4. Suit for Interest, if any advance has given</li> <li>5. Right to treat the contract as rescinded or operative in case of repudiation of contract by seller before due date</li> </ol>

**22.0 AUCTION SALE**

<b>Meaning</b>	An auction sale is a public sale where intending buyers (known as bidders) offer the purchase price (known as bids) at which they are ready to buy the goods and the sale is complete when auctioneer announces its completion by the fall of hammer or in other customary manner (e.g., by saying 1, 2, 3)
<b>Advertisement</b>	An advertisement to sell the goods by auction is merely an invitation to make an offer to buy and not an offer to sell and the intending buyers have no right to sue the auctioneer if auctioneer cancels or postpones the sale by auction.
<b>Reserve Price</b>	A sale can be subject to reserve price below which the auctioneer will not sell the goods.
<b>Seller's Right to Bid</b>	A seller can reserve a right to bid at auction.
<b>One Puffer</b>	A seller can appoint only one puffer to raise the bid.
<b>Bidder's Right to Withdraw Bid</b>	A bid once given can be withdrawn before completion of sale.
<b>Voidable Sale</b>	If a seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.
<b>Right to Refuse Bid</b>	An auctioneer can refuse to accept even the highest bid because 'bid' is only an offer which may or may not be accepted by the auctioneer.
<b>Damping</b>	Damping which is intended to discourage the bidders from bidding is an unlawful act.
<b>Knock-out Arrangement</b>	A knock-out arrangement between the bidders not to bid against each others is lawful unless it is made to defraud a third party.

<b>Liabilities of an Auctioneer</b>	<p>On the basis of various decision taken by the court, it can be said that an auctioneer is liable for damages in the following cases:</p> <ol style="list-style-type: none"> <li>1. If the auctioneer had no authority to sell the goods. [Anderson v. Creall &amp; Sons Ltd.]</li> <li>2. If there is a defect in principal's title. [Benton v. Compbell Parker &amp; Co.]</li> <li>3. If the auctioneer refuses to give the possession on the payment of the price</li> <li>4. If the buyer's possession is disturbed by his principal or himself.</li> </ol>
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### 32.0 SOME OF THE IMPORTANT SECTIONS OF THE SALE OF GOODS ACT, 1930

Sec 4	Contract of Sale
Sec 2 (7)	Goods
Sec 12 (2)	Condition
Sec 12 (3)	Warranty
Sec 16	Caveat Emptor
Sec 27, 28, 30	Sale by Non-owners
Sec 33 to 39	Delivery
Sec 45	Unpaid Seller
Sec 64	Auction Sale

### 33.0 SOME OF THE IMPORTANT CASE-LAWS:

<b>1. Sheldon V. Cox</b>	There is nothing in law to prevent the consideration from being partly in money and partly in goods.
<b>2. Robinson V. Graves</b>	The control in which rendering of service and exercise of skill is the essence of contract and the delivery of goods is merely ancillary to the contract is a contract for work and labour and not contract of sale.
<b>3. Lee V. Butler</b>	Test of Hire Purchase Agreement
<b>4. Niblett Ltd. V. Confectioner's Material Co.</b>	Condition as to title (Infringement of Trade Mark)
<b>5. Nicholson &amp; Venn V. Smith Marriott</b>	Sale by Description (Goods dating & 17th century)
<b>6. Priest V. Last</b>	Condition as to Quality/Fitness (Hot water Bottle burst)
<b>7. Baldry V. Marshall</b>	Condition as to Quality/Fitness (Car unsuitable for touring purpose)

<b>8. Evens V. Stelle Benjamin</b>	Condition as to Quality/Fitness (Refrigerator failed to make ice)
<b>9. Dr. Baretto V. TR Pruce</b>	Condition as to Quality/Fitness (Set of false teeth not fit for mouth)
<b>10. Griffiths V. Peter Conway Ltd.</b>	No Condition as to Quality/Fitness (Non- disclosure of abnormally sensitive skin)
<b>11. Morelli V. Fitch &amp; Gibbons</b>	Condition as to Merchantable Quality (Bottle broke off while opening its cork)
<b>12. Godley V. Perry</b>	Condition as to Merchantable Quality (Plastic Catapult, broke)
<b>13. Wilson V. Rickett Cackerrel &amp; Co.</b>	Condition as to Merchantable Quality & Co. (Cooking Coal contained as explosive substance)
<b>14. Thornett &amp; Fehs V. Bears &amp; Sons</b>	No, Condition as to Merchantable Quality (Buyer failed to examine glue packed in barrels)
<b>15. Frost V. Aylesbury Dairy Co. Ltd.</b>	Condition as to wholesomeness (Milk contained typhoid germs)
<b>16. Jones V. Bowden</b>	Condition implied by Custom (failure to disclose sea damage in goods)
<b>17. Mason V. Burmingham</b>	Warranty as to Quiet Possession (Seizure of goods by Police)
<b>18. Clarke V. Army &amp; Navy Co-operative Society Ltd.</b>	Warranty as to disclose Dangerous Nature of Goods (Seller failed to disclose about special Care to be taken)
<b>19. Ward V. Hobbs</b>	Doctrine of Caveat Emptor (Sale of Pigs subject to all faults)
<b>20. Kirkham V. Attenborough</b>	Goods sent on approval basis (Pledging of goods amount to adoption of transaction)
<b>21. Phillips V. Brooks</b>	Sale by a person in possession under voidable contract (Purchaser of diamond ring in good faith & without notice of seller's defective title, gets good title)
<b>22. Vilas Udyog Ltd. V. Prag Vanaspati Products</b>	Short/Excess Delivery (Seller's right to tender again the delivery if short/ excess delivery is rejected by buyer)

### TRUE OR FALSE QUESTIONS

**State giving reasons whether each of the following statements is 'True' or 'False':**

1. A contract of sale of goods includes the sale of goods and not an agreement to sell goods.
2. The consideration for the contract of sale can be partly in money and partly in goods.
3. The subject matter of the contract of sale can be all movable goods.

4. In a sale the property in goods is transferred when the buyer pays the price.
5. A sale by a partner of a firm to his firm is void.
6. Future goods cannot be the subject-matter of sale.
7. In case of destruction of unascertained goods, the contract becomes void.
8. In case of contract of sale of goods, price of the goods must be fixed at the time of sale.
9. Parties to a contract of sale can get the price of goods fixed by third parties.
10. Where the price is not determined in any manner, the buyer must pay the seller the market price of the goods.
11. Stipulation as time of payment is deemed to be essence of a contract of sale unless otherwise agreed.
12. A stipulation the breach of which gives the aggrieved party a right to terminate the contract is called a warranty.
13. A breach of warranty can be treated as a breach of condition in some cases.
14. In a contract of sale by sample the bulk of goods must correspond to either sample or merchantability.
15. In a contract of sale by description and by sample, the bulk of goods must correspond to either description or sample.
16. In a contract for sale of goods there is no implied condition or warranty as to the quality of the goods or their fitness for any particular purpose.
17. A seller need not disclose the defect of his goods to the buyer before sale.
18. The implied condition as to fitness for a particular purpose does not apply to goods if the buyer had examined the goods.
19. The implied condition as to merchantable quality applies to goods whether or not the buyer has examined the goods.
20. The term property in goods and possession of goods mean the same thing.
21. The property in goods passes only when the goods are delivered.
22. Property in goods can pass only in case of ascertained goods.
23. Where there is an unconditional contract for sale of specific goods in deliverable state, the property in goods passes when the goods are delivered.
24. Where there is a contract for sale of specific goods not in deliverable state, the property in goods passes when the goods are put into a deliverable state whether or not the buyer has notice thereof.
25. Where there is a contract for sale of specific goods in a deliverable state but the seller has to do some act to ascertain the price, the property in goods passes when the seller has done that act to ascertain price.
26. In a contract for the sale of unascertained goods, the property in goods passes when the contract is made.
27. In case of unascertained goods, the goods can be appropriate either by the seller or the buyer with the consent of the other.

28. The consent of the seller or buyer as to appropriation of unascertained goods must be given before the appropriation is made.
29. Where the seller delivers the goods to the buyer or to a carrier or other bailee for the purpose of transmission to the buyer and reserves the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract.
30. When the goods are sent on sale or return basis, the property in goods passes when the buyer retains the goods beyond a reasonable time.
31. Pledging of goods obtained on sale or return basis will complete the sale.
32. When the goods are sent on sale or return basis, the property in goods will pass when the buyer delivers that goods to a third person on the same basis.
33. Delivery of the goods to the carrier amounts to transfer of ownership to the buyer.
34. Property in goods passes to the buyer where the seller has reserved the right of disposal.
35. When the seller takes a railway receipt in the name of buyer and sends the railway receipt to his agent, he is said to have reserved the right.
36. When a bill of exchange is sent together with documents of title, the property in goods passes when the buyer honours the bill of exchange.
37. Generally, risk follows ownership whether the goods have been delivered or not and whether price has been paid or not.
38. Sale by a non-owner does not make the buyer an absolute owner of goods.
39. A seller in possession of goods under a voidable contract can pass a good title to a bonafide buyer.
40. A seller in possession of goods in the capacity of a bailee can pass a good title to bona fide buyer.
41. A joint owner in sole possession of goods with the consent of majority of other joint owners can pass a good title to a bona fide buyer.
42. Delivery means the compulsory transfer of possession from one person to another.
43. Delivery of the key of a warehouse where goods are lying amounts to symbolic delivery.
44. Unless otherwise agreed, delivery of goods and payment of the price need not be concurrent conditions.
45. A delivery of part of goods with an intention of separating it from the whole lot does not amount to the delivery of the whole of the goods.
46. In case there is no contract as to the place of delivery, the goods are to be delivered at the place of buyer.
47. In case there is no contract as to the time of delivery, the goods are to be delivered within 1 month.
48. In case of delivery of wrong quantity, the buyer may reject the whole lot.
49. Buyer must accept the delivery by instalment.
50. Delivery to a carrier is prima facie deemed to be a delivery to the buyer.



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51. Delivery of goods amounts to acceptance of goods.
  52. When goods are rejected by the buyer, he must return them to the seller.
  53. Where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract, the seller may sue the buyer only for claims and not for price.
  54. The right of lien can be exercised only when the buyer has become insolvent.
  55. The right of lien cannot be exercised if the seller possesses the goods as agent or bailee for buyer.
  56. In case of part delivery, the unpaid seller can exercise his right of lien over the remainder even if the part delivery is intended as delivery of the whole.
  57. The right of lien cannot be exercised when the unpaid seller has obtained a decree for the price of the goods.
  58. The right of lien is lost when the seller takes railway receipt in the name of buyer and sends the railway receipt to his agent.
  59. The right of stoppage in transit can be exercised even in case of non-payment of price by buyer who is solvent.
  60. The right of stoppage in transit commences only when the right of lien is lost.
  61. An unpaid seller can exercise the right of stoppage in transit when the carrier holds the goods as seller's agent.
  62. Transit comes to an end where the carrier wrongfully refuses to deliver the goods to the buyer or his agent.
  63. Transit does not come to an end when the goods are delivered to a ship.
  64. In case of part delivery, the unpaid seller can exercise his right of stoppage-in-transit over the remainder if the part delivery is not intended as delivery of the whole.
  65. The right of stoppage in transit is lost when the unpaid seller gives his consent to the sale by the buyer.
  66. Where the transfer of documents of title was by way of pledge, the unpaid seller's right of lien or stoppage-in-transit can only be exercised subject to right of the transferor.
  67. An unpaid seller is bound to resale the goods.
  68. The unpaid seller must give a notice of resale to the buyer irrespective of the nature of goods.
  69. Where the seller has expressly reserved the right of resale, the unpaid seller need not give any notice of the resale to the buyer.
  70. Where a notice of resale has been given to the buyer and there is loss on resale, the unpaid seller can recover it from the buyer.
  71. If notice of resale is not given, the new buyer will not get a good title.
  72. The relationship between the owner of the goods and the auctioneer is that of the principal and agent.
  73. A seller cannot reserve a right to bid at an auction.
  74. Where the right to bid at an auction is expressly reserved by the seller, the seller or anyone person on his behalf may bid the auction.

- 75. An auction sale cannot be subject to a reserve price.
- 76. In an auction sale, a bid once given cannot be withdrawn.
- 77. An auctioneer can refuse to accept even the highest bid.
- 78. In an auction sale, bidder can enter into an agreement to keep the bid low by eliminating competition amongst them.

#### ANSWERS

1. False 2. True 3. False 4. False 5. False 6. True 7. False 8. False 9. True  
10. False 11. False 12. False 13. False 14. False 15. False 16. True 17. True  
18. False 19. False 20. False 21. False 22. True 23. False 24. False 25. True  
26. False 27. True 28. False 29. False 30. True 31. True 32. True 33. False  
34. False 35. True 36. True 37. True 38. True 39. True 40. False 41. False  
42. False 43. True 44. False 45. True 46. False 47. False 48. True 49. False  
50. True 51. False 52. False 53. False 54. False 55. False 56. False 57. False  
58. False 59. False 60. True 61. False 62. True 63. False 64. True 65. True  
66. False 67. False 68. False 69. True 70. True 71. False 72. True 73. False  
74. True 75. False 76. False 77. True 78. True

#### VERY SHORT ANSWER TYPE QUESTIONS

- 1. Define a 'contract of sale'.
- 2. Does the term 'contract of sale' include an agreement to sell?
- 3. When does an agreement to sell become sale?
- 4. Can a contract of sale be implied from the conduct of parties?
- 5. Can a contract of sale be partly in writing and partly by words of mouth?
- 6. Can an offer to sell by words of month be accepted in writing?
- 7. Can an offer in writing be accepted by words of mouth?
- 8. What is the true test of hire-purchase agreement?
- 9. What is a contract for work and labour?
- 10. Is a contract for work and labour covered under the Sale of Goods Act, 1930?
- 11. Define the term 'goods'.
- 12. Do old rare coins constitute goods?
- 13. Do actionable claims constitute goods?
- 14. Do money other than old rare coins constitute goods?
- 15. Do immovable property constitute goods?
- 16. Do all movable property constitute goods?
- 17. What is meant by 'existing goods'?

18. What is meant by 'specific goods'?
19. What is meant by 'ascertained goods'?
20. What is meant by 'unascertained goods'?
21. Define 'future goods'.
22. Define 'contingent goods'.
23. What is the effect of destruction of specific goods on contract of sale?
24. What is the effect of destruction of specific goods on an agreement to sell?
25. What is the effect of destruction of unascertained goods on a contract of sale?
26. Define 'condition' in a contract of sale of goods.
27. What is a 'warranty' in a contract of sale of goods?
28. What is meant by 'passing of property'?
29. What is meant by '*nemo dat quid non-habet*'?
30. What is meant by delivery of goods?
31. What is symbolic delivery?
32. What is constructive delivery?
33. Define an unpaid seller.
34. What is a 'right of lien'?
35. What is a 'right of stoppage of goods in transit'?
36. Is the unpaid seller bound to return the surplus realised on resale of goods?
37. What in an auction sale?
38. What is a bid?
39. Define 'bidder'.
40. Define 'auctioneer'.
41. What is a 'reserve price'?
42. What is a knock-out agreement?
43. Is a knock-agreement lawful?
44. What is damping?
45. Is damping lawful?
46. Can a seller appoint any person to bid on his behalf in auction?
47. Can a bidder withdraw his bid?
48. Can an auctioneer refuse to accept even a highest bid?
49. Can the seller fix a reserve price in an auction sale?

### SHORT ANSWER TYPE QUESTIONS

1. Enumerate the implied conditions and implied warranties.
2. What is meant by 'sale by description'?
3. What is meant by 'sale by sample'?
4. What is meant by 'sale by sample as well as by description'?

5. What is meant by 'condition as to quality or fitness'?
6. State the conditions to be satisfied to avail of the condition as to fitness.
7. State two cases where the condition as to fitness may not be applicable.
8. What is meant by 'condition as to merchantable quality'?
9. When can a breach of condition be treated as a breach of warranty?
10. What is doctrine of 'caveat emptor'?
11. Enumerate the exceptions to the doctrine of caveat emptor.
12. State the reason of knowing the exact moment when property in goods passes to the buyer.
13. State the rules relating to transfer of property of specific goods from seller to buyer.
14. State the rules relating to transfer of property of unascertained goods from seller to buyer.
15. State the rules relating to transfer of property of goods delivered on approval or on sale or return basis.
16. Does delivery of goods to a carrier amount to transfer of ownership?
17. What is meant by reservation of right of disposal?
18. Enumerate the circumstances when a non-owner can transfer a better title than what he himself possess.
19. Explain the rules regarding place of delivery.
20. Explain the rules regarding delivery of wrong quantity.
21. Explain the rules regarding delivery by instalments.
22. Explain the rules regarding delivery by a carrier or wharfinger.
23. When the buyer is said to have accepted the goods?
24. State the rights of seller when the buyer refuses or neglects to take delivery of the goods.
25. Enumerate the rights of an unpaid seller.
26. State the circumstances under which an unpaid seller can exercise his right of lien.
27. State the circumstances under which an unpaid seller cannot exercise his right of lien.
28. State the conditions under which an unpaid seller can exercise his right of stoppage of goods in transit.
29. State the circumstances under which an unpaid seller loses his right of stoppage of goods in transit.
30. How is stoppage in transit effected?
31. What are the effects of sub-sale or pledge by buyer on the unpaid seller's right of lien and stoppage in transit?
32. When can an unpaid seller resell the goods?
33. State the circumstances under which a notice of resale is not required to be given.
34. State the effects of resale of goods with or without notice under the circumstances

when a notice is required to be given.

35. State the rights of an unpaid seller against the buyer personally.
36. State the rights of a buyer against the seller.
37. Comment on the following statements:
  - (a) In a contract for the sale of goods there is no implied condition or warranty as to the quality of the goods or their fitness for any particular purpose.
  - (b) The seller of goods is not bound to disclose defects in the goods that he intends to sell.
  - (c) No seller of goods can transfer better title to the buyer of the goods than he himself possesses.
  - (f) Risk prima facie passes with ownership.
  - (g) The fact that the buyer of the goods has received the goods does not mean that he has accepted them.
  - (h) Delivery does not amount to acceptance of goods by buyer.
    - (i) Delivery of goods to a carrier amounts to delivery to the buyer.
    - (j) Delivery of goods to a carrier amounts to transfer of ownership.
  - (k) Right of stoppage in transit is an extension of the right of lien.
  - (l) In case of 'sale by sample as well as buy description', the goods must not only correspond to the sample but also to the description.
  - (m) The condition as to merchantability extends only to the latent defects.
38. Distinguish between the followings:
  - (a) A Sale and an Agreement of Sell.
  - (b) A Sale and Hire-Purchase Agreement.
  - (c) A Sale and a Contract for work and labour.
  - (d) Future goods and Contingent Goods.
  - (e) Ascertained goods and Unascertained Goods.
  - (f) Specific goods and Ascertained goods.
  - (g) Condition and Warranty.
  - (h) Symbolic Delivery and Constructive Delivery.
    - (i) Part Delivery and Instalment Delivery.
    - (j) Right of lien and Right of Stoppage in transit.

### LONG ANSWER TYPE QUESTIONS

1. (a) Define a contract of sale.  
 (b) Explain the essentials of a valid contract of sale.  
 (c) How is a contract of sale different from an agreement to sell?
2. (a) How is a contract of sale made? State briefly with illustrations the necessary formalities of such a contract.
3. (a) Explain the term 'goods as defined in, the Sale of Goods Act, 1930.

- (b) What are the various types of goods?
- 4. What is the effect of destruction of specific goods?
- 5. (a) Distinguish between condition and warranty.  
(b) Briefly discuss the implied conditions and warranties in a contract of sale.  
(c) Under what circumstances does a condition descend to the level of a warranty?
- 6. (a) What is the doctrine of 'caveat emptor'?  
(b) What are the exceptions to this rule?
- 7. (a) What is a 'sale by sample'?  
(b) Explain the implied conditions inherent in a sale by sample.
- 8. (a) Why is it important to know the exact time when the property in goods passes from a seller to buyer?  
(b) Explain with example, the rules governing the transfer of ownership of goods from seller to buyer.
- 9. What are the rules for ascertaining the intention of the parties as to the time when the property in specific goods is to pass to the buyer?
- 10. "No seller of goods can give the buyer of goods a better title to those goods than what he himself possesses." Examine this statement and mention whether there are any exceptions to this rule.
- 11. What is meant by reservation of the right of disposal in a contract of sale of goods?
- 12. Explain in brief the rules relating to the delivery of goods.
- 13. Explain with examples the rules relating to (a) part delivery, (b) delivery by instalments, and (c) delivery of wrong quantity.
- 14. Define an unpaid seller. Explain his right (i) against the goods and (ii) against the buyer personality.
- 15. (a) What is meant by the right of lien in respect of sale of goods?  
(b) Under what circumstances this right can be exercised?  
(c) When is this right lost?  
(d) What is the effect of sub-sale or pledge on this right?
- 16. (a) What is meant by the right of stoppage in transit in respect of sale of goods?  
(b) Under what conditions this right can be exercised?  
(c) When is this right lost?  
(d) How is this right effected or exercised?  
(e) What is effect of sub-sale or pledge on this right?
- 17. When can a seller resell the goods?
- 18. (a) What is an auction sale?  
(b) Explain in brief the rules applicable to an auction sale.



# The Indian Partnership Act, 1932

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## 1.0 INTRODUCTION

1. Partnership is one of the specific contracts which were part of the Indian Contract Act, 1872.
2. In 1930, however, the provisions relating to partnership contract were repealed and a separate Act called the Indian Partnership Act, 1932 was passed which is in force till today.

### WHAT IS THE TERRITORY TO WHICH THE ACT APPLIES?

It extends to the whole of India except the State of Jammu and Kashmir.

### WHEN THE ACT CAME INTO FORCE?

It has come into force on the 1st day of October 1932 except Section 69, which came into force on the 1st day of October 1933.

### DO THE PROVISIONS OF THE INDIAN CONTRACT ACT, 1872 APPLY TO FIRMS?

The provisions of the Indian Contract Act, 1872 also apply to firms except where The Indian Partnership Act, 1932, specifically provides to the contrary [Section 3].

## 2.0 WHAT IS PARTNERSHIP

“Partnership is the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.” [Section 4]

## 3.0 WHAT ARE THE ESSENTIAL ELEMENTS OF PARTNERSHIP

### TWO OR MORE PERSONS

There must be at least two persons to form a partnership and all such persons must be competent to contract. According to Section 11 of the Indian Contract Act, 1872, every person except the following, is competent to contract:

- (i) Minor
- (ii) Persons of unsound mind (e.g. lunatics, idiots), and
- (iii) Persons disqualified by any law to which they are subject (e.g., alien enemies, insolvents).

However, the Partnership Act is silent about the maximum number of members that a partnership may have. It is Section 11 of the Companies Act which gives us the maximum limit. It states that any association having a membership of more than 10 in case of banking business or 20 in case of non-banking business must be registered as a corporate body failing which it would become an illegal association.

### AGREEMENT

There must be an agreement to form a partnership. This agreement may be express (whether written or oral) or implied. This essential element is further clarified under Section 5. Section 5 provides that the relation of partnership arises from contract and not from status. That is why, a Hindu undivided family carrying on a family business is not considered a partnership. The reason is that the coparceners of a Hindu undivided family acquire interest in the business because of their status (i.e., birth) in the family and not because of any agreement between them. Thus, partnership is voluntary and contractual in nature.

### BUSINESS

There must exist a business. According to Section 2(b), the term 'Business' includes every trade, occupation and profession. For example, when two or more persons agree to share the income of a joint property (e.g., rent from a building), it does not amount to a partnership because there does not exist any business. Similarly, an association created for charitable, religious or social purpose cannot be regarded as partnership because there does not exist any business. It may also be noted that an agreement to carry on business at a future time does not result in partnership unless that time arrives and the business is started. [*R.R. Sarna, v. Reuben*]

### SHARING OF PROFITS

There must be sharing of profits. Sharing of profits does not necessarily imply sharing of losses as well. That is why there are minor partner and partner in profits only. It may also be noted that sharing of profits is a *prima facie* evidence and not a conclusive evidence of partnership. That is why, everyone who shares the profits of business need not necessarily be a partner. **For example**, a manager who receives a particular share in the profits of a business as part of his remuneration, is simply an employee and not a partner (for more details, see Explanations I and II to Sec. 6 discussed in para 7.2).

### MUTUAL AGENCY

There must exist a mutual agency relationship among the partners. 'Mutual Agency' relationship means that each partner is both an agent and a principal. Each partner is an agent in the sense that he has the capacity to bind other partners by his acts done. Each partner is a principal in the sense that he is bound by the acts of other partners. Such mutual agency relationship in case of a firm of X, Y and Z has been shown on next page.

The mutual relationship of agency is emphasised in Section 18 of the Indian Partnership Act, which reads as under:



*“Subject to the provision of this Act, a partner is the agent of the firm for the business of the firm.”*

Moreover, the use of the words ‘carried as by all or by any of them acting for all, in Section 4 of the Act clearly emphasises agency relationship.

#### Mutual Agency Relationship in Case of a Firm of X, Y and Z

	When X does an act	When Y does an act	When Z does an act
Who is an Agent	X	Y	Z
Who are Principles	Y and Z	X and Z	X and Y

Because of the existence of mutual agency relationship amongst the partners, the law of partnership is also regarded as an extension of the general law of agency. It may be noted that the mutual agency relationship distinguishes a partnership from co-ownership and simple agreement for sharing profits.

#### 4.0 MEANING OF ‘PARTNER’, ‘FIRM’ AND ‘FIRM NAME’

1. Persons who have entered into partnership with one another are called individually ‘partners’ and collectively ‘a firm’;
2. The name under which their business is carried on is called the ‘firm name’.

#### 5.0 WHAT IS THE MAXIMUM LIMIT ON NUMBER OF PARTNERS

According to Section 11 of the Companies Act, 1956, the maximum limit is as under:

- (a) In case of a partnership firm carrying on a banking business—10
- (b) In case of a partnership firm carrying on any other business—20

If the number of partners exceeds the aforesaid limit, the partnership firm becomes an illegal association.

**Note:** These statutory limits do not apply to a Hindu Undivided Family. However in case of amalgamation of two or more families these limit apply. [Refer to *Practical Problems 4 to 7*]

#### 6.0 NATURE OF A PARTNERSHIP FIRM

1. A partnership firm is not a person in the eyes of law [except under Section 2(31) of the Income Tax Act, 1961]. It has no separate legal entity apart from the partners constituting it [*Malabar Fisheries Co. v. CIT*].
2. Thus, firm themselves cannot enter into a contract for partnership though their partners can. **For example**, two firms, namely, M/s A&B and M/s X&Y, themselves cannot form a new partnership though the partners of the individual firms can form a partnership.

## 7.0 WHAT IS THE TEST OF PARTNERSHIP

### LEGAL POSITION

According to Section 6, “In determining whether a group of persons is or is not a firm, regard shall be had to the real relation between the parties as shown by all relevant facts taken together.” The real relation between the partners can be ascertained as under:

<b>I. If there is an express contact.</b>	The real relation is ascertained from the terms of partnership contract.
<b>II. If there is no express contract.</b>	The real relation is ascertained from all the relevant factors such as contract of parties, books of accounts, statement of employees etc.

Section 6 is based on the principle laid down in an important case of *Cox v. Hickman* (1860). The analysis of this section reveals that the following is the true test of partnership:

- (a) The partnership is determined from the real relation between partners and such relation must show the existence of mutual agency relationship, and
- (b) The sharing of profit is *prima facie* evidence but not a conclusive test of partnership.

A group of persons shall be regarded as partnership if the real relation between the partners shows that all essential elements of partnership are present.

### CASES WHERE THE PARTNERSHIP RELATION DOES NOT EXIST

The **two** cases where the partnership relation does not exist are given below:

- (a) ***Joint owners of some property sharing profits or gross returns arising from the property [Explanation 1 to Section 6].***

**Example** X and Y jointly purchased a building and contributed capital equally to convert the building into a hotel. They let it out on a rent of ₹ 1,00,000 per annum and share the rental income equally.

**Decision:** X and Y are regarded as co-owners and not partners.

**Reason:** X and Y do not have mutual agency relationship.

[**Leading case:** *Govind Nair v. Maga*]

- (b) ***Persons sharing the profits but not having mutual agency [Explanation II to Section 6]*** The sharing of profits is *prima facie* evidence. This statement is true in the sense that some persons though sharing the profits of a business, are not regarded as partners since they do not have mutual agency relationship. Such persons are:

- (i) a lender of the firm (who has lent money) who receives a share of profits; [*Mollow March & Co. v. The Court of Wards*]
- (ii) a widow or child of a deceased partner who receives a share of profits; [*I.T. Commissioner v. Kesharmal Keshardeo*]

- (iii) a servant or an agent who receives a share of profits as part of his remuneration; and [*Munshi Abdul Latif v. Gopeshwar Chatteraj*]
- (iv) a person who receives a share of profits in consideration of sale of business or goodwill of the business. [*Rawlinson v. Clarke*]

**Conclusion:** The true test of partnership is not the sharing of profits but the existence of mutual agency relationship, i.e., the capacity of a partner to bind other partners by his acts done in firm's name and be bound by the acts of other partners in firm's name.

[Refer to Practical Problems 8 to 16]

### WHO ARE NOT PARTNERS?

In addition to the persons sharing the profits but not having mutual agency relationship (as listed in aforesaid Para (b)), the following persons are not treated as partners:

- (a) Members of a Hindu undivided family (HUF) carrying on family business.
- (b) Burmese Buddhist husband and wife carrying on a business.

### CONCLUSION

Thus, partnership can be presumed when (a) there is an agreement to share the profits of a business and (b) the business must be carried on by all or by any of them acting for all. Even when the exclusive power and control is vested with one partner under an agreement, partnership shall be presumed to exist. [*K.D. Kamath & Co. v. Commissioner of Income. Tax*, 1972, 82 ITR 680 (SC)]

## 8.0 DISTINCTION BETWEEN PARTNERSHIP AND CO-OWNERSHIP

### MEANING OF CO-OWNERSHIP

Co-ownership means joint ownership of some property. The two or more persons who own some property jointly are called co-owners. As per Explanation I to Section 6, the joint owners of some property sharing profits or gross returns arising from the property do not become partners.

**Example** Two sons who inherit a building from their father, let it out on a rent of ₹ 10,000 per annum and share the rental income equally, are regarded as co-owners. If, however, they enter into an agreement to run a hotel in that building and share the income thereof, they will be regarded as partners.

### DISTINCTION BETWEEN PARTNERSHIP AND CO-OWNERSHIP

Basis of distinction	Partnership	Co-ownerships
1. Agreement	It arises from an agreement.	It may or may not arise from agreement.
2. Business	It is formed to carry on a business.	It may or may not involve carrying on a business.

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<b>3. Profit or loss</b>	It involves profit or loss.	It may or may not involve profit or loss.
<b>4. Mutual agency</b>	Partners have a mutual agency relationship.	Co-owners do not have a mutual agency relationship.
<b>5. Name of persons involved</b>	The persons who form partnership are called partners.	The persons who own some property jointly are called co-owners.
<b>6. Maximum limit</b>	The maximum limit of partners is 10 for a banking business and 20 for any other business.	There is <i>no</i> maximum <i>limit</i> of co-owners.
<b>7. Transfer of interest</b>	A partner <i>cannot transfer</i> his share to a stranger without the consent of other partners.	A co-owner <i>can transfer</i> his share to a stranger without the consent of other co-owners.
<b>8. Right to claim partition</b>	A partner has <i>no right</i> to claim partition of property but he can sue the other partners for the dissolution of the firm and accounts.	A co-owner <i>has</i> the <i>right</i> to claim partition of property.
<b>9. Lien on property</b>	A partner has a lien on the partnership property for expenses incurred by him on behalf of the firm.	A co-owner has <i>no</i> such <i>lien</i> .

### 9.0 DISTINCTION BETWEEN PARTNERSHIP AND HINDU UNDIVIDED FAMILY (HUF)

#### MEANING OF HINDU UNDIVIDED FAMILY (HUF)

- (a) According to the Hindu Law, "Hindu undivided family is a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters."
- (b) Three successive generations in the male line (son, grandson, and great-grandson) who inherit the ancestral property are called 'Coparceners'.
- (c) The property which a man inherits from any of his three immediate male ancestors (i.e., his father, grandfather and great grandfather), is called 'ancestral property'.
- (d) There are two schools of Hindu Law—Dayabhaga and Mitakshara.
- (e) Under Dayabhaga School of Law, which is applicable to West Bengal and Assam, a son acquires an interest in the ancestral property only after the death of his father.
- (f) Under Mitakshara School of Law, which is applicable to whole of India (except West Bengal and Assam), each son acquires by birth an interest in the ancestral property.

**DISTINCTION BETWEEN PARTNERSHIP AND HINDU UNDIVIDED FAMILY**

<b>Basis of Distinction</b>	<b>Partnership</b>	<b>Hindu Undivided Family</b>
<b>1. Agreement</b>	It arises from an agreement.	It arises by status or operation of law.
<b>2. Regulating law</b>	It is governed by the Indian Partnership Act, 1932.	It is governed by Hindu Law.
<b>3. Name of the persons involved.</b>	The persons who form partnership are called 'partners.'	The persons who are the members of the HUF are called 'Coparceners.'
<b>4. Maximum limit</b>	The maximum limit of partner is 10 for a banking business and 20 for any other business.	There is no maximum limit of coparceners.
<b>5. Admission of new members</b>	A person can be admitted to the existing partnership with the consent of all other partners.	A male person becomes a member merely by his birth.
<b>6. Minor members</b>	A minor can be admitted to the benefits of partnership with the consent of all the partners.	A male minor becomes a member merely by his birth.
<b>7. Female members</b>	A female can become a full fledged partner.	A female does not become member merely by her birth.
<b>8. Implied authority</b>	Each partner has implied authority to bind the firm by acts done in the ordinary course of the business of the firm.	Only the <i>Karta</i> has implied authority.
<b>9. Liability of members</b>	The liability of all the partners is unlimited.	Only <i>Karta's</i> liability is unlimited and the liability of the other coparceners is limited only to their shares in the family property.
<b>10. Right to demand accounts</b>	Each partner has a right to inspect and copy the account books and ask for the account of profits and losses.	The coparceners have no right to ask for the account of past dealings.
<b>11. Effect of death of a member</b>	Unless otherwise agreed partnership is dissolved on the death of any partner.	The Hindu undivided family continues to operate even after the death of a coparcener.

**10.0 DISTINCTION BETWEEN PARTNERSHIP AND COMPANY****MEANING OF COMPANY**

A company is an artificial person created by law having separate legal entity, perpetual succession, and a common seal.

**DISTINCTION BETWEEN PARTNERSHIP AND COMPANY**

<b>Basis of distinction</b>	<b>Partnership</b>	<b>Company</b>
<b>1. Legal entity</b>	A firm doesn't enjoy separate legal existence. Partners are collectively termed as a firm and individually as partners.	It has a separate legal existence. A company is separate from its members.
<b>2. Liability</b>	The liability of partners is unlimited.	Liability of its members is limited to the extent of the value of shares held by them.
<b>3. Tenure</b>	It does not enjoy a long lease of life. Death, sickness, retirement of partners may affect its existence so as to dissolve it. Dissolution may take place on flimsy grounds.	It enjoys perpetual existence. Even an atom bomb cannot destroy a company unless it is wound up under the due process of law. Winding up may take years.
<b>4. Number of members</b>	Minimum number of partners is 2. Maximum may be 10 (in case of banking business) or twenty (in case of non-banking business).	A public company must have a minimum 7 members to start with. However, there is no limit on the maximum number of members of a company.
<b>5. Transfer of interest</b>	A partner cannot transfer his share without the consent of other partners.	A member may transfer his share's as and when he likes. There is no restriction on transfer of shares.
<b>6. Agency</b>	Each partner represents the other partners so as to bind and be bound to others.	There is no agency relationship among members of a company as they do not bind each other with their actions.
<b>7. Distribution of profits</b>	Profits are distributable among partners as per the partnership deed.	There is no such compulsion that profits must be distributed. Only when the dividends are declared that the members get a share of profits.

<b>8. Management</b>	The entire management lies with all the partners.	Members cannot participate in management unless appointed as directors. However, members may attend and vote at meetings while making the appointment of Directors, Auditors etc.
<b>9. Property</b>	Property of the firm is the joint property of all its partners.	Property of the company is not the property of its members as the company and members have separate legal existence.
<b>10. Remedy of creditors</b>	The creditors of the firm can proceed against the partners jointly & severally	The creditors of a company can proceed only against the company and not against its members.
<b>11. Contract</b>	A partner can not contract with the firm.	A member can contract with the company
<b>12. Restriction on Authority</b>	Restrictions on partner's authority do not bind the outsiders.	Such restrictions contained in Articles bind the outsiders.
<b>13. Audit</b>	Not compulsory	Compulsory

## 11.0 DISTINCTION BETWEEN PARTNERSHIP AND CLUB

### MEANING OF CLUB

A club is an association of persons aimed at promoting non-profit making objects like culture, health, recreation etc.

### DISTINCTION BETWEEN PARTNERSHIP AND CLUB

Basis of distinction	Partnership	Club
<b>1. Objects</b>	It has business oriented objects aimed at profit sharing.	It is not aimed at making profits and hence has no business interests.
<b>2. Number of members</b>	Membership limited to 10 or 20 depending upon the nature of business.	There is no limit on the number of its members.
<b>3. Tenure</b>	Change in membership affects its existence and therefore generally does not enjoy a long tenure.	Change in membership does not affect its existence.

<b>4. Agency</b>	It is based on agency relationship among partners.	A member of a club is not agent of other members and therefore they do not bind each other with their acts.
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## 12.0 PARTNERSHIP DEED

### WHAT IS PARTNERSHIP DEED

The document which contains the term of a partnership as agreed among the partners is called 'partnership deed'. The deed is required to be duly stamped as per the Indian Stamp Act, 1889 and duly signed by all the partners.

### WHY IS IT NECESSARY TO PARTNERSHIP DEED IN WRITING

A partnership is formed by an agreement. This agreement may be express (i.e., oral or in writing) or implied. Though the law does not expressly require that the partnership agreement should be in writing, it is desirable to have it in writing in order to avoid any dispute with regard to the terms of the partnership.

### WHAT ARE THE CONTENTS OF PARTNERSHIP DEED

The partnership deed contains various provisions relating to various matters such as:

- (a) Name of the firm.
- (b) Names and addresses of all partners
- (c) Nature and place of business
- (d) Date of commencement of partnership
- (e) Duration of partnership
- (f) Amount of capital of each partner
- (g) Profit sharing ratio
- (h) Interest on capital
- (i) Interest on drawings
- (j) Interest on loan advanced by a partner to the firm
- (k) Salary or commission payable to any partner
- (l) Method of valuation of goodwill and other assets and liabilities in case of admission or retirement or death of a partner
- (m) Settlement of accounts in case of retirement/death of a partner or dissolution of firm

### WHAT A PARTNERSHIP DEED MUST NOT CONTAIN?

The partnership deed must not contain any term which is in contravention with the provisions of the Indian Partnership Act.

### HOW CAN TERMS OF A PARTNERSHIP DEED BE VARIED

The terms laid down in the partnership deed may be varied with the consent of *all* the partners.



## 13.0 REGISTRATION

### MEANING OF REGISTRATION

Registration means getting the partnership registered with the Registrar of Firm of the area in which the place of business of the firm is situated or proposed to be situated.

### WHAT IS THE PROCEDURE FOR REGISTRATION

The practical steps involved in the registration of a firm are given below:

#### PRACTICAL STEPS INVOLVED IN THE REGISTRATION OF A FIRM

**Step 1:** *Obtain a Statement in the prescribed form from the office of the Registrar of Firms of the area in which any place of business of the firm is situated or proposed to be situated.*

**Step 2:** *State the following information in the statement:*

- (a) the name of the firm;
- (b) the principal place of the firm;
- (c) the names of other places where the firm carries on business;
- (d) the date when each partner joined the firm;
- (e) the names in full and permanent addresses of the partner;
- (f) the duration of the firm.

**Step 3:** *Get the statement duly verified and signed by all the partners or by their duly authorised agents.*

**Step 4:** *File the Statement alongwith prescribed fees with the Registrar of the Firms of the area.*

**Step 5:** *Obtain a Certificate from the Registrar.*

**Note:** When the Registrar is satisfied that the provisions of Section 58 have been duly complied with, he shall record an entry of the Statement in the register called 'Register of Firms' and file the statement. He shall then issue a certificate of registration [Section 59].

It may be noted that if any change is made in the particulars filed with the Registrar, the same should be duly notified to the Registrar so that he can incorporate the same in the 'Register of Firms'.

### WHEN CAN A FIRM BE REGISTERED

Since the registration of a firm is not compulsory, it can be effected at any stage, i.e., at the time of its formation or at anytime thereafter. Section 69(2) provides that no suit can be filed by or on behalf of an unregistered firm in a court. This means the firm must be got registered before any suit is filed in a court.

### WHEN DOES REGISTRATION BECOMES EFFECTIVE

Registration becomes effective from the date of filing of the duly signed and verified statement alongwith the prescribed form and not from the date of issue of certificate

of registration since the act of the Registrar in recording an entry of the statement in the Register of Firms is only a clerical act. **[J.R. and O.M. Contractors v. Income Tax Commissioner]**

### IS THE REGISTRATION OF FIRM COMPULSORY

Under the Indian Partnership Act 1932, the registration of a firm is not compulsory. But, indirectly, by creating certain liabilities (also termed as effects of non-registration u/s 69) from which an unregistered firm suffers, the law has made the registration of firms desirable.

**The effects of non-registration of a firm are as follows:**

1. **No suit by a partner against the firm or the other partner [Section 69(1)]** A partner of an unregistered firm cannot file a suit against the firm or any partner of the firm to enforce any right arising from contract. *For example*, if a partner of an unregistered firm is not paid his share of profits, he cannot claim it through the court.  
**Note:** Section 69(1) prohibits the institution of civil suit and not the criminal suit.
2. **No suit by the firm against third parties [Section 69(2)]** An unregistered firm cannot file a suit against a third party to enforce any right arising from contract. *For example*, if an unregistered firm has sold some goods to a customer, it cannot file a suit against the customer for the recovery of the price of goods. On the other hand, if any unregistered firm has purchased some goods from a supplier, such supplier can file a suit against the firm for the recovery of the price of goods. Thus, it is only a suit by the unregistered firm or its partners against a third party, which is prohibited and not a suit by the third party against the unregistered firm or its partners. It may be noted that this disability can be removed by getting the firm registered before filing the suit. In case of *Puran Mal v. Central Bank of India*, it was held that a subsequent registration could not cure the defect that existed at the time of filing the suit.
3. **No right to claim set off in excess of ₹ 100 [Section 69(3)]** An unregistered firm or any partner thereof cannot claim a set off (if value exceeds ₹ 100) in proceeding instituted against the firm by a third party to enforce a right arising from a contract. *For example*, if an unregistered firm owes ₹ 10,000 to X, a third party, X owes ₹ 1,000 to such firm, X files a suit against the firm for the recovery of ₹ 10,000. In this case, an unregistered firm cannot say that ₹ 1,000 should be adjusted against ₹ 10,000.

### WHAT ARE THE RIGHTS NOT AFFECTED BY NON-REGISTRATION

1. **Rights of unregistered firm or partners thereof**
  - (i) Right of firm or partner of a firm having no place of business in India. [Section 69(4)(a)].
  - (ii) Right to file a suit or claim of set-off if the value of suit does not exceed ₹ 100 [Section 69(4)(b)].
  - (iii) Right of a partner to sue (a) for the dissolution of the firm, (b) for the accounts of a dissolved firm, or (c) for claiming share of the assets of a dissolved firm [Section 69(3)(a)].

(iv) Right to enforce a right arising otherwise than out of a contract, e.g. infringement of a Patent right by a third party. The firm may file a suit to restrain the third party from misusing the Patent right.

**2. Right of a third party to file a suit against the unregistered firm or partners thereof.**

**3. Power of an Official Assignee or Receiver or Court to realise the property of an insolvent partner [Section 69(3)(b)].**

**Example** *X and Y purchased a taxi and they were plying it in partnership. The firm was not registered. After 1 year, X sold the taxi without Y's consent and did not pay anything to Y. Y filed a suit against X to recover his share in the sale proceeds. X defended the suit on the ground that the firm was not registered. It was held that the suit was maintainable because it was for the realisation of the assets of a dissolved firm. [Basant Lal v. Chiranjit Lal] [Refer to Practical Problems 17 to 22]*

#### 14.0 WHAT ARE THE TYPES OF PARTNERSHIP ON THE BASIS OF ITS DURATION

On the basis of duration, the partnership can be *either* Partnership at will or Particular Partnership.

##### WHAT IS PARTNERSHIP AT WILL ?[SECTION 7]

When there is no provision in partnership agreement for duration of the partnership, the partnership is called 'Partnership at Will'. A partnership at will may be dissolved by any partner by giving a notice in writing to *all other* partners of his intention to dissolve the firm.

##### WHAT IS PARTICULAR PARTNERSHIP ?[SECTION 8]

When a partnership is formed for a specific venture or for a particular period, the partnership is called a 'Particular Partnership'. Such partnership comes to an end on the completion of the venture *or* on the expiry of the period. If such partnership is continued after the expiry of term or completion of the venture, it is deemed to be a partnership at will. A particular partnership may be dissolved before the expiry of the term *or* completion of the venture only by the mutual consent of *all* the partners.

#### 15.0 WHAT ARE THE TYPES OF PARTNERS?

A person who deals or intends to deal with a firm, must know who the partners are and to what extent each partner is liable. To ascertain the extent of partner's liability, it becomes necessary to know the various types of partners which are given on next page:

TYPES OF PARTNERS	
<b>Actual or Ostensible Partner</b>	<ol style="list-style-type: none"> <li>1. He takes an active part in the conduct of the business.</li> <li>2. He alongwith other partners is liable to third parties for all the acts of the firm.</li> <li>3. He must give public notice of his retirement.</li> <li>4. His insanity or permanent incapacity to perform his duties may be a ground for the dissolution of the firm.</li> </ol>

<b>Sleeping or Dormant Partner</b>	<ol style="list-style-type: none"> <li>1. He does not take an active part in the conduct of the business.</li> <li>2. He alongwith other partners is liable to third parties for all the acts of the firm.</li> <li>3. He need not give public notice of his retirement.</li> <li>4. His insanity or permanent incapacity to perform his duties is no ground for the dissolution of the firm.</li> </ol>
<b>Nominal Partner</b>	<ol style="list-style-type: none"> <li>1. He lends his name to the firm without having any real interest in the firm. He <i>neither</i> contributes to the capital <i>nor</i> shares the profits or takes part in the conduct of the business of the firm.</li> <li>2. He alongwith other partners is liable to third parties for all the acts of the firm if he is an actual partner.</li> <li>3. He must give public notice of his retirement.</li> <li>4. His insanity or permanent incapacity to perform his duties is no ground for the dissolution of the firm.</li> </ol>
<b>Partner in Profits Only</b>	<ol style="list-style-type: none"> <li>1. He shares the profits only and not the losses.</li> <li>2. He alongwith other partners is liable to third parties for all the acts of the firm.</li> <li>3. He must give public notice of his retirement.</li> <li>4. His insanity or permanent incapacity to perform his duties may be a ground for the dissolution of the firm.</li> </ol>
<b>Sub-Partner</b>	<ol style="list-style-type: none"> <li>1. He is a third person with whom a partner agrees to share his profits derived from the firm.</li> <li>2. He has no right against the firm nor is he liable for the acts of the firm.</li> <li>3. There is no question of public notice at all since he is a third person and not a partner</li> <li>4. His insanity or permanent incapacity to perform his duties is no ground for the dissolution of the firm since he is a third person and not a partner.</li> </ol>

## 16.0 PARTNER BY ESTOPPEL OR HOLDING OUT

### TWO CONDITIONS FOR PARTNER BY ESTAPPLE OR HOLDING OUT

A person is held liable as a partner by estoppel or holding out if the following two conditions are fulfilled:

- (a) He must have represented himself to be a partner by word spoken or written or by his conduct (such type of representation may be called as active representation), or He must have knowingly permitted himself to be represented as a partner (such type of representation may be called as tacit representation); and

- (b) The other person acting on the faith of such representation must have given credit to the firm. It is immaterial whether the person so representing to be a partner, is aware or not that the representation has reached the other person.

**Example I** *Ram, a sole proprietor of Ram Shyam & Co. employed Shyam as manager. Ram introduced Shyam as his partner to S, a supplier of goods. Shyam remained silent. Treating Shyam a partner S supplied the goods on credit. Ram failed to pay the price of goods. S filed a suit against both Ram and Shyam for the recovery of the price. Here, Shyam is liable as a partner by holding out because he has knowingly permitted himself to be represented as a partner and the S the supplier has acted on the faith of such representation. [Martyn v. Grag]*

**Example II** *Patudi, a renowned sportsman assumed the honorary presidentship of a publishing business which brings out a sports magazine because other partners requested him to do. S a supplier gave credit to this firm in the bona fide belief that Patudi was a partner in a firm. Here, Patudi is liable as a partner by holding out because he has knowingly permitted himself to be represented as a partner and the supplier has acted on the faith of such representation.*

### **POSITION OF A RETIRING PARTNER AS PARTNER BY HOLDING OUT [SECTION 28(2)]**

Where, after the retirement of a partner, the firm uses the retired partner's name as a partner, the retired partner who has not given public notice of his retirement, is held liable on grounds of holding out to third parties who give credit to the firm on the faith that he is still a partner.

### **EXCEPTIONS TO THE PRINCIPLE OF HOLDING OUT [SECTIONS 28(2) AND 34]**

The principle of holding out does not apply in the following cases:

- (a) Where, after the death of a partner, the firm uses the deceased partner's name as a partner, the estate of the deceased partner or his legal representatives cannot be held liable for acts of the firm done after his death. It may be noted that a public notice of a partner's death is not required.
- (b) The estate of the insolvent partner cannot be held liable for the acts of the firm done after the date of the order of adjudication [Section 34]. It may be noted that a public notice of a partner's insolvency is not required.

## **17.0 POSITION OF MINOR AS A PARTNER**

### **CAN A MINOR ENTER INTO A PARTNERSHIP AGREEMENT?**

Since a minor is not capable of entering into a contract, an agreement by or with a minor is void *ab-initio* (*Mohni Bibi v. Dharamdas Ghosh*). Since partnership is formed by an agreement, a minor cannot enter into a partnership agreement.

### **CAN A MINOR BE ADMITTED AS PARTNER?**

On the basis of the general rule that a minor cannot be a promisor, but can be a promisee or a beneficiary, Section 30 of the Indian Partnership Act 1932, provides as under:

**“With the consent of *all* the partners for the time being, a minor may be admitted to the benefits of partnership.”**

An analysis of the above provision highlights the following three conditions:

- (a) Before admission of a minor as a partner, there must be an existence of partnership;
- (b) There must be mutual consent of *all* the partners;
- (c) A minor can be admitted only to the benefits of partnership.

**Note:** There cannot be a partnership consisting of all the minors or of one major and all other minors. [*Shivaram v. Gaurishanker*]

#### **WHAT ARE THE RIGHTS AND LIABILITIES OF A MINOR PARTNER BEFORE ATTAINING MAJORITY?**

<b><i>Rights</i></b>	<b><i>Liabilities</i></b>
(a) He has a right to share the profits and property of the firm in accordance with the agreement. [Section 30(2)]	(a) He is liable only to the extent of his share in the profits and the property of the firm. He is not personally liable to third parties. [Section 30(3)]
(b) He has a right to have access to, and inspect and copy, any of the accounts of the firm. But he does not enjoy such rights in respect of books other than account books. [Section 30(2)]	(b) He cannot be declared insolvent on declaration of firm's insolvency, his share vests in the Official Receiver or Official Assignee.
(c) He has a right to file a suit for his share of profits or the property of the firm when he is not given his due share of profits. However, he can exercise this right only when he decides to sever his connections with the firm [Section 30(4)].	

#### **WHAT ARE THE RIGHTS AND LIABILITIES OF A MINOR PARTNER ON ATTAINING MAJORITY?**

Within six months of date of his attaining majority or date of his obtaining knowledge that he had been admitted to the benefits of firm, whichever is later, the minor partner has to exercise his option whether or not to become a partner. Such option is required to be exercised by giving a public notice within the said six months. If he fails to give a public notice, he is deemed to have become a partner in the firm on the expiry of the said six months [Section 30(5)]. The various rights and liabilities of a minor partner on his attaining majority are given below:

<b><i>When he elects to become a partner</i></b>	<b><i>When he elects not to become a partner</i></b>
(a) He becomes personally liable to third parties for all acts of the firm since he was admitted to the benefits of partnership [Section 30(7)(a)].	(a) His rights and liabilities continue to be those of minor up to the date of giving public notice [Section 30(8)(a)].

(b) His share in the property and profits of the firm remains the same as he was entitled as a minor [Section 30(7)(b)].	(b) His share is not liable for any acts of the firm done after the date of the public notice [Section 30(8)(b)].  (c) He is entitled to sue the partners for his share of the property and profits in the firm [Section 30(8)(c)].
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## 18.0 PROPERTY OF THE FIRM

### MEANING OF PROPERTY OF THE FIRM [SECTION 14]

Unless otherwise agreed by the partners, the property of the firm includes:

- all properties, rights and interests originally brought to the common stock of the firm,
- the property acquired by purchase or otherwise by or for the firm,
- the property acquired with money belonging to the firm, and
- the goodwill of the business of the firm. The Act does not define the term goodwill. But it is understood in the sense of value of reputation of the firm judged in respect of its capacity to bring super profits due to general public patronage. It is a part of the partnership property and can be sold either separately or alongwith the other property of the firm [Section 55(1)].

**Example** *X, Y and Z are partners. X bought three plots of land—one in firm's name, one in his own name, one in the name of a fictitious person with money belonging to the firm. All the plots of land will be treated as the property of the firm.*

### USE OF THE PROPERTY OF THE FIRM [SECTION 15]

Unless otherwise agreed by the partners, the property of the firm shall be held and used by the partners exclusively for the purposes of the business of the firm. [Refer to *Practical Problem 23*]

## 19.0 MUTUAL RIGHTS AND DUTIES

### PROVISIONS WHICH GOVERN RIGHTS & DUTIES OF PARTNERS

The mutual rights and duties of partners are governed by (a) the Partnership Agreement and (b) the Partnership Act. The various provisions of the Partnership Act governing the mutual rights and duties of partners are summarised below:

Provisions of Sections 9 and 10	Provisions of Sections 11, 12, 16 to 25
(a) These provisions lay down the mandatory duties of partners	(a) These provisions lay down the <i>general</i> rights and duties.
(b) These provisions cannot be changed by an agreement amongst the partners.	(b) These provisions <i>can be changed</i> by an agreement amongst the partners

### WHAT ARE THE MANDATORY DUTIES OF PARTNERS? [SECTIONS 9 AND 10]

The mandatory duties are:

1. to carry on the business of the firm to the greatest common advantage,
2. to be just and faithful to each other, i.e. every partner should act in good faith. Good faith requires that a partner should not deceive the other partner by concealment of material facts.
3. to render true accounts and full information of all things affecting the firm to any partner or his legal representative.
4. to indemnify (i.e., to make good or to compensate) the firm for loss caused to it by his fraud in the conduct of the business of the firm.

**Note:** These mandatory duties can not be changed by mutual agreement amongst partners.

### WHAT ARE THE GENERAL DUTIES OF PARTNERS?

The general duties of partners as provided in the Act are subject to the agreement by partners. These can be changed by an agreement amongst the partners. Unless otherwise agreed by the partners, every partner has the following duties:

1. **To attend diligently [Section 12(b)]:** Every partner is bound to attend diligently (i.e. carefully) to his duties in the conduct of his business.
2. **Not to claim remuneration for taking part [Section 13(a)]:** A partner is not entitled to receive remuneration for taking part in the conduct of the business.
3. **To contribute equally to the losses [Section 13(b)]:** A partner must contribute equally to the losses sustained by the firm.
4. **To indemnify the firm [Section 13(f)]:** A partner must indemnify (i.e., compensate) the firm for any loss suffered by the firm due to his wilful neglect in the conduct of the business of the firm. The term 'wilful neglect', is something more than a mere 'negligence' and has been described as 'culpable negligence'.
5. **To hold and use firm's property for business purpose [Section 15]:** The partners must hold and use the firm's property for the purposes of the business.
6. **To account for and pay the personal profits from transactions of firm etc. [Section 16(a)]:** Every partner must account for and pay to the firm the profits earned by him from any transaction of the firm or from the use of firm's property, business connection or name. If a partner is entrusted with the job of buying sugar for the firm and he supplies sugar to the firm at a higher price from personal supplies held by him, he is liable to account for profits made (*Bentley v. Craven* (1853) 18 Beave).
7. **To account for and pay the personal profits from a competing business [Section 16(b)]:** Every partner must account for and pay all profits earned by him in the competing business. It may be noted that Section 11(2) permits the partners to enter an agreement restraining a partner from carrying on any business other than the business of the firm so long as he is a partner. [Refer to Practical Problems 24 to 27]



### WHAT ARE THE RIGHTS OF PARTNERS?

The rights of partners as provided in the Act are subject to the agreement by partners. These can be changed by an agreement amongst the partners. Unless otherwise agreed by the partners, every partner has the following rights:

1. **Right to take part [Section 12 (a)]:** Every partner has a right to take part in the conduct of the business.
2. **Right to express opinion [Section 12(c)]:** Every partner has the right to express his opinion before the matter is decided. **All matters except the change in the nature of the business, may be decided by a majority** of the partners. The change in the nature of the business may be made only with the *unanimous consent* of all the partners.
3. **Right to have access to books [Section 12(d)]:** Every partner has a right to have access to and to inspect and copy any of the books of the firm.
4. **Rights to share profits equally [Section 13(b)]:** A partner is entitled to share the profits of the business of the firm equally.
5. **Right to receive interest on capital out of profits [Section 13(c)]:** If the partnership agreement provides for the payment of interest on capital, the interest on capital shall be payable only out of profits. In other words, if there are losses, interest on capital will not be allowed.
6. **Right to claim interest on advances [Section 13(d)]:** A partner is entitled to claim interest on advances made by him to the firm @ 6% p.a. Interest on advances is payable whether there are profits or losses. It may be noted that the partner is not entitled to interest after the date of dissolution of firm unless otherwise agreed.
7. **Right to be indemnified [Section 13(e)]:** A partner has a right to recover from the firm the payments made and liabilities incurred by him:
  - (i) in the ordinary and proper conduct of the business, and
  - (ii) in doing act in emergency for the purpose of protecting the firm from loss if he has acted in a manner as a person of ordinary prudence would have acted in similar circumstances in his own case.
8. **Right to prevent the introduction of a new partner [Section 31]:** Every partner has the right to prevent the introduction of a new partner without the consent of all the existing partners.
9. **Right to retire [Section 32]:** Every partner has the right to retire with the consent of all other partners and in the case of a partnership at will, by giving notice to that effect in writing to all the other partners.
10. **Right not to be expelled [Section 33]:** Every partner has the right not to be expelled from the firm by any majority of partners unless such power is conferred by partnership agreement and is exercised in good faith. Thus expulsion may be exercised subject to the following conditions.
  - (a) It must be approved by majority of the partners.
  - (b) It must be exercised in good faith without any private animosity.
  - (c) The concerned partner must be given an opportunity to make a representation.

11. **Right to carry on competing business [Section 36(1)]:** Every outgoing partner has a right to carry on a competing business and to advertise such business. But, he cannot (i) use the firm's name, (ii) represent the firm, or (iii) solicit the firm's customers.
12. **Right to share subsequent profits [Section 37]:** Every outgoing partner or the estate of any partner who ceased to be a partner has the right to claim *either* a share in the subsequent profits of the firm *or* interest @ 6% p.a. on his share in the firm's property till the accounts are finally settled.
13. **Right to dissolve the partnership [Section 40]:** Every partner has the right to dissolve the partnership with the consent of all partners and in the case of a partnership at will, by giving notice to that effect in writing to all the other partners.

## 20.0 RELATION OF PARTNERS WITH THIRD PARTIES [SECTION 18]

The relations of partners with third parties are governed by the mutual agency relationship existing among the partners. According to Section 18, "every partner is an agent of the firm for the purposes of the business of the firm." In other words, every partner has the capacity to bind other partners by his acts done in firm's name. Therefore, all partners are liable to third parties for the acts of every partner done for the purpose of the business of the firm. [Refer to Practical Problem 28]

## 21.0 IMPLIED AUTHORITY OF A PARTNER [SECTION 19]

### MEANING OF IMPLIED AUTHORITY

The authority of a partner means the capacity of a partner to bind the firm by his act. This authority may be express or implied. The authority conferred on a partner by mutual agreement is called 'express authority'. The authority conferred on a partner by the provisions of Section 19 of the Indian Partnership Act is called 'implied authority'. Reading together Sections 19(1) and 22. Implied authority covers those acts of partners which fulfill the following three conditions:

- (a) The act must relate to the normal business of the firm;
- (b) The act must have been done in the usual way of carrying on the business of the firm; (It may be noted that the question as to what is usual and what is unusual in a business depends on the nature of business and the usage of trade, e.g. taking loan is considered as usual activity in case of a trading concern but unusual activity in case of a professional concern of solicitors.)
- (c) The act must be done in the firm's name or in any other manner expressing or implying an intention to bind the firm.

A firm was engaged in trapping elephants. One of the partners of the firm hired out an elephant without the consent of the other partners. Held, the act fell within the implied authority of the partner (*Mathuranath v. Bageshwari Rani*).

**Example** A, B, C, D and E are partners of a banking firm. State the legal position of firm for the following acts of partners:

- (a) *A* borrows money in the name of the firm,
- (b) *B* orders for a certain quantity of wine, on the firm's letter head.
- (c) *C* receives money from a borrower of a firm and utilised this amount for personal use without informing other partners about the receipt of this money.
- (d) *D* borrows money on his own credit by giving his own promissory note and utilises subsequently this amount for firm's use.

**SOLUTION:****Analysis of Partner's Acts whether Satisfying the Conditions of Sec. 19**

Partner's act	Whether the act done relates to the normal business of the firm	Whether the act has been done in the usual way	Whether the act has been done in firm's name or with an intention to bind <i>firm</i>
<i>A</i> 's act	Yes	Yes	Yes
<i>B</i> 's act	No	Yes	Yes
<i>C</i> 's act	Yes	Yes	Yes
<i>D</i> 's act	Yes	Yes	No

**Decision and reason:**

- (a) The firm is liable for the acts of *A* and *C*. Their acts fall within the scope of implied authority because all the conditions of Section 19 have been fulfilled.
- (b) The firm is not liable for the acts of *B* and *D*. Their acts do not fall within the scope of implied authority because all the conditions of Section 19 have not been fulfilled.

**WHAT ARE THE ACTS WITHIN THE IMPLIED AUTHORITY?**

An implied authority of a partner of a trading firm include the following acts:

- (a) To purchase goods of the kind that are used in the business of the firm;
- (b) To sell the goods of the firm;
- (c) To settle accounts with the persons dealing with the firm;
- (d) To receive payment of the debts due to the firm and issue receipts for the same;
- (e) To engage servants for the business of the firm;
- (f) To engage a lawyer to defend an action brought against the firm;
- (g) To borrow money for the purpose of the firm's business;
- (h) To pledge the goods of the firm as security for the repayment of borrowings made for the purpose of firm's business;
- (i) To draw, accept, endorse Bill of Exchange and other negotiable instruments in the name of the firm.

**RESTRICTIONS ON THE IMPLIED AUTHORITY OF A PARTNER [SECTIONS 19 AND 20]**

The restrictions on the implied authority of a partner may be discussed under the following two heads:

- (I) Statutory Restrictions and
- (II) Restrictions imposed by mutual agreement.

**I. Statutory Restrictions [Section 19(2)]** In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to do the following acts namely—

- (a) To submit a dispute to arbitration relating to the business of the firm;
- (b) To open a Bank Account on behalf of the firm in partner's own name;
- (c) To compromise or relinquish any claim or portion of the claim by the firm;
- (d) To withdraw a suit or proceedings filed on behalf of the firm;
- (e) To admit any liability in a suit or proceedings against the firm;
- (f) To acquire immovable property on behalf of the firm;
- (g) To transfer immovable property belonging to the firm; and
- (h) To enter into partnership on behalf of the firm. [Refer to Practical Problem 30]

**Note:** A partner can do any of the above-mentioned acts only if he is expressly authorised to do that act or the usage or custom of the trade permits him to do that act.

*For example,* a partner may open a Bank Account on behalf of the firm in his own name if he is expressly authorised to do so by mutual agreement.

### **Liability of the Firm for the above Restricted Acts of Partner**

The firm is not liable to third party for the above mentioned restricted acts of a partner whether or not the person dealing with the firm knew about such restrictions.

**II. Restrictions Imposed by Mutual Agreement [Section 20]** The partners of a firm by mutual agreement may extend or restrict the scope of implied authority of any partner. But a third party is not bound by any such restriction unless it has the knowledge of such restriction. In other words, the firm is liable to third party only if the third party has no knowledge of the restrictions.

**Example** *X, Y and Z are partners in a trading firm. They decide that no partner shall have the right to borrow beyond ₹ 20,000 without the consent of other partners. X without consulting Y and Z borrows from W ₹ 25,000 in the name of the firm and utilised the same in paying of the firm's debts. The firm is liable to pay W if W is unaware of the restriction but it will not be liable to pay W if W was aware of such restriction.*

### **IMPLIED AUTHORITY AND THIRD PARTIES [SECTIONS 20, 23 TO 27]**

All partners are liable to third parties for all acts of a partner which fall within the scope of his implied authority. Their liability to third parties in various cases are summarised as under:

**1. Effect of Restriction on Implied Authority [Section 20]** The partners of a firm by mutual agreement, may extend or restrict the scope of implied authority of any partner. But, the third party is not bound by any restriction imposed on the implied authority of a partner unless it has the knowledge of such restriction. For example, X, Y and Z are partners in a trading firm. By an agreement, they decided that no

partner shall have the right to buy goods beyond the value of ₹ 1,00,000 without the consent of other partners. A third party who had no knowledge of such restriction sold goods worth ₹ 2,00,000 to X who did not consult his other partners about this transaction. The firm is liable to pay the full amount to the third party.

**Note:** The above-mentioned extension or restriction is only possible with the consent of all the partners. Any one partner or even a majority of the partners, cannot restrict or extend the implied authority.[Refer to Practical Problem 31]

**2. Effect of Admissions by a Partner [Section 23]** Any admission or representation (e.g., acknowledgement signed by a partner) by a partner is sufficient evidence against the firm if the following two conditions are fulfilled:

- (i) Such admission or representation must relate to the affairs of the firm; and
- (ii) Such admission or representation must be made in the ordinary course of business.

**Notes:**

- (a) In the opinion of the Calcutta, Bombay and Allahabad High Courts, an acknowledgement signed by a partner in connection with partnership debt will extend the period of limitation against the firm under the Limitation Act. The High Court of Madras, however, has taken the view that the special authority must be proved.
- (b) The provisions of Section 23 would not apply after the dissolution of the firm [*Premji Dossa* 10 Bombay 358].

**3. Effect of Notice to an Acting Partner [Section 24]** Any notice to a partner operates as a notice to the firm if the following three conditions are fulfilled:

- (i) Such notice must relate to the affairs of the firm;
- (ii) Such notice must be given to a working partner and not to a sleeping partner.
- (iii) There must not be any fraud committed by the partners and the third party against the firm.[Refer to Practical Problem 33]

**4. Contractual Liability [Section 25]** Every partner is liable jointly with other partners and also severally (i.e., individually) for all those acts of the firm which have been done while he was a partner.

**Example** X, Y and Z were partners in a firm when infringement of a trademark took place. X retired. Later on, damages arising out of the alleged infringement arose after the dissolution of the firm. It was held that all the partners who were members of the firm at the time when infringement of a trademark took place, were liable. [*Thomas Bear & Sons v. Ralia Ram*] [Refer to Practical Problem 35]

**5. Liability of the Firm for Wrongful Acts of a Partner [Section 26]** The firm is liable to the same extent as the partner for any loss or injury caused to any third party or any penalty by the wrongful act or omission of a partner if *either* of the following two conditions is fulfilled:

- (i) Such wrongful act or omission must have been done by a partner while he was acting in the ordinary course of business of the firm, or

- (ii) Such wrongful act or omission must have been done by a partner with the authority of the other partners.

**Note:** The term 'wrongful act' includes fraud or negligence of the partners.

**Example** X, Y, Z are partners in a magazine business. X allows the publication of a defamatory article about a prominent person 'Sharad Pawar', without checking its validity. Sharad Pawar files a suit against the firm. The firm will be liable for this act of the editor partner on the following two grounds:

- (i) Such act caused loss of goodwill to Sharad Pawar,  
 (ii) Such act was done in the usual course of business. [Refer to Practical Problem 36]

- 6. Liability of Firm for Misappropriation by Partner [Section 27]** The firm is liable to the third parties in the following two cases of misappropriation by a partner:

Case	Condition
(a) <b>Where a partner receives money or property from a third person and misapplies it.</b>	The receipt of money or other property by a partner must be an act within the scope of his apparent authority.
(b) <b>Where a firm, in the course of its business, receives money or property from a third person and the same is misapplied by any of its partners.</b>	The partner must have misapplied while the property was in the custody of firm.

**Notes:**

- (i) The provisions of Section 26 deals with general wrongful act or defaults of a partner, whereas Section 27 deals with one particular wrong, i.e. misapplication of money or property by a partner.  
 (ii) Under Clause (a) of Section 27, it is not necessary that the property must have actually come into the custody of the firm whereas under Clause (b) of Section 27, it is necessary.

**Example** X, Y and Z are partners in a trading firm. W, a debtor of the firm, repays his debt of ₹ 5,000 to X who does not inform Y and Z about the repayment and misuses the money. W would be discharged of the debts on account of payment made to X because whatever is done by a partner, in the ordinary course of partnership business and within the scope of his authority, is deemed to have been done by him only as an agent for the other partners and it is immaterial whether or not the other partners have notice of this act.

[Refer to Practical Problems 37 and 38]

**PARTNER'S AUTHORITY IN AN EMERGENCY [SECTION 21]**

A partner's authority in an emergency covers those acts which fulfill the following two conditions:

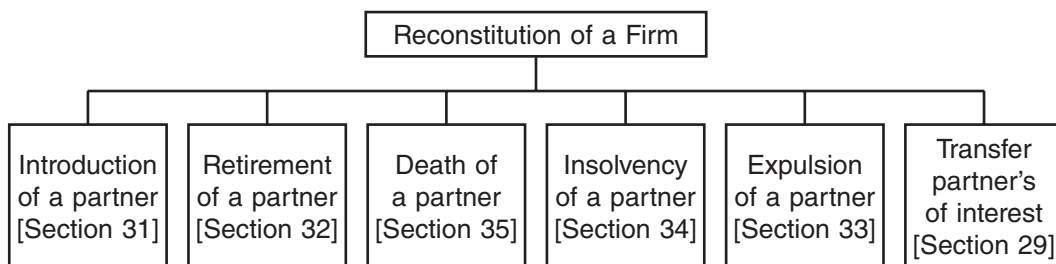
- (a) The act must be done to protect the firm from loss; and  
 (b) The act must be such as a prudent man would undertake under similar circumstances in his own case.

It may be noted that these acts do not form part of the implied authority of the partner but, nevertheless, they would bind the firm. A partner's authority in an emergency is similar to that of an agent in similar circumstances u/s 189 of the Indian Contract Act.

**Example** *X, Y and Z are partners in a trading firm. By an agreement, they decided that no partner would have authority to sell goods of the firm above the value of ₹ 50,000 without the consent of other partners. Owing to a sudden slump in the market, the prices crashed. One partner, in order to save the firm from loss, sold all the stock worth ₹ 5,00,000 without consulting any other partner. Such an act would bind the firm.*

## 22.0 RECONSTITUTION OF A FIRM

The reconstitution of a firm takes place when there is any change in the composition of the partnership. The various ways in which a firm is reconstituted are shown below:



### INTRODUCTION OF A PARTNER [SECTION 31]

Subject to provisions of Section 30 (regarding minor partner), a person may be admitted as a partner *either*—

- (i) with the consent of all the existing partners, or
- (ii) in accordance with a contract already entered into between the existing partners for the admission of a new partner.

**Example** *The partnership agreement between X and Y provides that X could introduce into partnership any of his sons on attaining the age of majority. X decides to admit his son (who has attained majority) as a partner. Y refused to consent, Y's consent is not required since the clause in the partnership agreement operated as a consent [Leading case: Byrne v. Reid]*

**Liability of an Incoming Partner for Firm's Acts done before his Admission** An incoming partner is not liable for all the acts of the firm done before his admission. This general rule has two exceptions which are as follows:

- (i) An incoming partner is liable for the acts done before his admission if (a) the new firm assumes the liabilities of the old firm, and (b) the creditors accept the new firm as their debtor and discharge the old firm from its liability.
- (ii) A minor who, on attaining majority decides to become a partner, is liable for all acts of the firm done since he was admitted to the benefits of partnership.



**Liability of an Incoming Partner for Firm's Acts done after his Admission** An incoming partner is liable for all the acts of the firm done after his admission.

### RETIREMENT OF A PARTNER [SECTION 32]

A partner may be retire from the firm in any of the following ways:

- (i) with the consent of all the other partners; or
- (ii) in accordance with an express agreement among the partners; or
- (iii) in the case of partnership at will, by giving a notice to all other partners of his intention to retire.

**Note:** In case of a partnership at will, a partner may retire by notice even if the pending contracts have not been completed. [Keshav Lal v. Bhai Lal]

**Liabilities of a Retiring Partner** The liabilities of a retiring partner may be discussed as under:

<b>(a) For Firm's acts before his retirement [Section 32(2)]</b>	He continues to be liable to third party unless he is discharged for the same by a tripartite agreement between him, third party and the partners of the reconstituted firm.
<b>(b) For Firm's acts after his retirement [Section 32(3), (4)]</b>	He continues to be liable to third party (other than one who deals with the firm without knowing that he was a partner) until public notice of his retirement is given <i>either</i> by himself <i>or</i> any of the other partners. This liability of a retiring partner is based on the principle of holding out.

**Rights of a Retiring Partner [Sections 36 and 37]** A retiring partner has the following two rights:

<b>(a) Right to carry on competing business [Section 36]</b>	He may carry on a business competing with that of the firm and may advertise such business but unless otherwise agreed he cannot— (i) use the firm's name; (ii) represent himself as carrying on firm's business; (iii) solicit the old customers.
<b>(b) Right in case of no final settlement of accounts [Section 37]</b>	He at his option, is entitled to claim, either of the following: (i) such share of profits earned after his retirement which is attributable to the use of his share of the property of the firm, or



	<p>(ii) Interest at the rate of 6% p.a. on the amount of his share in the property.</p> <p><b>Notes:</b> This right is available to a retiring partner even if only a part of his property is used in the business. [Ramakrishna Ayyar v. Muthu-swami Ayyar]</p> <p>This right is also available to the legal representatives of a deceased partner.</p>
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[Refer to Practical Problems 42 to 44]

### EXPULSION OF A PARTNER [SECTION 33]

A partner may be expelled if the following four conditions are satisfied:

- Express Power** – the power to expel a partner must have existed in a contract between the partners;
- By Majority** – the power must have been exercised by a majority of the partners, and
- Good Faith** – the power must have been exercised in good faith without any private animosity.
- Opportunity** – The affected partner must be given an opportunity to make a representation before being dismissed.

The expulsion, without the satisfaction of the aforesaid conditions, is said to be an irregular expulsion which is null and void. The partner who has been wrongly expelled, has a right to claim reinstalment as a partner and not to recover damages for wrongful expulsion.

The rights and liabilities of an expelled partner are the same as those of a retired partner. [Section 33(2)]

### INSOLVENCY OF A PARTNER [SECTION 34]

The effects resulting from the insolvency of a partner are summarised below:

- He ceases to be a partner on the date of the orders of adjudication;
- Unless otherwise agreed, the firm is dissolved; [Section 42(d)]
- His estate is not liable for firm's acts done after the date of the order;
- Firm is not liable for his acts done after the date of the order.

**Note:** No public notice is required on the insolvency of a partner. [Section 45] [Refer to Practical Problem 45]

### DEATH OF A PARTNER [SECTIONS 35 AND 42(C)]

Unless otherwise agreed by the partners, a firm is dissolved on the death of a partner [Section 42(c)]. Where under the contract a firm is not dissolved by the death of a partner, the estate of the deceased partner is not liable for any act of the firm done after the date of his death [Section 35].

**Note:** No public notice is required on the death of a partner. [Section 45]

**Example** *X was a partner in a firm. The firm ordered goods in X's life time but the delivery of the goods was made after X's death. In such a case, X's estate would not be liable*

*for this debt because there was no debt due in respect of such goods in X's life time.*  
[Leading case: *Bagel v. Miller*]

### RIGHTS OF TRANSFeree OF A PARTNER'S SHARE [SECTION 29]

A partner may transfer his interest in the firm by sale, mortgage or charge fully or partially. The rights of such a transferee are as follows:

<b>(a) During the continuance of the partnership</b>	He is entitled to receive the share of the profits of the transferring partner and the account of profits agreed to by the partners. He is not entitled (a) to interfere with the conduct of the business (b) to require accounts; (c) to inspect the books of the firm.
<b>(b) On the dissolution of firm or on the retirement of the transferring partner</b>	He is entitled to receive (a) the share of the assets of the transferring partner and (b) an account as from the date of the dissolution for the purpose of ascertaining the share.

**Sub-partnership:** A sub-partnership arises when a partner of a firm agrees to share his share in the firm, with a stranger. It was assumed in *Venkatratnam v. Venkatratnam* (A.I.R. 1944, Madras, 394) that a sub-partner is a transferee within the meaning of Section 29. Thus, the rights of a sub-partner are the same as those of a transferee of partner's share under Section 29.

### EFFECT OF THE CHANGE IN THE CONSTITUTION OF THE FIRM ON CONTINUING GUARANTEE [SECTION 38]

A continuing guarantee is a guarantee which extends to a series of transactions. Unless otherwise agreed by the partners, a continuing guarantee given to a firm or to a third party in respect of the transaction of a firm is revoked as to the future transactions from the date of any change in the constitution of the firm. [Refer to Practical Problem 47]

### RIGHTS AND DUTIES OF PARTNERS AFTER CHANGE IN THE FIRM [SECTION 17]

The rights and duties of the partners of the reconstituted firm shall be the same as they were before the change in the firm. Section 17 provides for the following **three types of changes** in the firm:

- Where there is a change in the Constitution of the firm. [Section 17(a)]
- Where the firm continues after the expiry of the term of the firm. [Section 17(b)]
- Where the firm carries on an additional undertaking. [Section 17(c)]

## 23.0 DISSOLUTION OF FIRM [SECTIONS 39 TO 47]

### MEANING OF DISSOLUTION

The term 'dissolution' stands for discontinuation. Under the Indian Partnership Act, 1932, the dissolution may be *either* of Partnership *or* of a firm.

### MEANING OF DISSOLUTION OF PARTNERSHIP

Dissolution of partnership refers to the change in the existing relations of the partners. The firm continues its business after being reconstituted. This may happen on admission, retirement or death of a partner or change in profit sharing ratio in the firm

**Example** *X, Y and Z are partners in a firm. X retires. The partnership between X, Y and Z comes to an end and new partnership between Y and Z comes into existence. This new partnership between Y and Z shall be known as 'reconstituted firm'. Thus, on retirement of partner, the old partnership stands dissolved, but the firm continues its business with the remaining partners Y and Z.*

### MEANING OF DISSOLUTION OF FIRM

Dissolution of a firm means the dissolution of partnership between all the partners of a firm. In such a situation, the business of the firm is discontinued, its assets are realised, the liabilities are paid off and the surplus (if any) is distributed among the partners according to their rights.

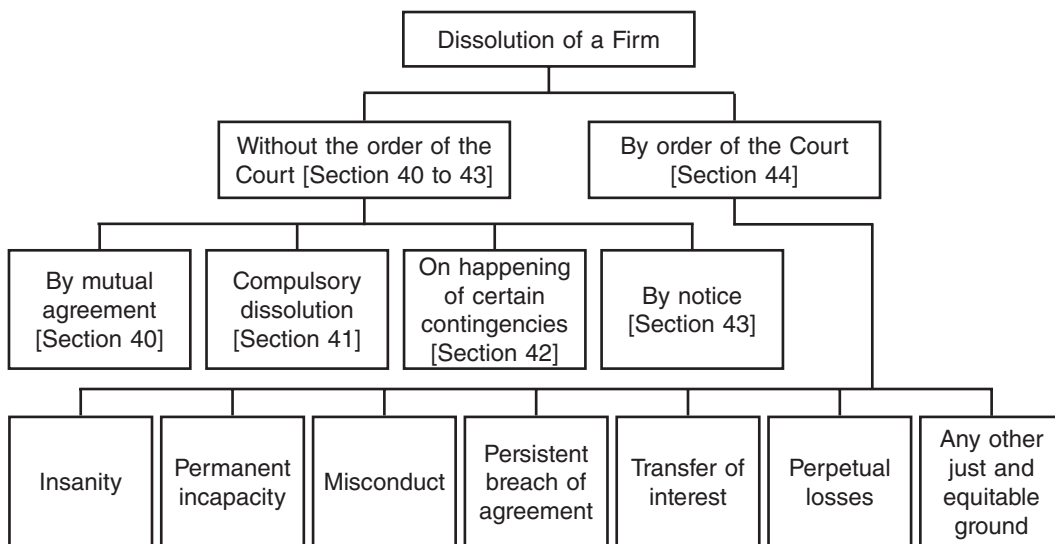
### DISTINCTION BETWEEN DISSOLUTION OF PARTNERSHIP AND DISSOLUTION OF A FIRM

<i>Basis of distinction</i>	<i>Dissolution of partnership</i>	<i>Dissolution of firm</i>
<b>1. Termination of old partnership and formation of new partnership</b>	Old partnership comes to an end a new partnership comes into existence.	Old partnership comes to an end but no new partnership comes into existence.
<b>2. Constitution of business under firm's name</b>	The business continues under firm's name.	The business does not continue under firm's name.
<b>3. Revaluation vs. Realisation</b>	Revaluation account is prepared.	Under firm's dissolution, Realisation account is prepared.

Thus, dissolution of firm involves dissolution of partnership but dissolution of partnership may not lead to dissolution of firm.

**WHAT ARE THE MODES OF DISSOLUTION OF A FIRM [SECTIONS 40 TO 44]**

The dissolution of a firm may take place *either* without the order of the court *or* by an order of the court. The circumstances under which dissolutions take place are shown below

**DISSOLUTION WITHOUT THE ORDER OF THE COURT [SECTIONS 40 TO 43]**

Dissolution of firm without the order of the court may take place in the following ways:

1. **Dissolution by mutual agreement [Section 40]:** A firm may be dissolved by mutual agreement among all the partners.

*Note:* Even a firm for a fixed duration may be dissolved by mutual agreement. [Refer to Practical Problem 48]

2. **Compulsory dissolution [Section 41]:** A firm is compulsorily dissolved in the following two circumstances:

- (a) If all the partners, or all but one partner of the firm are declared insolvent; [The reason is that there must be at least two persons to continue a firm and such persons must be competent to contract].
- (b) If some event takes place which makes it unlawful for the firm's business to be carried on.

**Example** X a resident in India and Y a resident in Pakistan, are partners in a trading firm. War breaks out between India and Pakistan. In such a situation, on outbreak of war, it becomes unlawful for the business of the firm to be carried on.

**Note:** The illegality of one or more business but not all businesses would not necessitate the dissolution of the firm. [Refer to Practical Problems 49(a), (b) and 50]

3. **Dissolution on the happening of certain contingencies [Section 42]:** Unless otherwise agreed by partners, a firm is dissolved on the happening of any of the following four contingencies:

- (a) On the expiry of the fixed term for which the firm was constituted;
- (b) On completion of the venture(s) or undertaking(s) for which the firm was constituted;
- (c) On the death of a partner; and
- (d) On the insolvency of a partner.

**Note:** If all the partners or all but one partner of the firm are dead, the firm shall be compulsorily dissolved even if the partnership agreement provided that the firm shall not be dissolved on the death of a partner. The reason is that there must be at least two partners to continue a firm. [Refer to *Practical Problems 49(c) and 51*]

4. **Dissolution by notice [Section 43]:** Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all other partners of his intention to dissolve the firm. The firm is dissolved from the date of dissolution mentioned in the notice or if no date is mentioned, as from the date of the communication of the notice.

**Note:** Notice once given cannot be withdrawn without the consent of all other partners. [Jones v. Lloyd] [Refer to *Practical Problem 52*]

### WHAT ARE THE GROUNDS FOR DISSOLUTION BY AN ORDER OF COURT

This section deals with those grounds on which the court may, on the receipt of petition by a partner, order for the dissolution of the firm. These grounds are:

1. **Insanity [Section 44(a)]:** When a partner has become of unsound mind, the court may allow dissolution of the firm on a suit by any partner of the firm. However, temporary sickness is no ground for dissolution of partnership. Similarly, a dormant partner's insanity will be no ground to seek dissolution under this head as such partner has hardly any duties to perform.  
**Note:** In this particular case only, the petition may be filed *either* by any other partner or the next friend of the insane partner.
2. **Permanent Incapacity [Section 44(b)]:** When a partner [i.e., an active partner and not a sleeping partner] has become permanently incapable of performing his duties as a partner, any other partner may apply for dissolution. Such permanent incapacity may result from physical disablement, illness etc.
3. **Misconduct [Section 44(c)]:** When a partner is guilty of misconduct which is likely to adversely affect the carrying on of the business, the court may allow dissolution. The court may order the dissolution of a firm on account of misconduct of any partner other than the one filing a suit for dissolution. It is not necessary that the misconduct must relate to the business of the firm e.g. in *Carmichael v. Evans* (1 Ch. 486), a partner of the firm was convicted on account of travelling without ticket in Rail, the court ordered the firm to be dissolved on petition by other partners as such act of the partner was detrimental to the interest of the firm.

Similarly, in *Abbot v. Grump* (1870) 5 Bang. L.R. 109, the court ordered the firm to be dissolved on account of adultery committed by one partner against the wife of the other partner. Dissolution was ordered as such act of adultery would adversely affect the mutual trust and confidence among partners.

4. **Persistent Breach of Agreement [Section 44(d)]:** When a partner willfully or persistently (i.e., frequently) commits breach of agreement in matters relating to the business of the firm, any other partner may seek for dissolution of the firm. Embezzlement, fraudulent breach of trust, or keeping erroneous accounts may be sufficient ground for the court to order dissolution of the firm, e.g. a partner as a matter of routine holding more cash than allowed under the partnership deed, refusal to show accounts despite repeated requests, would be a sufficient ground to uphold dissolution. However, the partner seeking dissolution must not be a party to such misconduct.
5. **Transfer of Interest [Section 44(e)]:** When a partner has transferred the *whole* of his interest in the firm to a third party *or* allowed his share to be charged on account of a decree passed by a court towards payment of liabilities of that partner *or* allowed his share to be sold in the recovery of arrears of land revenue, it would be sufficient to attract dissolution.
6. **Perpetual Losses:** Where the business of the firm cannot be carried on except at a loss, the court may order dissolution of the firm.
7. **Any other Just and Equitable Ground [Section 44(f)]:** Where the court is satisfied that it is just and equitable to dissolve the firm it may allow dissolution using its discretionary power to meet the ends of justice. Examples of such grounds include continued quarrelling between the partners, refusal to meet on matters of business. Complete deadlock in management due to partners not on speaking terms or lack of confidence and good faith between partners.

**Note:** The right of a partner to file a suit for dissolution on any of the above seven grounds cannot be excluded by any agreement to the contrary.

[Hardit Singh v. Mukha Singh] [Refer to Practical Problem 53]

## 24.0 WHAT ARE THE RIGHTS OF A PARTNER ON DISSOLUTION

The various rights of a partner on dissolution are as follows:

### PARTNER'S GENERAL LIEN [SECTION 46]

Every partner or his representative is entitled—

- (i) to have the firm's property applied in payment of the firm's debts, and
- (ii) to have the surplus distributed amongst the partners or the representatives according to their respective rights.

### RIGHT TO CLAIM THE RETURN OF PREMIUM ON PREMATURE WINDING UP [SEC. 51]

If a partner joined a firm for a fixed term and had paid a premium and the firm is dissolved before the fixed term, he is entitled to return of the premium. The amount of premium will depend upon (i) the terms upon which he became a partner, and (ii) the length of the time during which he was a partner. However, such a partner cannot claim any return of the premium in the following three circumstances:

- (i) When the dissolution is due to the death of partner;

- (ii) When the dissolution is mainly due to the misconduct of the partner who paid the premium; or
- (iii) The dissolution is according to an agreement which had no provision for the return of premium or any part thereof. [Refer to *Practical Problem 54*]

### **RIGHTS OF A PARTNER IN CASE OF DISSOLUTION ON ACCOUNT OF FRAUD OR MISREPRESENTATION [SECTION 52]**

Where the partnership is rescinded on grounds of fraud or misrepresentation, the aggrieved partner, besides other rights under other provisions, has the following rights:

- (i) He has a right of lien on the surplus assets after the payment of firm's debts, for any sum paid by him for purchase of a share in the firm or for any capital contributed by him;
- (ii) He is entitled to rank as a creditor of the firm in respect of any payment made by him towards firm's debts;
- (iii) He is entitled to be indemnified by the partner(s) guilty of fraud or misrepresentation against all the debts of the firm.

### **RIGHT TO RESTRAIN FROM USE OF FIRM NAME OR FIRM PROPERTY [SECTION 53]**

Unless otherwise agreed by the partners, every partner or his representative may restrain any other partner or his representative from carrying on a similar business in the firm name or from using the property of the firm for his own benefit till the affairs of the firm are completely wound up.

## **25.0 WHAT ARE THE LIABILITIES OF A PARTNER ON DISSOLUTION**

The various liabilities of a partner on dissolution are as follows:

### **CONTINUING LIABILITY FOR ACTS OF PARTNERS DONE AFTER DISSOLUTION [SECTION 45]**

Until a public notice is given of dissolution, the partners continue to be liable for any act done by any of them after dissolution and such act is deemed to be an act done before the dissolution.

**Example** *X, Y and Z are partners in a trading firm. They executed a dissolution deed to dissolve the firm as from 1st March but did not give public notice till 31st March. On 20th March, X borrowed ₹ 20,000 in the firm's name. The firm is liable.*

**Exceptions** The following shall not be liable for acts done after the dissolution of the firm even though the public notice has not been given:

- (i) the estate of a deceased partner;
- (ii) the estate of an insolvent partner;
- (iii) a sleeping or dormant partner who has retired from the firm. [Refer to *Practical Problem 55*]

**CONTINUING AUTHORITY OF PARTNERS AFTER DISSOLUTION [SECTION 47]**

After the dissolution of a firm, the authority of a partner to bind the firm and the other mutual rights and obligations of the partners continue, so far as may be necessary—

- (i) to wind up the affairs of the firm, and
- (ii) to complete the unfinished transactions pending at the date of dissolution.

**26.0 SETTLEMENT OF ACCOUNTS [SECTIONS 48, 49 AND 55]**

Unless otherwise agreed by the partners, the accounts of a dissolved firm shall be settled according to the provisions of Sections 48, 49 and 55. These provisions are as follows:

**TREATMENT OF LOSSES [SECTION 48(A)]**

Losses including deficiencies of capital are to be paid in the following manner:

- (i) First out of profits; (ii) Then out of capital;
- (iii) Lastly by partners individually in their profit-sharing ratio. [Section 48(a)] [*Refer to Practical Problem 56*]

**APPLICATION OF ASSETS [SECTION 48(B)]**

The assets of the firm (including the sums, if any, contributed by the partners to make up the deficiencies of capital) shall be applied in the following manner and order:

- (i) in paying firm's debts to the third parties;
- (ii) in paying to each partner rateably what is due to him on account of advances;
- (iii) in paying to each partner rateably what is due to him on account of capital;
- (iv) the residue, if any, shall be divided among the partners in their profit-sharing ratio. [Section 48(b)]. [*Refer to Practical Problem 57*]

**PAYMENT OF FIRM'S DEBTS AND PARTNER'S PRIVATE DEBTS [SECTION 49]**

Where there are firm's debts and partner's private debts, the following provisions shall apply:

- (i) Firm's property shall be applied first in payment of firm's debts then the surplus, if any, shall be applied in the payment of partner's private debts to the extent to which the concerned partner is entitled to share in the surplus; and
- (ii) Partner's private property shall be applied first in payment of his private debts and the surplus, if any, in payment of firm's debts if firm's liabilities exceed the firm's assets. [Section 49][*Refer to Practical Problem 58*]

**DISTINCTION BETWEEN FIRM'S DEBTS AND PRIVATE DEBTS**

Firm's Debts and Private Debts can be distinguished as under:

<i>Basis of distinction</i>	<i>Firm's debts</i>	<i>Private debts</i>
<b>1. Who incurs</b>	Firm's debts are incurred by the firm.	Private debts are incurred by a partner in the individual capacity of a household and not in the capacity of a partner of a firm.



<b>2. Who is liable</b>	For firm's debts, all partners are jointly and severally liable.	For private debts, only the concerned partner is liable.
<b>3. Application of firm's property</b>	For firm's debts, firm's property shall be applied first.	For private debts, only the share of concerned partner in the excess of firm's property over firm's debts can be applied.
<b>4. Application of private property</b>	For firm's debts, only the excess of partner's private property over his private debts can be applied.	his private debts can be applied.

### **TREATMENT OF LOSS ARISING DUE TO INSOLVENCY OF A PARTNER**

The Capital Account of a partner may show a debit balance after making all adjustments (including the share of any profit or loss on realisation and the receipts from his private estate, if any). It may be noted that the private estate of each partner is applied first to pay off his private debts and the surplus (i.e. excess of private estate over private debts), if any, is applied to pay off the firm's debts. If a partner having a debit balance in his Capital Account is unable to bring in the necessary cash to make up the deficiency, he is said to be an insolvent partner. The irrecovered debit balance is called the loss arising due to the insolvency of a partner. Now the question arises, should this loss be regarded as an ordinary loss (which is shared by the partners in their profit sharing ratio) or an extraordinary one? This issue was involved in the leading case of *Garner v. Murray* (1904).

### **DECISION IN GARNER V. MURRAY**

**Justice Joyee** held that the loss arising due to the insolvency of a partner must be distinguished from an ordinary loss (including realisation loss). Unless otherwise agreed, the decision in *Garner v. Murray* requires—

- (a) that the solvent partners should bring in cash equal to their respective shares of the loss on realisation;
- (b) that the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.

The Last Agreed Capital should be interpreted as under:

<b>Case</b>	<b>Meaning of last agreed capital</b>
<b>(a) In case of Fixed Capitals</b>	Last Agreed Capital means the Fixed Capital (as given in the Balance Sheet) without any adjustment.

<b>(b) In case of Fluctuating Capitals</b>	Last Agreed Capital means the Capital after making adjustments for past accumulated reserves, profits or losses, drawings, interest on capitals, interest on drawings, remuneration to a partner, etc. to the date of dissolution but before making adjustment for profit or loss on realisation.
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## 27.0 SALE OF GOODWILL [SECTION 55]

Unless otherwise agreed by the partners, the goodwill shall be included in the assets and may be sold *either separately or* alongwith other property of the firm. In case of sale of goodwill of dissolved firm, the rights of buyer and seller are as under:

<b>Rights of a buyer</b>	<b>Rights of a seller</b>
<b>(i) to use the firm's name.</b>	(i) to carry on a business competing with that of the buyer.
<b>(ii) to represent himself carrying on the as business of the old firm.</b>	(ii) to advertise such business. But subject to agreement between him and the buyer, he is not entitled (a) to use the firm's name, (b) to represent himself as carrying on business of the old firms, or (c) to solicit the old customers.
<b>(iii) to solicit the old customers</b>	

It may be noted that any partner may enter into an agreement with the buyer of goodwill that such partner will not carry on any business similar to that of the dissolved firm within a specified period or within the specified local limits. Such agreement shall be valid if restrictions imposed are reasonable.

**Note:** Though such an agreement is in restraint of trade and is void under Section 27 of the Indian Contract Act but Section 55(3) of the Indian Partnership Act permits and declares such agreements as valid.[Refer to Practical Problem 59]

## 28.0 PUBLIC NOTICE [SECTION 72]

### WHEN A PUBLIC NOTICE IS REQUIRED TO BE GIVEN?

A public notice is required to be given in the following three cases:

- on the retirement or expulsion of a partner, or
- on the dissolution of the firm,
- on the election to become or not to become a partner by a minor on his attaining majority.

**WHEN A PUBLIC NOTICE IS NOT REQUIRED TO BE GIVEN?**

A public notice is not required to be given in the following two cases:

- (a) on the death of a partner;
- (b) on the insolvency of a partner.

**WHAT IS THE MODE OF GIVING PUBLIC NOTICE?**

The mode of giving public notice is given as under:

<b>In case of a registered firm</b>	<b>In case of an unregistered firm</b>
(a) It must be given by publication in the Official Gazette.	(a) It must be given by publication in the Official Gazette.
(b) It must be given by publication in at least one vernacular newspaper circulating in the district where the firm to which it relates has its place or principal place of business.	(b) It must be given by publication in at least one vernacular newspaper circulating in the district where the firm to which it relates has its place or principal place of business.
(c) It must be given to the Registrar of Firms.	

**WHAT ARE THE CONSEQUENCES OF NOT GIVING A PUBLIC NOTICE?**

If a public notice is not given in cases in which it is required to be given, the consequences will be as follows:

<b>Case</b>	<b>Consequences</b>
<b>(a) On election to become or not to become a partner by a minor on his attaining majority</b>	Minor is deemed to have become a partner on the expiry of 6 months [Section 30(5)].
<b>(b) On retirement of a partner</b>	Retiring partner and the other partners continue to be liable as partner to the third parties for firm's acts done after retirement [Section 32(3)].
<b>(c) On expulsion of a partner</b>	The expelled partner and the other partners continue to be liable to third parties for firm's acts done after his expulsion [Section 33(2)].
<b>(d) On dissolution of a firm</b>	All the partners continue to be liable to third parties for firm's acts done after the dis-solution of firm [Section 45].

## PRACTICAL PROBLEMS

### PROBLEM 1

Two brothers X (age 18 years), Y (age 17 years), decide to form a partnership. Can they do so?

**Solution:** Section to which the given problem relates: Section 4.

**Decision:** No.

**Reason:** There must be at least two persons and such persons must be competent to contract. In the given case, Y is not competent to contract because he is a minor. Hence, there is only one person X who alone cannot form a partnership.

[**Leading case:** *Shivaram v. Gauri Shankar*]

### PROBLEM 2

Three brothers, X (age 19 years), Y (age 18 years) and Z (age 17 years), decide to form a partnership with a provision that Z will share the profits only.

**Solution:** Section to which given problem relates: Section 4.

**Decision:** No.

**Reason:** All the persons entering into partnership agreement must be competent to contract. Z is not competent to contract because he is a minor. It may be noted that no partnership can be formed with a minor partner. But after the formation of partnership, a minor can be admitted to the benefits of partnership with the consent of all other partners of the firm as per the provisions of Section 30 of the Act.

[**Leading case:** *Shivaram v. Gauri Shankar*]

### PROBLEM 3

Ten major persons form an association to which each member contributes ₹ 10,000. The purpose is to produce medicines for free distribution to poor patients. Is there a valid partnership?

**Solution:** Section to which the given problem relates: Section 4.

**Decision:** No.

**Reason:** There is no intention to carry on the business and to share the profits thereof.

**PROBLEM 4**

X, Y and Z agreed to share the profits and losses and to carry on the business by all or anyone acting for all for mutual benefits and gain. The management and control was entrusted in X with power to restrict the right of Y and Z. Is there a valid partnership?

**Solution:** Section to which the given problem relates: Section 4.

**Decision:** Yes.

**Reason:** All the essential elements of partnership exist under the partnership agreement.

[**Leading case:** *K.D. Kamath Co. v. Commission of Income Tax* (1972) 82, ITR 680 (SC)]

**PROBLEM 5**

X and Y agreed to share the profits of a business carried on by all or any of them acting for all. Later on, Z lent ₹ 1,00,000 to the firm on the condition that he will take 25% share in profits. Can Z be regarded as a partner?

**Solution:** Section to which the given problem relates: Sections 4 and 6.

**Decision:** No.

**Reason:** Sharing of profit, which is a *prima facie* evidence, exists, but the mutual agency relationship among X, Y and Z, which is a conclusive evidence, does not exist.

[**Leading case:** *Mollow March & Co. v. The Court of Wards*]

**PROBLEM 6**

X, a contractor, appointed Y one of his servants to manage his business of loading and unloading railway wagons. Y was to receive 50% of the profits of the business and also to bear the losses, if any. Is Y a partner of X?

**Solution:** Section to which the given problem relates: Sections 4 and 6.

**Decision:** No.

**Reason:** Sharing of profit which is a *prima facie* evidence, exists but the mutual agency relationship among X and Y, which is a conclusive evidence, does not exist. Here, Y is an agent of X but X is not an agent of Y.

[**Leading case:** *Munshi Abdul Latif v. Gopeshwar Chatteraj*]

**PROBLEM 7**

X, Y and Z were partners in a firm. X died. It was agreed that the widow of X would receive 10% share of profits of business as annuity. Is the widow of X a partner?

**Solution:** Section to which the given problem relates: Sections 4 and 6.

**Decision:** No.

**Reason:** Sharing of profit, which is a *prima facie* evidence, exists but the mutual agency relationship among X, Y and widow of X, which is a conclusive evidence, does not exist.

[**Leading case:** *I.T. Commissioner v. Kesharmal Keshardeo*]

#### PROBLEM 8

X and Y who jointly own a house, let it out on rent of ₹ 10,000 p.a., and share the rental income equally. Can X and Y be regarded as partners?

**Solution:** Section to which the given problem relates: Explanation 1 to Section 6.

**Decision:** No.

**Reason:** X and Y are merely co-owners who are sharing the gross returns arising from a joint property.

[**Leading case:** *Govind Nair v. Maga*]

#### PROBLEM 9

X and Y who jointly own a house, converted that house into a hotel after investing ₹ 1,00,000 each. X manages the hotel and meet all expenses and retains half of gross earnings and hands over the other half to Y. Can X and Y be regarded as partners?

**Solution:** Section to which the given problem relates: Explanation 1 to Section 6.

**Decision:** No.

**Reason:** X and Y are merely co-owners who are sharing the gross returns arising from a joint property.

[**Leading case:** *Govind Nair v. Maga*]

#### PROBLEM 10

X and Y who jointly own a house, converted that house into a hotel after investing ₹ 1,00,000 each. It was agreed that X would manage the hotel on his own behalf and on behalf of Y and the net earnings would be divided equally. Can X and Y be regarded as partners?

**Solution:** Section to which the given problem relates: Section 4.

**Decision:** Yes.

**Reason:** All the essential elements of partnership exist.

#### PROBLEM 11

X, a publisher agrees to publish at his own expense, a book written by Y and to pay Y half of the net profits. Can X and Y be regarded as partners?

**Solution:** Section to which the given problem relates: Sections 4 to 6.

**Decision:** No.

**Reason:** Sharing of profit, which is a *prima facie* evidence, exists but mutual agency among X and Y, which is a conclusive evidence does not exist.

**PROBLEM 12**

X admits Y as a partner. Y does not bring any capital. He is not liable for any loss and is to receive ₹ 1,000 p.m. as salary in lieu of profits and have all the powers of a partner. Can Y be regarded as a partner?

**Solution:** Section to which the given problem relates: Sections 4 and 6.

**Decision:** Yes.

**Reason:** All the essential elements of partnership are present. Bringing of capital and sharing of losses are not essential elements to constitute a partnership.

**PROBLEM 13**

X, Y and Z are partners in an unregistered firm. X steals the property of the firm. Y filed a suit against X. X resisted Y's claim on the plea that the firm was not registered. Will Y succeed?

**Solution:** Section to which the given problem relates: Section 69(1).

**Decision:** Yes.

**Reason:** Section 69(1) prohibits the institution of civil suit and not the criminal suit.

**PROBLEM 14**

An unregistered firm sold goods to W on credit. On the expiry of the term of credit, the firm filed a suit against W for the recovery of the amount due from W. Will the firm succeed? What difference would it make if immediately after filing the suit, the firm got itself registered?

**Solution:** *First Part*

**Section to which the given problem relates:** Section 69(2).

**Decision:** No.

**Reason:** The firm is not registered at the time of institution of the suit.

**Second Part**

It would not make any difference because the subsequent registration cannot cure the initial defect.

**PROBLEM 15**

X, Y and Z are partners in a registered firm. X died. The firm filed a suit against W in the name and on behalf of firm without notifying to the Registrar of firms about the changes in the constitution of the firm. Is the suit maintainable?

**Solution:** Section to which the given problem relates: Section 69(2).

**Decision:** Yes.

**Reason:** Both the requirements of Section 69(2) have been complied with (i) the suit must be instituted by or on behalf of the firm which had been registered; (ii) the persons suing must have been shown as partners in the Register of Firms. Persons suing means all the partners at the date of instituting the suit.

[**Leading case:** *Durga Das v. Preete Shah*]

#### PROBLEM 16

X, Y and Z are partners in a registered firm. X died and D was admitted as a partner. The firm filed a suit against W in the name and on behalf of firm without notifying to the Registrar of Firms about the changes in the constitution of the firm. Is the suit maintainable?

**Solution: Section to which the given problem relates:** Section 69(2).

**Decision:** No.

**Reason:** First requirement of Section 69(2) that the suit must be instituted by or on behalf of the firm which had been registered, had been complied with, whereas the second requirement of Section 69(2) that all the partners at the date of instituting the suit have been shown in the Register of Firms, had not been complied with.

[**Leading case:** *V.S. Behal v. Kapur & Co.*]

#### PROBLEM 17

An unregistered firm sold goods worth ₹ 1,000 to W who gave a cheque which was dishonoured. X, a partner demanded money from W who paid only 50%. In the meantime, the firm was dissolved. X sued W for the recovery of the balance. Will X succeed?

**Solution: Section to which the given problem relates:** Section 69(3).

**Decision:** Yes.

**Reason:** Non-registration of firm does not affect the right of a partner to realise the property of a dissolved firm.

#### PROBLEM 18

An unregistered firm purchased goods worth ₹ 1,000 from W in whose favour a cheque was issued which was dishonoured. At the same time, this firm sold some other goods worth ₹ 600 to W. W sued the unregistered firm for the recovery of ₹ 1,000. The firm pleaded that W also owed ₹ 600 to the firm, the same should be adjusted against the claim in question. Is W's suit maintainable? Is the contention of the unregistered firm correct?

**Solution:** *Part (a)*

**Section to which the given problem relates:** Section 69(2).

**Decision:** Yes.

**Reason:** Non-registration of a firm does not affect the right of a third party to sue an unregistered firm.



*Part (b):* Section to which the given problem relates: Section 69(2) and 69(3).

**Decision:** No.

**Reason:** An unregistered firm cannot claim a set off exceeding ₹ 100 in value.

#### **PROBLEM 19**

X and Y are partners. X, without the consent of Y, buys shares in his own name with the moneys of the firm. Do such shares constitute partnership property? Would it make any difference if X debits himself in the firm books and becomes a debtor to the firm for the amount of purchase money?

**Solution:** *Part (a)*

**Section to which the given problem relates:** Section 14.

**Decision:** Yes.

**Reason:** Unless the contrary intention appears, the property acquired with the money of the firm is deemed to have been acquired for the firm.

*Part (b):* In this case, shares do not constitute partnership property because the debit entry in X's account shows that the shares were not acquired for the firm.

#### **PROBLEM 20**

X and Y are in partnership for refining sugar. Y was appointed to buy sugar for the firm. Without the knowledge of X, he supplied his own sugar to the firm at market price and made a huge gain. Is he accountable to firm for profit he makes?

**Solution:** **Section to which the given problem relates:** Section 16(a).

**Decision:** Yes.

**Reason:** Subject to contract between the partners, if a partner derives any profit for himself from any transaction of the firm, he must account for the profit and pay it to the firm.

[**Leading case:** *Bentley v. Craven*]

#### **PROBLEM 21**

X, Y and Z carry on a partnership business as merchants trading between Mumbai and London. W, a merchant in London, to whom they send their consignments, secretly allow Z share of the commission which he received upon such consignments in consideration of Z using his influence to obtain the consignments for him. Is Z liable to account to the firm for the moneys so received by him?

**Solution:** **Section to which the given problem relates:** Section 16(a).

**Decision:** Yes.

**Reason:** Subject to contract between the partners, if a partner derives any profit for himself from any transaction of the firm, he must account for the profits and pay it to the firm.

### PROBLEM 22

X, Y and Z are partners in a trade. Z without the knowledge of X and Y, obtains for his own sole benefit a lease of the house in which the partnership business is carried on. Are X and Y entitled to participate in the benefit of the lease?

**Solution:** Section to which the given problem relates: Section 16(a).

**Decision:** Yes.

**Reason:** Subject to contract between the partners, where a partner derives any profit for himself from the use of the property of the firm, he must account for the profit and pay it to the firm.

[**Leading case:** *Featherstonhaugh v. Fenwick*]

### PROBLEM 23

X and Y are in partnership for supplying meat to the government. Subsequently, it is found out that X is engaged with Z in the supplying of meat to the same government. Can he retain the profits made out of the second engagement?

**Solution:** Section to which the given problem relates: Section 16(b).

**Decision:** No.

**Reason:** Subject to contract between the partners, if a partner carries on competing business, he must account for and pay to the firm all profits made by him in that business.

[**Leading case:** *Loch v. Lynam*]

### PROBLEM 24

A, B, C, D and E are partners. A and B executed a promissory note in favour of C agreeing to pay him a certain sum due to him on taking partnership accounts. Are D and E bound by the promissory note?

**Solution:** Section to which the given problem relates: Section 18.

**Decision:** No.

**Reason:** The principle of agency is applicable only to the act done by partners for the purpose of the business of the firm.

[**Leading case:** *Hoshier Singh v. Udairam*]

### PROBLEM 25

A, B, C, D and E are partners of a banking firm. State the legal position of firm for the following acts of partners:

- (a) A borrows money in the name of the firm.
- (b) B orders for certain quantity of wine, on the firm's letter head.
- (c) C receives money from a borrower of a firm and utilised this amount for personal use without informing other partners about the receipt of this money.

- (d) *D* borrows money on his own credit by giving his own promissory note and utilises subsequently this amount for firm's use.

**Solution:**

Analysis of partner's acts whether satisfying the conditions of Sec. 19.

Partner's act	Whether the act done relates to the normal business of the firm	Whether the act has been done in the usual way	Whether the act has been done in firm's name or with an intention to bind firm
A's act	Yes	Yes	Yes
B's act	No	Yes	Yes
C's act	Yes	Yes	Yes
D's act	Yes	Yes	No

**Decision and Reason:**

- (a) The firm is liable for the acts of *A* and *C*. Their acts fall within the scope of implied authority because all the conditions of Section 19 have been fulfilled.
- (b) The firm is not liable for the acts of *B* and *D*. Their acts do not fall within the scope of implied authority because all the conditions of Section 19 have not been fulfilled.

**PROBLEM 26**

*X* and *Y* are partners in a firm of solicitors. *X* accepts a bill of exchange on behalf of the firm. Is the firm liable?

**Solution:** Section to which the given problem relates: Section 19.

**Decision:** No.

**Reason:** This act has not been done in the usual way of carrying on the firm's business.

**PROBLEM 27**

*X*, *Y*, *Z* are partners in a trading firm. They decide that no partner shall have the right to borrow beyond ₹ 20,000 without the consent of other partners. *X* without consulting *Y* and *Z* borrows from *W* ₹ 25,000 in the name of the firm and utilized the same in paying off the debts of the firm. Is the firm liable to pay to *W*? Would it make any difference if *W* was aware of this restriction?

**Solution:** Section to which the given problem relates: Section 20.

Decision and Reason:

**Part (a):** The firm is liable to pay to *W* because *W* was unaware of the restriction.

**Part (b):** The firm is not liable to pay to *W* because *W* was aware of the restriction.

### PROBLEM 28

X and Y are partners of a trading firm. They decide that no partner shall have the right to buy or sell goods beyond the value of ₹ 10,000 without the consent of the other partner. Owing to a sudden slump in the market, the prices crashed X, in order to save the firm from loss, sold all the perishable stock worth ₹ 2,00,000 without consulting Y. Is firm bound by X's act?

**Solution:** Section to which the given problem relates: Section 21.

**Decision:** Yes.

**Reason:** (i) The act has been done to protect the firm from loss.

(ii) The act has been done in the same manner as a man of ordinary produce would have done in his own case under similar circumstances.

### PROBLEM 29

X, Y and Z are partners of a trading firm. X who actively participates in the management of the business of the firm, bought for the firm, certain goods. The seller told X about the defect in the goods. Is the firm liable to seller? Would it make any difference if there was a collusion between X and the seller to conceal the defect from the other partners?

**Solution:** Section to which the given problem relates: Section 24.

**Decision and Reason:**

**Part (a):** The firm is liable to seller because notice to a working partner operates as notice to the firm.

**Part (b):** The firm is not liable to seller because notice to a working partner does not operate a notice to the firm in case of fraud committed by a partner and third party against the firm.

### PROBLEM 30

X, Y and Z were partners when an infringement of a trademark by the firm took place. X retired and damages arose after the dissolution of the firm. Are all partners liable for damages?

**Solution:** Section to which the given problem relates: Section 25.

**Decision:** Yes.

**Reason:** Every partner is liable jointly and severally for all acts of the firm done while he is a partner.

[**Leading case:** *Thomas Bear & Sons v. Ralia Ram*]

### PROBLEM 31

X, Y and Z were partners when goods were sent to a firm on approval. Goods not required were returned after the dissolution of the firms. Are all partners liable for goods accepted?

**Solution:** Section to which the given problem relates: Section 25.

**Decision:** Yes.

**Reason:** Every partner is liable jointly and severally for all acts of the firms done while he is a partner.

[Leading case: *Mayadas v. Marley*]

### PROBLEM 32

It was in the course of the business of a firm of grain merchants to obtain by legitimate means information in regard to contracts made by competing firms and one of the partners obtained such information by bribing a clerk of a competitor in the business. Consequently, competitor lost some business and sued the firm for damages. Will the competitor succeed?

**Solution:** Section to which the given problem relates: Section 26.

**Decision:** Yes.

**Reason:** The firm is liable for the wrongful act of partner done in the ordinary course of the business.

[Leading case: *Hamlyn v. Houston & Co.*]

### PROBLEM 33

A, B, C and D are partners in a firm of solicitors. A receives money from a client X for the purpose of making a specific investment. A never invests it but applies it to his own use. The other partners are not aware of this transaction. Is the firm liable for A's act?

**Solution:** Section to which the given problem relates: Section 27.

**Decision:** Yes.

**Reason:** The firm is liable for misapplication of money by a partner who received while acting within the scope of his apparent authority.

[Leading case: *Blair v. Bromley*]

### PROBLEM 34

X and Y are partners of a banking firm. X receives certain securities from a customer for safe custody and puts in the safe custody of the firm. Y disposes off those securities and applies the money for his own use. Is the firm liable for Y's act?

**Solution:** Section to which the given problem relates: Section 27.

**Decision:** Yes.

**Reason:** The firm is liable for the misapplication of property by a partner if the property was in the custody of the firm.

[Leading case: *Devaynes v. Noble*]

### PROBLEM 35

Ram, a sole proprietor of Ram Shyam & Co. employed Shyam as manager of firm's business. Ram introduced Shyam as his partner to C's a supplier of goods. Shyam remained silent. Treating Shyam a partner, C supplied the goods on credit. Is Shyam liable to supplier?

**Solution:** Section to which given problem relates: Section 28.

**Decision:** Yes.

**Reason:** Shyam is a partner by estoppel. Both conditions of Section 28 are fulfilled.

- (i) Shyam has knowingly permitted himself to be represented as a partner,
- (ii) Supplier has acted on the faith of such representation.

### PROBLEM 36

Pataudi, a renowned sportsman assumed the honorary presidentship of a publishing business bringing out a sports magazine because other partners requested him to do so. A supplier gave credit to the firm in the bona fide belief that Pataudi was a partner in the firm. Is Pataudi liable to the supplier?

**Solution:** Section to which the given problem relates: Section 28.

**Decision:** Yes.

**Reason:** Pataudi is a partner by estoppel. Both the conditions of Section 28 are fulfilled.

- (i) Pataudi has knowingly permitted himself to be represented as a partner
- (ii) Supplier has acted on the faith of such representation.

[Leading case: *Lake v. Duke of Argyll*]

### PROBLEM 37

A, B, C and D were partners in a firm. One of the terms of partnership deed was that A could introduce into partnership any of his sons on their attaining the age of 18. A's son attained the age of 18 and he proposed to make him a partner. C and D objected to admission of A's son. Is admission of A's son justified?

**Solution:** Section to which the given problem relates: Section 31(1).

**Decision:** Yes.

**Reason:** Admission is in accordance with a contract already entered into.

[Leading Case: *Byrne v. Reid*]

### PROBLEM 38

X, Y and Z are partners. Z gives notice of retirement to the other partners but does not give public notice of it. W gives credit to the firm without having notice of the change. Can W sue Z if (a) Z is an active partner, (b) Z is a dormant partner (sleeping partner)?

**Solution:** Section to which the given problem relates: Section 32(3).

**Decision and Reason:**

**Part (a)** A retiring partner is liable for firm's acts done after his retirement if no public notice is given.

**Part (b)** A retiring partner is not liable to any third party who deals with the firm without knowing that he was a partner.

**PROBLEM 39**

X, Y and Z are partners. Z gives notice of his retirement to other partners but does not give public notice of it. X and Y admit P and continues business in the old name. W gives credit to the firm without having notice of the change? Can W sue X, Y, Z and P jointly?

**Solution: Section to which the given problem relates:** Section 32(3).

**Decision:** No.

**Reason:** He can sue at his option *either* old partners (X, Y and Z) on grounds of estoppel or new partners (X, Y and P) on grounds of facts.

**PROBLEM 40**

X, Y and Z are partners sharing the profits in the ratio of 3:4:1. X becomes bankrupt and Y and Z continued the business without settling accounts with his estate. X's estate claims 3/8th of the profits made from the date of X's insolvency? Will this claim sustain?

**Solution: Section to which the given problem relates:** Section 37.

**Decision:** Yes.

**Reason:** Section 37 specifically entitles to claim as such.

**PROBLEM 41**

X, Y and Z are partners. On 1.1.97, Z applies for insolvency. On 1.2.97 he endorses a Bill of Exchange in favour of W. On 1.3.97 he is declared insolvent. Does W acquire a good title to the Bill?

**Solution: Section to which the given problem relates:** Section 34.

**Decision:** Yes.

**Reason:** Z was a partner when the Bill was endorsed. He ceased to be a partner on the date on which order of adjudication is made, i.e. 1.3.97.

**PROBLEM 42**

X, Y and Z are partners. The firm ordered goods. Thereafter X died. The delivery of the goods was made after X's death. Is X's estate liable for the debt?

**Solution: Section to which the given problem relates:** Section 35.

**Decision:** No.

**Reason:** There was no debt in respect of goods in X's life time.

[**Leading case:** *Bagel v. Miller*]

#### PROBLEM 43

A became surety to the firm of 'NC Mookerji' for B's conduct as cashier to the firm. The constitution of the firm subsequently underwent a change. Two sons of N. Mookerji were admitted as partners and its name was altered to "N. Mookerji and Sons". Subsequently B defalcated. Is A liable for B's defalcation?

**Solution:** **Section to which the given problem relates:** Section 38.

**Decision:** No.

**Reason:** A continuing guarantee is revoked as to the future transactions from the date of any change in the constitution of the firm.

#### PROBLEM 44

X, Y and Z are partners. The majority of the partners decide to dissolve the firm. Discuss the legal position in each of the following alternative cases:

**Case (a):** If the partnership agreement is silent.

**Case (b):** If the partnership agreement provides for dissolution by mutual agreement only.

**Case (c):** If the partnership agreement provides for dissolution by any majority of the partner.

**Solution:** **Section to which the given problem relates:** Section 40.

**Decision and Reason:**

**Case (a):** The firm cannot be dissolved by majority of partners. If partnership agreement is silent, the firm can be dissolved with the consent of all the partners.

**Case (b):** The firm cannot be dissolved by majority of partners because the partnership agreement provided for dissolution by mutual agreement, i.e. with the consent of all the partners.

**Case (c):** The firm can be dissolved by majority of partners because the partnership agreement provides for the same.

#### PROBLEM 45

X, Y and Z are partners. The partnership agreement is silent. State whether the firm is dissolved in each of the following alternative cases:

**Case (a):** If X, Y, Z are declared as insolvent,

**Case (b):** If X and Y are declared as insolvent,

**Case (c):** If only X is declared as insolvent.



**Solution: Cases (a) and (b)**

**Section to which the given problem relates:** Section 41.

**Decision and Reason:** Cases (a) and (b) Yes. The firm is compulsorily dissolved because Section 41 specifically provides for the same. The firm does not exist at all because there must be at least two persons to constitute a firm.

**Case (c): Section to which the given problem relates:** Section 42.

**Decision and Reason:** If partnership agreement is silent, a firm is dissolved by the adjudication of a partner as an insolvent.

**PROBLEM 46**

X, a resident in India and Y, a resident in Pakistan are partners. The firm is carrying on the business of importing and exporting Commodity I and Commodity II. State whether the firm is dissolved in each of the following alternative cases:

**Case (a):** If a war breaks out between India and Pakistan;

**Case (b):** If a law is passed by which imports and exports of Commodity I are prohibited;

**Case (c):** If a law is passed by which import and export of Commodities I and II are prohibited.

**Solution: Section to which the given problem relates:** Section 41.

**Decision and Reason:**

**Case (a):** The firm is compulsorily dissolved. On the outbreak of war, it becomes unlawful for the firm's business to be carried on.

**Case (b):** The firm is not compulsorily dissolved because the illegality of the business shall not necessitate the dissolution of the firm in respect of lawful business (i.e., Commodity II).

**Case (c):** The firm is compulsorily dissolved because on passing of law prohibiting the import and export of Commodities I and II, it becomes unlawful for the firm's business to be carried on.

**PROBLEM 47**

X, Y and Z are partners. The partnership agreement is silent. State whether the firm is dissolved on 31.03.2018 in each of the following alternative cases:

**Case (a):** If the firm was constituted for 5 years and 5 years have expired on 31.03.2018.

**Case (b):** If the firm was constituted for completion of a construction of a bridge and the construction completed on 31.03.2018.

**Case (c):** If X died on 31.03.2018.

**Case (d):** If X applies for insolvency on 31.03.2018 and is declared insolvent on 30.04.2018.

**Case (e):** If X retires on 31.03.2018.

**Case (f):** If X is expelled as partner on 31.03.2018 and the expulsion is invalid.

**Solution: Section to which the given problem relates:** Section 42.

**Decision and Reason:** Unless agreed otherwise, the provisions of Section 42 would be applicable.

**Case (a):** The firm is dissolved by the expiry of the fixed term.

**Case (b):** The firm is dissolved on the completion of that particular adventure for which the firm was constituted.

**Case (c):** The firm is dissolved on the death of a partner.

**Case (d):** The firm is not dissolved on 31.03.2018. The firm would be dissolved on the date of order of adjudication, i.e., 30.04.2018.

**Case (e):** The firm is not dissolved on the retirement of a partner.

**Case (f):** The firm is not dissolved on expulsion of a partner irrespective of the fact whether expulsion is valid or not.

#### PROBLEM 48

X, Y and Z are partners and there is no provision in partnership agreement for duration of the partnership. State whether the firm is dissolved in each of the following alternative case:

**Case (a):** If X gives a notice in writing to Y of his intention to dissolve the firm on 31.03.2018.

**Case (b):** If X gives a notice in writing to Y on 31.03.2018 and to Z on 02.04.2018. The notice contained X's intention to dissolve the firm but no date of dissolution was mentioned in the notice.

**Case (c):** If in case (b), it was mentioned in the notice that the firm will be dissolved from 1st May, 2018.

**Solution:**

**Decision and Reason:**

**Case (a):** The firm is not dissolved since notice was not given to Z.

**Case (b):** The firm is dissolved on 02.04.2018 because the communication of notice to all other partners completes on 02.04.2018. If no date of dissolution is mentioned in the notice, the firm is dissolved from the date of the communication of the notice.

**Case (c):** The firm is dissolved from the date mentioned in the notice as the date of dissolution, i.e. 01.05.2018.

#### PROBLEM 49

X, Y and Z are partners in a firm. State whether the court may pass an order for dissolution of a firm in each of the following alternative cases:

**Case (a):** If X (an active partner) becomes insane and the suit is filed by the X's next friend who is not a partner.

**Case (b):** If X (a dormant partner) becomes insane and the suit is filed by Y.

**Case (c):** If X had an attack of paralysis and the suit is filed by Y. According to doctors, paralysis was of a temporary nature and the patient's condition was improving.

**Case (d):** If X has adulterous relations with Y's wife.

**Case (e):** If X was convicted of travelling on a railway without a ticket and with intent to defraud.

**Case (f):** If X has adulterous relations with W's wife.

**Case (g):** If X has adulterous relation with W's wife who is a regular patient of medical firm of X, Y and Z.

**Case (h):** If X omitted to enter a particular receipt of money in the books of accounts.

**Case (i):** If X continuously omits to enter receipts of money in the books of accounts.

**Case (j):** If X transferred the whole of his interest in a firm to a third party.

**Case (k):** X, Y and Z enter into a partnership agreement for 20 years. The business resulted in a loss each year. X and Y decide to dissolve the firm as the business cannot be carried on except at a loss. Z objects. X filed a suit.

**Case (l):** X, Y and Z are partners in a firm and are not on speaking terms with each other.

**Solution: Section to which the given problem relates:** Section 44.

**Decision and Reason:**

**Case (a):** The court may pass an order for dissolution when a partner has become of unsound mind. The suit can be filed by the next friend of such partner or any other partner.

**Case (b):** The court may not pass an order for dissolution because such a partner does not take an active part in the conduct of firm's business.

**Case (c):** The court will not pass an order for dissolution because incapacity of a partner was of a temporary nature. [*Whitwell v. Arthur*]

**Case (d):** The court will pass an order for dissolution because X's conduct is likely to affect prejudicially the carrying on of the business because this destroys the mutual confidence between X and Y. [*Abbot v. Crump*]

**Case (e):** The court will pass an order for dissolution because X's conviction was for dishonesty which is likely to affect prejudicially the carrying on of the business. [*Carmichael v. Evans*]

**Case (f):** The court may not pass an order for dissolution as X's conduct does not affect prejudicially the carrying on of the business. [*Snow v. Milform*]

**Case (g):** The court will pass an order for dissolution since X's conduct is likely to affect prejudicially the carrying on of medical profession. [*Snow v. Milform*]

**Case (h):** The court may not pass an order for dissolution since there is no persistent breach.

**Case (i):** The court will pass an order for dissolution since there was persistent breach.

**Case (j):** The court will pass an order for dissolution since X has transferred the whole of his interest in a firm to a third party.

**Case (k):** The court will pass an order for dissolution because the business has been running at loss and it cannot be carried on except at a loss.

**Case (l):** The court will pass an order for dissolution because absence of speaking terms is sufficient ground to justify dissolution.

#### PROBLEM 50

X paid Y and Z a premium of ₹ 20,000 on entering into partnership for 10 years and the firm is dissolved at the end of 8 years. State whether X is entitled to repayment of proportionate premium in each of the following alternative cases:

**Case (a):** If the dissolution is by the death of Y.

**Case (b):** If the dissolution is due to X's own misconduct.

**Case (c):** If the dissolution is in pursuance of an agreement which contains no provision for the return of the premium.

**Case (d):** If the dissolution is due to Y's misconduct.

**Case (e):** If the dissolution is due to the insolvency of Y.

**Solution: Section to which the given problem relates:** Section 51.

**Decision and Reason:**

**Cases (a), (b) and (c):** X is not entitled to claim any return of premium because the right to return of premium is not available under these three cases.

**Cases (d) and (e):** X is entitled to claim ₹ 4,000 (i.e., ₹ 20,000 × 2/10).

#### PROBLEM 51

A, B, C, D and E are partners in a firm. They decided to dissolve the firm from 1st January 2018 but failed to give a public notice of its dissolution and continued the business of the firm even after that date. D died on 5th January 2018 and E was declared insolvent on 10th January 2018. On 11th January 2018, A borrowed in the firm's name ₹ 20,000 from R who was ignorant of the dissolution. Discuss the liability of partners for ₹ 20,000.

**Solution: Section to which the given problem relates:** Section 45.

**Decision:** A, B and C are liable but the estate of D and E are not liable for ₹ 20,000.

**Reason:** Partners continues to be liable to third parties for any act done by any of them after the dissolution until public notice is given of the dissolution but this provision is not applicable to the estate of deceased partner, insolvent partner and dormant partner who had retired.

**PROBLEM 52**

X, Y and Z are partners in a business sharing profits and losses equally. Z dies and the firm is dissolved. On the date of dissolution, the capital of X, Y and Z were ₹ 20,000, ₹ 15,000 and ₹ 10,000 respectively and the outside liabilities amounted to ₹ 65,000. The total assets of the firm realised ₹ 50,000. What is the amount of deficiency and how the partners shall share such deficiency if the partnership agreement is silent?

**Solution:** Section to which the given problem relates: Section 48(a).

**Decision:** The deficiency works out at ₹ 15,000 (i.e., ₹ 65,000 – ₹ 50,000). Such deficiency must be shared by X, Y and the estate of Z in their profit sharing ratio.

**PROBLEM 53**

X, Y and Z are partners in a business sharing profits and losses equally. Z dies and the firm is dissolved. On the date of dissolution, the capitals of X, Y and Z were ₹ 20,000, ₹ 15,000 and ₹ 10,000 respectively and the outside liabilities amounted to ₹ 65,000. X had advanced ₹ 10,000 as loan to the firm. State how the amount realised shall be used if the assets realised (a) ₹ 1,35,000 (b) ₹ 1,05,000?

**Solution:** Section to which the given problem relates: Section 48(b).

**Decision:**

**Case (a):** First, ₹ 65,000 to pay outside liabilities. Next, ₹ 10,000 to pay X's loan, and then ₹ 45,000 to pay the capital of A, B and C and the balance ₹ 15,000 among A, B and C in their profit sharing ratio.

**Case (b):** First ₹ 65,000 to pay outside liabilities. Next ₹ 10,000 to pay X's loan. ₹ 30,000 to pay the capital balance of X, Y and Z [i.e. after adjusting the loss of ₹ 15,000 (₹ 1,20,000 – ₹ 1,05,000)] in their profit sharing ratio]

X will be paid ₹ 15,000 (i.e. ₹ 20,000 – ₹ 5,000)

Y will be paid ₹ 10,000 (i.e. ₹ 15,000 – ₹ 5,000)

Z will be paid ₹ 5,000 (i.e. ₹ 10,000 – ₹ 5,000).

**PROBLEM 54**

X, Y and Z are partners in a business sharing profits and losses equally. X dies and the firm is dissolved. On the date of dissolution, the capitals of X, Y and Z were ₹ 20,000, ₹ 15,000 and ₹ 10,000 respectively and the outside liabilities amounted to ₹ 65,000. The assets of the firm realised ₹ 15,000. The private estate and debts of each partners were as follows:

Private estate ₹ 1,00,000, Y ₹ 2,00,000, Z ₹ 3,00,000

Private debt ₹ 1,10,000, Y ₹ 1,90,000, Z ₹ 3,10,000

The outside creditors claim that the deficiency of ₹ 50,000 (i.e., ₹ 65,000 – ₹ 15,000) should be contributed by the partners out of their private estate which amounted to

₹ 6,00,000 because the partners are jointly and severally liable to pay firm's debts. Discuss the validity of their claim.

**Solution: Section to which the problem relates:** Section 49.

**Decision:** The creditors can only ask Y to contribute ₹ 10,000.

**Reason:** Partner's private assets can be used for payment of firm's debts only after his private debts have been paid off.

### PROBLEM 55

X and Y are partners. They decided to dissolve their firm. After dissolution they sold the goodwill of firm to W. State the legal position of the following acts:

**Case (a):** Can X or Y carry on a business competing with that of W?

**Case (b):** Can X or Y advertise such business?

**Case (c):** Can X or Y use the firm name if there is no agreement between them and W?

**Case (d):** Can X or Y represent himself as carrying on firm's business if there is no agreement between them and W?

**Case (e):** Can X or Y solicit the business from the customers of dissolved firm if there is no agreement between them and W?

**Case (f):** Can X or Y make an agreement with W that *either* of them will not carry on any business similar to that of a firm within a specified period *or* within specified limits?

**Solution: Section to which the given problem relates:** Section 55(2).

**Decision and Reason:** Cases (a) and (b): Yes. Section 55 entitle them to do so.

**Cases (c), (d) and (e):** No. Section 55 does not entitle them to do so by making specific provision to that effect.

**Case (f):** Section to which the given problem relates: Section 55(3).

**Decision:** Yes. Such agreement shall be valid if the restrictions imposed are reasonable.

### PROBLEM 56

X, Y and Z are partners in a Partnership Firm. They were carrying their business successfully for the past several years. Spouses of X and Y fought in ladies club on their personal issue and X's wife was hurt badly. X got angry on the incident and he convinced Z to expel Y from their partnership firm. Y was expelled from partnership without any notice from X and Z. Considering the provisions of the Indian Partnership Act, 1932, state whether they can expel a partner from the firm. What are the criteria for test of good faith in such circumstances?

**Solution: Section to which the given problem relates:** Section 33

According to the test of good faith as required under Section 33(1), expulsion of Partner Y is not valid.

**PROBLEM 57**

A, B and C were partners in a firm. By his willful neglect C caused serious loss to the business of the firm. After several warnings to C, A and B passed a resolution expelling C from the firm. But another resolution, they admitted D as a partner in place of C. C objects to his expulsion, as also to admission of D. Is he legally entitled to do so? Decide with reference to the provisions of the Indian Partnership Act in this regard.

**Solution:** Expulsion irregular and hence inoperative.

**PROBLEM 58**

D and A entered into a partnership agreement for 10 years. D did not take any active part in the business of the firm all over the 10 years period. After the end of the above period . A continues with the same business in the name of the firm, with the property of the firm. A does not give any account to D, of the profits earned by him after the above period. D on coming to know about A's continuing with the business and earning profits, seeks your advice with reasons

- (i) Whether D will be entitled to the profits earned by A?
- (ii) Whether the Partnership Firm stands dissolved on the expiry of 10 years?
- (iii) What provisions exist in the Indian Partnership Act in this regard?

**Solution:** D can claim a share in the profits of the firm. The partnership does not get dissolved automatically on the expiry of the fixed period.

**PROBLEM 59**

A carried business in the name of X, Y & Co. and employed a person whose name had the initials of X Y to act as manager of the business. People started taking X Y as a partner of the firm. X Y neither objected to it nor disclosed his true status. Would he be liable as a partner by a estoppel?

**Solution:** Y was a partner by estoppel. See *Bevan v. The National Bank Ltd.* (1906) 23 TLR. 65.

**PROBLEM 60**

Kumar, Kishore and Krishna are partners in a business. Kumar is entitled, according to the terms of the partnership deed to three eighths of the partnership property and profits. Kumar retires from the firm. Kishore and Krishna continue the business under the same name of the firm, without paying out the share of Kumar in the assets of the firm or settling accounts with Kumar. Is Kumar entitled to any profits of the firm made after the date of his retirement?

Decide with reference to the provisions of the Indian Partnership Act in this regard.

**Solution:** Kumar may claim either share of his profits or interest @ 6% p.a. on his share in the partnership property.

### PROBLEM 61

A, B and C are partners in a firm called ABC. A with the intention of deceiving D a supplier of office stationery, buys certain stationery on behalf of the ABC firm. The stationery is of use in the ordinary course of the firm's business. A does not give the stationery to the firm, instead brings it to his own house. The supplier D, who is unaware of the private use of stationery by A, claims the price from the firm. The firm refuses to pay for the price on the plea that the stationery was never received by it. Decide

- (i) Whether the Firm's contention is tenable?
- (ii) What would be your answer if a part of stationery so bought by A was delivered to the firm by him, and the rest of the stationery was used by him for private use, for which neither the firm nor the supplier D was aware?
- (iii) Explain the provisions of the Indian Partnership Act in this regard.

**Solution:** The firm is liable as the act is within the implied authority of a partner. However, if some loss is caused to the firm due to the fraud of a partner, he is bound to indemnify the firm for any loss suffered by it. See section 10.

### PROBLEM 62

X Y and Z were partners in a Firm. During the course of partnership, the firm ordered ABC Limited to supply a textile machinery to the Firm. After the order was placed with ABC Limited, but before the machinery was delivered, X expired. The machinery was later delivered to the Firm. However, thereafter the remaining partners became insolvent and the Firm was unable to pay for the machine. Explain with reason :

- (i) Whether X's private estate will be liable for the price of the machinery purchased?
- (ii) Against whom can be creditors obtain a decree for the recovery of the price?

**Solution:** X's estate will not be liable, creditors can sue only the surviving partners.

### PROBLEM 63

D, J and A are the only partners in a Firm. They decide to dissolve their partnership with effect from 1 st April, 2018. The partners do not give a public notice of the dissolution, but continued the business. During the course of business D, J and A endorse certain bills of exchange of the partnership to a third party M, who was not aware of the dissolution. M, the third party had supplied certain stationery to the Firm. The bills of exchange are dishonoured. The third party M wants to claim the money. Decide—

- (i) Whether the firm will be liable to pay for the bills of exchange?
- (ii) What are provisions of the Indian Partnership Act in this regard?

**Solution:** As no public notice was given of the dissolution, the firm is liable on the bills.

### PROBLEM 64

A, B and C are partners in a firm called ABC. A with the intention of deceiving D a supplier of office stationery, buys certain stationery on behalf of the ABC firm. The stationery is



of use in the ordinary course of the firm's business. A does not give the stationery to the firm, instead brings it to his own house. The supplier D, who is unaware of the private use of stationery by A, claims the price from the firm. The firm refuses to pay for the price on the plea that the stationery was never received by it. Decide

- (i) Whether the Firm's contention is tenable?
- (ii) What would be your answer if a part of stationery so bought by A was delivered to the firm by him, and the rest of the stationery was used by him for private use, for which neither the firm nor the supplier D was aware?
- (iii) Explain the provisions of the Indian Partnership Act in this regard.

**Solution:** The firm is liable as the act is within the implied authority of a partner. However, if some loss is caused to the firm due to the fraud of a partner, he is bound to indemnify the firm for any loss suffered by it. See section 10.

## IMPORTANT POINTS TO REMEMBER

### 1.0 The Indian Partnership Act, 1932

<b>Effective Date</b>	It came into force w.e.f. 1st Oct, 1932 but Sec. 69 came into w.e.f. 1st Oct. 1933.
<b>Territory</b>	It extends to the Whole of India except the State of Jammu & Kashmir.
<b>Scope</b>	The provisions of the Indian Contract Act, 1872 also apply to firms except where the Indian Partnership Act, 1932, specifically provides to the contrary [Section 3].

### 2.0 Meaning and Essential Elements of Partnership

<b>Meaning of Partnership</b>	"Partnership is the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all." [Section 4]
<b>Five Essential Elements of Partnership</b>	<ol style="list-style-type: none"> <li>1. At least two persons competent to contract</li> <li>2. An agreement [whether Implied or Express (<i>i.e.</i>, written/oral)]</li> <li>3. Business (Lawful)</li> <li>4. Sharing of Profits</li> <li>5. Mutual Agency (<i>i.e.</i>, carrying on of business by all or any of them acting for all)</li> </ol> <p><b>Note:</b> The law of partnership is regarded as an extension of law of agency because of existence of mutual agency.</p>

### 3.0 Partners, Firm, Firm Name and Maximum Limit of Partners

<b>Partners</b>	Persons who have entered into partnership with one another are individually called partners.
<b>Firm</b>	Persons who have entered into partnership with one another are collectively called a firm.
<b>Firm Name</b>	The name under which business is carried on is called firm name.
<b>Maximum Limit of Partners</b>	<p>As per Sec. 11 of Companies Act, 1956 – 10 for banking business, 20 for other business</p> <p><b>Note:</b></p> <ol style="list-style-type: none"> <li>1. If the number of partners exceeds the aforesaid limit, the partnership firm becomes an illegal association.</li> <li>2. These statutory limits do not apply to a Hindu Undivided Family. However in case of amalgamation of two or more families these limits apply. (only major persons &amp; not minors are considered for these limits)</li> </ol>

### 4.0 Nature of a Partnership Firm and test of Partnership

<b>Nature of Firm</b>	<p>A partnership firm has no separate legal entity apart from the partners constituting it.</p> <p><b>Note:</b> Firms themselves cannot enter into a contract for partnership though their partners can. For example, two firms namely, M/s A &amp; B and M/s X &amp; Y, themselves cannot form a new partnership though the partners of the individual firms can form a partnership.</p>
<b>Test of Partnership</b>	The conclusive evidence of partnership is existence of Mutual Agency relationship i.e., the capacity of a partner to bind other partners by his acts done in firm's name and be bound by the acts of other partners in firm's name and not the sharing of profits which is only a prime facie evidence.
<b>Cases where the Partnership Relation does not exist</b>	<ol style="list-style-type: none"> <li>1. Joint Owners of some property sharing profit or gross returns arising from the property.</li> <li>2. Person sharing the profits but not having mutual agency.</li> </ol> <p><b>For example:</b></p> <ol style="list-style-type: none"> <li>(i) a lender of the firm (who has lent money) who receives a share of profits;</li> <li>(ii) a widow or child of a deceased partner who receives a share of profits;</li> <li>(iii) a servant or an agent who receives a share of profits as part of his remuneration; and</li> </ol>

	<p>(iv) a person who receives a share of profits in consideration of sale of business or goodwill of the business.</p> <p>3. Members of a Hindu Undivided Family carrying on family business.</p> <p>4. Burmese Buddhist husband and wife carrying on a business.</p>
<b>Property of Firm</b>	Unless otherwise agreed by the partners, the property of the firm shall be held and used by the partners exclusively for the purposes of the business of the firm.

## 5.0 Co-ownership

<b>Meaning</b>	Co-ownership means joint ownership of some property.
<b>Co-owners</b>	Two or more persons who own some property jointly are called co-owners.
<b>Why Not Partners</b>	Joint Owners of some property sharing profit or gross returns arising from the property do not become partners due to lack of mutual agency relationship.

## 6.0 Hindu Undivided Family (HUF)

<b>Meaning</b>	“Hindu undivided family is a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters.”
<b>Coparceners</b>	Three successive generations in the male line (son, grandson, and great-grandson) who inherit the ancestral property are called ‘Coparceners’.
<b>Ancestral Property</b>	The property which a man inherits from any of his three immediate male ancestors (i.e., his father, grandfather and great grandfather), is called ‘ancestral property’.
<b>Hindu Law</b>	There are two schools of Hindu Law – Dayabhaga and Mitakshara.
<b>Dayabhaga School</b>	Under Dayabhaga School of Law, which is applicable to West Bengal and Assam, a son acquires an interest in the ancestral property only after the death of his father.
<b>Mitakshara School</b>	Under Mitakshara School of Law, which is applicable to whole of India, (except West Bengal and Assam), each son acquires by birth an interest in the ancestral property.
<b>Maximum Limit</b>	There is no maximum limit of coparceners.
<b>Implied Power</b>	Only Karta has implied power.
<b>Karta’s Liability</b>	Only Karta’s liability is unlimited.

<b>Coparcener's Liability</b>	The liability of other coparceners is limited only to their shares in the family property.
<b>Coparcener's Right</b>	The Coparceners have no right to ask for the account of past dealings.
<b>Effect of Death</b>	The Hindu undivided family continues to operate even after the death of a coparcener.

## 7.0 Partnership Deed

<b>Meaning</b>	The document which contains the terms of a partnership as agreed among the partners is called 'Partnership Deed'.
<b>Stamping</b>	It is required to be duly stamped as per the Indian Stamp Act, 1889.
<b>Signature</b>	It is required to be duly signed by all the partners or their duly authorised agents.
<b>Change</b>	The terms laid down in the partnership deed may be changed with the consent of all partners.
<b>No Contravention</b>	It must not contain any term which is contravention with the provisions of the Indian Partnership Act.

## 8.0 Registration of a firm

<b>Optional</b>	It is not compulsory.
<b>Time of Registration</b>	It can be effected at the time of its formation or at any time thereafter.
<b>Effective Date</b>	Registration becomes effective <b>from the date of filing of the duly signed and verified statement</b> along with the prescribed form and not from the date of issue of certificate of registration since the act of the Registrar in recording an entry of the statement in the Register of Firms is only a clerical act.
<b>Effects of Non-registration of a Firm</b>	<ol style="list-style-type: none"> <li>1. A partner can not file a suit against the firm or the other partners to enforce any right arising from contract</li> <li>2. The firm can not file a suit against third party to enforce any right arising from contract.</li> <li>3. A firm has no right to claim set off in excess of ₹ 100.</li> </ol>

<b>Rights not affected by Non-registration</b>	<ol style="list-style-type: none"> <li>1. Rights of unregistered firm or partners thereof               <ol style="list-style-type: none"> <li>(i) Right of firm or partner of a firm having no place of business in India,</li> <li>(ii) Right to file a suit or claim of set-off if the value of suit does not exceed ₹ 100.</li> <li>(iii) Right of a partner to sue (a) for the dissolution of the firm (b) for the accounts of a dissolved firm, or (c) for claiming share of the assets of a dissolved firm</li> <li>(iv) Right to enforce a right arising otherwise than out of a contract e.g., infringement of a Patent right by a third party. The firm may file a suit to restrain the third party from misusing the Patent right.</li> </ol> </li> <li>2. Right of a third party to file a suit against the unregistered firm or partners thereof.</li> <li>3. Power of an Official Assignee or Receiver or Court to realise the property of an insolvent partner.</li> </ol>
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## 9.0 Types of Partnership On the basis of Duration

<b>Partnership at Will</b>	<p><b>Meaning:</b> When there is no provision in partnership agreement for duration of the partnership, the partnership is called 'Partnership at Will'.</p> <p><b>Dissolution:</b> A partnership at will may be dissolved by any partner by giving a notice in writing to all other partners of his intention to dissolve the firm.</p>
<b>Particular Partnership</b>	<p><b>Meaning:</b> When a partnership is formed for a specific venture or for a particular period, the partnership is called a 'Particular Partnership'.</p> <p><b>Dissolution:</b> Particular partnership comes to an end on the completion of the venture or on the expiry of the period.</p> <p><b>Note:</b></p> <ol style="list-style-type: none"> <li>1. If such partnership is continued after the expiry of term or completion of the venture, it is deemed to be a partnership at will.</li> <li>2. A particular partnership may be dissolved before the expiry of the term or completion of the venture only by the mutual consent of all the partners.</li> </ol>

## 10.0 Types of Partners

<b>Actual or Ostensible Partner</b>	He takes an active part in the conduct of the business.
<b>Sleeping or Dormant Partner</b>	He does not take an active part in the conduct of the business.
<b>Nominal Partner</b>	He lends his name to the firm without having any real interest in the firm. He neither contributes to the capital nor shares the profits or takes part in the conduct of the business of the firm.
<b>Partner in Profits Only</b>	He shares the profits only and not the losses.
<b>Sub-Partner</b>	He is a third person with whom a partner agrees to share his profits derived from the firm.
<b>Partner by Estoppel or Holding Out</b>	<p>A person is held liable as a partner by estoppel or holding out if the following two conditions are fulfilled:</p> <p>(a) He must have represented himself to be a partner by words spoken or written or by his conduct (such type of representation may be called as active representation),</p> <p style="text-align: center;"><b>or</b></p> <p>He must have knowingly permitted himself to be represented as a partner (such type of representation may be called as tacit representation); and</p> <p>(b) The other person acting on the faith of such representation must have given credit to the firm. It is immaterial whether the person so representing to be a partner, is aware or not that the representation has reached the other person.</p> <p><b>Note:</b> Where, after the retirement of a partner, the firm uses the retired partner's name as a partner, the retired partner who has not given public notice of his retirement, is held liable on grounds of holding out to third parties who give credit to the firm on the faith that he is still a partner.</p>
<b>Two Exceptions to the Principle of Holding Out</b>	<p>The Principle of holding out does not apply in the following two cases:</p> <ol style="list-style-type: none"> <li><b>1. Deceased Partner:</b> Where, after the death of a partner, the firm uses the deceased partner's name as a partner, the estate of the deceased partner</li> </ol>

	<p>or his legal representatives cannot be held liable for acts of the firm done after his death. It may be noted that a public notice of a partner's death is not required.</p> <p>2. <b>Insolvent Partner:</b> The estate of the insolvent partner cannot be held liable for the acts of the firm done after the date of the order of adjudication [Section 34]. It may be noted that a public notice of a partner's insolvency is not required.</p>
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**11.0 Position of Minor as a Partner [Sec. 30]**

<b>How can be admitted?</b>	With the consent of all the partners for the time being, a minor may be admitted to the benefits of partnership.	
<b>Rights and Liabilities of a Minor Partner before attaining Majority</b>	<b>Rights</b>	<b>Liabilities</b>
	1. He has a right to share the profits and property of the firm in accordance with the agreement. [Section 30(2)]	1. He is liable only to the extent of his share in the profits and the property of the firm. He is <b>not personally liable</b> to third parties. [Section 30(3)]
	2. He has a right to have access to, and inspect and copy, any of the accounts of the firm. But he does not enjoy such rights in respect of books other than account books. [Section 30(2)]	2. He <b>cannot be declared insolvent</b> on declaration of firm's insolvency, his share vests in the Official Receiver or Official Assignee.
	3. He has a right to file a suit for his share of profits or the property of the firm when he is not given his due share of profits. However, he can exercise this right only when he decides to sever his connections with the firm [Section 30(4)].	

<b>Minor's Duty to give Public Notice</b>	Within 6 months of date of his attaining majority or date of his obtaining knowledge that he had been admitted to the benefits of firm, whichever is later, the minor partner has to exercise his option whether or not to become a partner by giving a public notice within the said 6 months.	
<b>Effect of Minor's failure to give public notice</b>	If he fails to give a public notice, he is deemed to have become a partner in the firm on the expiry of the said six months.	
	<b>When he elects to become a partner</b>	<b>When he elects not to become a partner</b>
	1. He becomes <b>personally liable</b> to third parties for all acts of the firm since he was admitted to the benefits of partnership [Section 30(7)(a)].	1. His <b>rights and liabilities continue to be those of minor up to the date of giving public notice</b> [Section 30(8)(a)].
	2. His <b>share</b> in the property and profits of the firm <b>remains the same</b> as he was entitled as a minor [Section 30(7)(b)].	2. His <b>share is not liable</b> for any acts of the firm done <b>after the date of the public notice</b> [Section 30(8)(b)].
		3. He is <b>entitled to sue the partners</b> for his share of the property and profits in the firm [Section 30(8)(c)].
<b>Note:</b> 1. A partnership initially cannot be formed with a minor because before minor's admission there must be an existence of partnership. 2. There cannot be a partnership consisting of all minors or of one major and all other minors.		

## 12.0 Mutual Rights and Duties

<b>Mandatory Duties of Partners</b>	(a) Mandatory duties are prescribed by Sec. 9 and 10.
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	<p>(b) Mandatory duties cannot be changed by mutual agreement amongst partners</p> <p>(c) Every partner has the following four mandatory duties:</p> <ol style="list-style-type: none"> <li>1. To carry on the business of the firm to the greatest common advantage,</li> <li>2. To be just and faithful to each other, i.e. every partner should act in good faith. Good faith requires that a partner should not deceive the other partner by concealment of material facts.</li> <li>3. To render true accounts and full information of all things affecting the firm to any partner or his legal representative.</li> <li>4. To indemnify (i.e., to make good or to compensate) the firm for loss caused to it by his fraud in the conduct of the business of the firm.</li> </ol>
<b>General Duties of Partners</b>	<p>(a) The general duties of partners as provided in the Act are subject to the agreement by partners.</p> <p>(b) These can be changed by an agreement amongst the partners.</p> <p>(c) Unless otherwise agreed by the partners, every partner has the following duties:</p> <ol style="list-style-type: none"> <li>1. To attend diligently (i.e., carefully)</li> <li>2. Not to claim remuneration for taking part</li> <li>3. To contribute equally to the losses</li> <li>4. To indemnify the firm for loss due to his wilful neglect.</li> <li>5. To hold and use firm's property for business purpose</li> <li>6. To account for and pay the personal profits from transactions of firm etc.</li> <li>7. To account for and pay the personal profits from a competing business.</li> </ol>
<b>General Rights of Partners</b>	<p>(a) The rights of partners as provided in the Act are subject to the agreement by partners.</p> <p>(b) These rights can be changed by an agreement amongst the partners.</p>

	<p>(c) Unless otherwise agreed by the partners, every partner has the following rights:</p> <ol style="list-style-type: none"> <li>1. <i>Right to take part in the conduct of the business</i></li> <li>2. <i>Right to express opinion before the matter is decided</i></li> <li>3. <i>Right to have access to and to inspect and copy any of the books of the firm.</i></li> <li>4. <i>Rights to share profits equally</i></li> <li>5. <i>Right to receive interest on capital out of profits if the partnership agreement provides.</i></li> <li>6. <i>Right to claim interest on advances if made by him to the firm @ 6% p.a.</i></li> <li>7. <i>Right to be indemnified against the payments made and liabilities incurred by him:</i> <ol style="list-style-type: none"> <li>(i) <i>in the ordinary and proper conduct of the business, and</i></li> <li>(ii) <i>in doing act in emergency for the purpose of protecting the firm from loss if he has acted in a manner as a person of ordinary prudence would have acted in similar circumstances in his own case.</i></li> </ol> </li> <li>8. <i>Right to prevent the introduction of a new partner without the consent of all the existing partners.</i></li> <li>9. <i>Right to retire with the consent of all other partners and in the case of a partnership at will, by giving notice to that effect in writing to all the other partners.</i></li> <li>10. <i>Right not to be expelled from the firm by any majority of partners unless such power is conferred by partnership agreement and is exercised in good faith.</i></li> <li>11. <i>Outgoing Partner's Right to carry on competing business and to advertise such business. But, he cannot (i) use the firm's name, (ii) represent the firm, or (iii) solicit the firm's customers.</i></li> <li>12. <i>Right to share subsequent profits as per Sec. 37</i></li> </ol>
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	<i>13. Right to dissolve the partnership with the consent of all partners and in the case of a partnership at will, by giving notice to that effect in writing to all the other partners.</i>
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**13.0 Relation of Partners with Third Parties [Sec. 18]**

<b>Every Partner An Agent</b>	“Every partner is an agent of the firm for the purposes of the business of the firm” every partner has the capacity to bind other partners by his acts done in firm's name. Therefore, all partners are liable to third parties for the acts of every partner done for the purpose of the business of the firm.
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**14.0 Implied Authority of a Partner**

<b>Partner's Authority</b>	The authority of a partner means the capacity of a partner to bind the firm by his act.
<b>Mode of Authority</b>	Authority of a partner may be express or implied.
<b>Express Authority</b>	The authority conferred on a partner by mutual agreement is called 'express authority'.
<b>Implied Authority</b>	The authority conferred on a partner by the provisions of Section 19 of the Indian Partnership Act is called 'implied authority'.
<b>Conditions for Implied Authority</b>	Reading together Sections 19(1) and 22. Implied authority covers those acts of partners which fulfill the following three conditions: <ol style="list-style-type: none"> <li>1. The act must relate to the normal business of the firm;</li> <li>2. The act must have been done in the usual way of carrying on the business of the firm;            (It may be noted that the question as to what is usual and what is unusual in a business depends on the nature of business and the usage of trade, e.g. taking loan is considered as usual activity in case of a trading concern but unusual activity in case of a professional concern of solicitors.)</li> <li>3. The act must be done in the firm's name or in any other manner expressing or implying an intention to bind the firm.</li> </ol>
<b>Implied Authority includes 9 Acts</b>	An implied authority of a partner of a trading firm include the following acts: <ol style="list-style-type: none"> <li>1. To purchase goods of the kind that are used in the business of the firm;</li> </ol>

	<ol style="list-style-type: none"> <li>2. To sell the goods of the firm;</li> <li>3. To settle accounts with the persons dealing with the firm;</li> <li>4. To receive payment of the debts due to the firm and issue receipts for the same;</li> <li>5. To engage servants for the business of the firm;</li> <li>6. To engage a lawyer to defend an action brought against the firm;</li> <li>7. To borrow money for the purpose of the firm's business;</li> <li>8. To pledge the goods of the firm as security for the repayment of borrowings made for the purpose of firm's business;</li> <li>9. To draw, accept, endorse Bill of Exchange and other negotiable instruments in the name of the firm.</li> </ol>
<b>Statutory Restrictions</b>	<p>In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to do the following eight acts namely—</p> <ol style="list-style-type: none"> <li>1. To submit a dispute to arbitration relating to the business of the firm;</li> <li>2. To open a Bank Account on behalf of the firm in partner's own name;</li> <li>3. To compromise or relinquish any claim or portion of the claim by the firm;</li> <li>4. To withdraw a suit or proceedings filed on behalf of the firm;</li> <li>5. To admit any liability in a suit or proceedings against the firm;</li> <li>6. To acquire immovable property on behalf of the firm;</li> <li>7. To transfer immovable property belonging to the firm; and</li> <li>8. To enter into partnership on behalf of the firm.</li> </ol> <p><b>Note:</b> A partner can do any of the above-mentioned acts only if he is expressly authorised to do that act or the usage or custom of the trade permits him to do that act.</p>

<b>No Liability of the firm to third party for the restricted acts of partner</b>	The firm is not liable to third party for the above mentioned restricted acts of a partner whether or not the person dealing with the firm knew about such restrictions.
<b>Restrictions Imposed by Mutual Agreement</b>	All partners of a firm by mutual agreement may extend or restrict the scope of implied authority of any partner. But a third party is not bound by any such restriction unless it has the knowledge of such restriction. In other words, the firm is liable to third party if the third party has no knowledge of the restrictions.
<b>Any Admission or Representation by a Partner</b>	Any admission or representation (e.g., acknowledgement signed by a partner) by a partner is sufficient evidence against the firm if the following two conditions are fulfilled: <ol style="list-style-type: none"> <li>1. Such admission or representation must relate to the affairs of the firm; and</li> <li>2. Such admission or representation must be made in the ordinary course of business.</li> </ol>
<b>Notice to Partner operates as Notice to Firm</b>	Any notice to a partner operates as a notice to the firm if the following three conditions are fulfilled: <ol style="list-style-type: none"> <li>1. Such notice must relate to the affairs of the firm;</li> <li>2. Such notice must be given to a working partner and not to a sleeping partner.</li> <li>3. There must not be any fraud committed by the partners and the third party against the firm.</li> </ol>
<b>Nature of Partner's Liability</b>	Every partner is liable jointly with other partners and also severally (i.e., individually) for all those acts of the firm which have been done while he was a partner.
<b>Firm's Liability for Wrongful Act/omission of a Partner</b>	The firm is liable to the same extent as the partner for any loss or injury caused to any third party or any penalty by the wrongful act or omission of a partner if either of the following <b>two</b> conditions is fulfilled: <ol style="list-style-type: none"> <li>1. Such wrongful act or omission must have been done by a partner while he was acting in the ordinary course of business of the firm,</li> <li>2. Such wrongful act or omission must have been done by a partner with the authority of the other partners.</li> </ol> <p><b>Note:</b> The term 'wrongful act' includes fraud or negligence of the partners.</p>

<b>Firm's Liability for Misappropriation by a Partner</b>	The firm is liable to the third parties in the following two cases of misappropriation by a partner:	
	<b>Case</b>	<b>Condition</b>
	<b>1. Where a partner receives money or property from a third person and misapplies it.</b>	The receipt of money or other property by a partner must be an act within the scope of his apparent authority.
	<b>2. Where a firm, in the course of its business, receives money or property from a third person and the same is misapplied by any of its partners.</b>	The partner must have misapplied while the property was in the custody of firm.
<b>Partner's Authority in an Emergency</b>	A partner's authority in an emergency covers those acts which fulfill the following two conditions:	
	1. The act must be done to protect the firm from loss; and 2. The act must be such as a prudent man would undertake under similar circumstances in his own case.  <b>Note:</b> <i>Acts in emergency do not form part of the implied authority of the partner but, nevertheless, they would bind the firm. A partner's authority in an emergency is similar to that of an agent in similar circumstances u/s 189 of the Indian Contract Act.</i>	

## 15.0 Reconstitution of a Firm

<b>Modes of Reconstitution</b>	The various ways in which a firm is reconstituted are: 1. Introduction of a Partner 2. Retirement of a Partner 3. Expulsion of a Partner 4. Insolvency of a Partner 5. Death of a Partner 6. Transfer of a Partner's interest
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	Incoming Partner	Retiring Partner	Insolvent Partner	Estate of Deceased Partner
<b>Liability of Partner For Firm's Acts done before</b>	Not liable unless he assumes by tripartite agreement	Liable unless he is discharged by tripartite agreement	Liable	Liable
<b>For Firm's Acts done after</b>	Liable	He continues to be liable to third party (other than one who deals with the firm without knowing that he was a partner) until public notice of his retirement is given <i>either</i> by himself <i>or</i> any of the other partners. This liability of a retiring partner is based on the principle of holding out.	Not liable after date of order	Not liable after date of death
<b>Is Public Notice required?</b>	No	Yes	No	No
<b>Is Firm dissolved?</b>	No	No	Unless otherwise agreed, Yes	Unless otherwise agreed, Yes
<b>Expulsion of a Partner [Sec 33]</b>	<p>A partner may be expelled if the following <b>four conditions</b> are satisfied:</p> <ol style="list-style-type: none"> <li>1. the <b>power</b> to expel a partner must have existed <b>in a contract</b> between the partners;</li> <li>2. the power must have been exercised by a <b>majority</b> of the partners, and</li> <li>3. the power must have been exercised in <b>good faith</b> without any private animosity.</li> <li>4. The affected partner must be given an <b>opportunity to make a representation</b> before being dismissed.</li> </ol> <p><b>Note:</b> <i>The rights and liabilities of an expelled partner are the same as those of a retired partner.</i></p>			

<b>Rights of Transferee of a Partner's Share</b>	A partner may transfer his interest in the firm by sale, mortgage or charge fully or partially. The rights of such a transferee are as follows:
<b>(a) During the continuance of the partnership</b>	<ul style="list-style-type: none"> <li>• <b>He is entitled to receive:</b> <ul style="list-style-type: none"> <li>(a) the share of the profits of the transferring partner and</li> <li>(b) the account of profits agreed to by the partners.</li> </ul> </li> <li>• <b>He is not entitled:</b> <ul style="list-style-type: none"> <li>(a) to interfere with the conduct of the business</li> <li>(b) to require accounts;</li> <li>(c) to inspect the books of the firm.</li> </ul> </li> </ul>
<b>(b) On the dissolution of firm or on the retirement of the transferring partner</b>	<b>He is entitled to receive:</b> <ul style="list-style-type: none"> <li>(a) the share of the assets of the transferring partner and</li> <li>(b) an account as from the date of the dissolution for the purpose of ascertaining the share.</li> </ul>
<b>Revocation of Continuing Guarantee from Date of Change</b>	Unless otherwise agreed by the partners, a continuing guarantee (i.e., a guarantee which extends to a series of transactions) given to a firm or to a third party in respect of the transaction of a firm is revoked as to the future transactions from the date of any change in the constitution of the firm.
<b>Rights and Duties of Partners</b>	<p>The rights and duties of the partners of the reconstituted firm shall be the same as they were before the change in the firm. Section 17 provides for the following three types of changes in the firm:</p> <ul style="list-style-type: none"> <li>(a) Where there is a change in the Constitution of the firm.</li> <li>(b) Where the firm continues after the expiry of the term of the firm.</li> <li>(c) Where the firm carries on an additional undertaking.</li> </ul>

## 16.0 Dissolution of Firm

<b>Meaning of Dissolution</b>	The term 'dissolution' stands for discontinuation. Under the Indian Partnership Act, 1932, the dissolution may be <i>either</i> of Partnership <i>or</i> of a firm.
<b>Meaning of Dissolution of Partnership</b>	Dissolution of partnership refers to the change in the existing relations of the partners. The firm continues its business after being reconstituted.



<b>Modes of Dissolution of Partnership</b>	1. Admission of a new partner 2. Retirement of a partner 3. Death of a partner 4. Change in profit sharing ratio	
<b>Meaning of Dissolution of Firm</b>	It means dissolution of partnership between all the partners of a firm.	
<b>Modes of Dissolution of Firm</b>	<b>Without Court's Order</b>	<b>By Court's order</b>
	1. By Mutual Agreement 2. Compulsory Dissolution (a) If all or all but one partner are declared insolvent (b) If some event takes place which makes it unlawful for firm's business to be carried on 3. On happening of certain contingencies – Unless otherwise agreed by partners. (a) On Expiry of fixed term (b) On Completion of venture (c) On Death of a partner (d) On Insolvency of a partner 4. By Notice in writing to all in case of partnership at will	On the following grounds: 1. Insanity of active partner on petition by any other partner or next friend of insane partner 2. Permanent incapacity of Active Partner on a suit by any other partner 3. Misconduct on a suit by any other partner 4. Wilfully or Persistent Breach of Agreement on a suit by any other partner 5. Transfer of whole Interest to a third party 6. Perpetual Losses 7. Any other just and equitable ground
<b>Rights of a Partner on Dissolution</b>	1. Partner's General Lien 2. Right to Claim the Return of Premium on Premature Winding Up 3. Rights of a Partner in Case of Dissolution on Account of Fraud or Misrepresentation 4. Right to Restrain from Use of Firm Name or Firm Property	

<b>Liabilities of a Partner on Dissolution</b>	<p>In general Liability for Acts of Partners done after Dissolution continues:</p> <p><b>Exceptions:</b> Following are not liable for acts of partners done after dissolution.</p> <ol style="list-style-type: none"> <li>1. the Estate of a Deceased Partner;</li> <li>2. the Estate of an Insolvent Partner;</li> <li>3. a Sleeping or Dormant Partner who has retired from the firm.</li> </ol>
<b>Continuing Authority of Partners After Dissolution</b>	<ol style="list-style-type: none"> <li>1. to wind up the affairs of the firm, and</li> <li>2. to complete the unfinished transactions pending at the date of dissolution.</li> </ol>

### 17.0 Settlement of Accounts

<b>Treatment of Losses</b>	<p>Losses including deficiencies of capital are to be paid in the following manner:</p> <ol style="list-style-type: none"> <li>(i) First out of profits;</li> <li>(ii) Then out of capital;</li> <li>(iii) Lastly by partners individually in their profit-sharing ratio. [Section 48(a)]</li> </ol>		
<b>Application of Assets</b>	<p>The assets of the firm (including the sums, if any, contributed by the partners to make up the deficiencies of capital) shall be applied in the following manner and order:</p> <ol style="list-style-type: none"> <li>(i) in paying firm's debts to the third parties;</li> <li>(ii) in paying to each partner rateably what is due to him on account of advances;</li> <li>(iii) in paying to each partner rateably what is due to him on account of capital;</li> <li>(iv) the residue, if any, shall be divided among the partners in their profit-sharing ratio. [Section 48(b)].</li> </ol>		
<b>Payment of Firm's Debts and Partner's Private Debts</b>	<b>Basis of Distinction</b>	<b>Firm's Debts</b>	<b>Private Debts</b>
	<b>1. Who incurs</b>	Private debts are incurred by a partner in the individual capacity of a household and not in the capacity of a partner of a firm.	Firm's debts are incurred by the firm.

	<b>2. Who is liable</b>	For private debts, only the debts, concerned partner is liable.	For firm's debts, all partners are jointly and severally liable.
	<b>3. Application of firm's property</b>	For private debts, only the share of concerned partner in the excess of firm's property over firm's debts can be applied.	For firm's debts, firm's property shall be applied first.
	<b>4. Application of private property</b>	For private debts, private property shall be applied first.	For firm's debts, only the excess of of partner's private property over his private debts can be applied.
<b>Decision in Garner v. Murray requires</b>	1. that the solvent partners should bring in cash equal to their respective shares of the loss on realisation; 2. that the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.		
<b>Sale of Goodwill</b>	Unless otherwise agreed by the partners, the goodwill shall be included in the assets and may be sold either separately or alongwith other property of the firm.		

**18.0 Public Notice**

<b>When required</b>	1. on the Retirement or Expulsion of a partner, 2. on the Dissolution of the Firm, 3. on the Election to become or not to become a partner By a Minor on his attaining majority.	
<b>When not required</b>	1. on the Death of a Partner; 2. on the Insolvency of a Partner.	
<b>Mode of Giving Public Notice</b>	<b>In Case of a Registered Firm</b>	<b>In Case of an Unregistered Firm</b>
	(a) in the Official Gazette.	(a) in the Official Gazette.
	(b) in at least one vernacular newspaper	(b) in at one vernacular newspaper
	(c) to the Registrar of Firms.	

Consequences of Not Giving a Public Notice	Case	Consequences
	(a) On Election to become or not to become a partner by a Minor on his attaining majority	Minor is deemed to have become a partner on the expiry of said 6 months [Section 30(5)].
	(b) On Retirement of a Partner	Retiring partner and the other partners continues to be liable as partner to the third parties for firm's acts done after retirement [Section 32(3)].
	(c) On Expulsion of a Partner	The expelled partner and the other partners continue to be liable to third parties for firm's acts done after his expulsion [Section 33(2)].
	(d) On Dissolution of a Firm	All the partners continue to be liable to third parties for firm's acts done after the dissolution of firm [Section 45].

### 19.0 Consent of Partners required

To Expel any Partner	Consent of Majority of partners
To Change the Nature of the Firm's Business	Consent of All Partners
To Change the Terms of Partnership	Consent of All Partners
To Admit Minor	Consent of All Partners
To Introduce a New Partner	Consent of All Partners
To Retire From a Particular Partnership	Consent of All Partners
To Dissolve Particular Partnership	Consent of All Partners

## TRUE OR FALSE QUESTIONS

State giving reasons whether each of the following statements is True or False:

1. A partnership can be formed with a minor.
2. There can be no partnership without express agreement.
3. A partnership can be formed for a charitable purpose.
4. A partnership can be formed for carrying on a profession.
5. Sharing of profits of a business implies sharing of its losses as well.
6. Sharing of profits is a conclusive evidence of a partnership.

7. Mutual agency is a *prima facie* evidence of a partnership.
8. Business of the firm must be carried on by majority of the partners.
9. The members of a joint Hindu family carrying on family business are called partners.
10. The maximum limit on number of members of a Joint Hindu family carrying on family banking business is 10.
11. Burmese Buddhist husband and wife carrying on a business are not regarded as partners.
12. Co-ownership is not necessarily the result of agreement.
13. Co-ownership necessarily involves profit or loss.
14. Co-ownership necessarily involves carrying on of a business.
15. A co-owner is an agent of the other co-owners.
16. A co-owner has no lien on the joint property for expenses.
17. A co-owner has no right to claim partition of joint property.
18. In co-ownership, there is no maximum limit of co-owners.
19. Mitakshra School of Hindu Law is applicable to Bengal and Assam.
20. Dayabhaga School of Hindu Law is applicable to the whole of India except Bengal and Assam.
21. A male person becomes a member in joint Hindu family on his birth under Mitakshra School of Hindu Law.
22. A male person becomes a member in joint Hindu family only on the death of the father under Dayabhaga School of Hindu Law.
23. The liability of the *Karta* is unlimited, whereas the other coparceners are liable only to the extent of their share in the family business.
24. If a coparcener takes part in the act performed or a transaction entered into by the *Karta*, the liability of that coparcener will be unlimited.
25. It is compulsory to have a partnership deed.
26. The partnership deed must be signed by the majority of the partners.
27. The terms laid down in the partnership deed may be varied by the consent of majority of the partners.
28. It is compulsory for a partnership firm to get itself registered.
29. Registration of firm provides protection to the outsiders dealing with the firm.
30. A partner of an unregistered firm cannot file a civil suit against the firm or other partner(s).
31. An unregistered firm can file a suit against a third party to enforce any right arising from contract if the value of a suit exceed ₹ 100.
32. A third party cannot file a suit against an unregistered firm or its partners.
33. An unregistered firm can file a suit against a third party if the value of suit does not exceed ₹ 100.
34. A partner of an unregistered firm can file a suit for the dissolution of firm.

35. A partner of dissolved unregistered firm can file a suit for the recovery of money from firm's debtors.
36. In case of an unregistered firm, the official assignee or receiver can realise the property of an insolvent partner.
37. Partnership at will is for an indefinite period.
38. Partnership at will can be dissolved simply by any partner giving notice in writing to any of the other partners.
39. Partnership for a fixed period cannot be dissolved before the expiry of fixed period.
40. Partnership for a fixed period can be dissolved only with the consent of majority of the partners.
41. A firm has no legal existence apart from the partners.
42. A minor can become a partner.
43. A minor can be admitted to the benefits of partnership with the consent of majority of the partners.
44. A minor cannot take part in the conduct of the firm's business.
45. A minor has a right to have access to and inspect and copy any of the books of the firm.
46. A minor has a right to file a suit for his share of profits or the property of the firm when he is not given his due share of the profit without severing his connections with the firm.
47. A minor is personally liable to the third parties.
48. A minor cannot be declared insolvent in the event of firm's failure to pay off its debts.
49. A minor must give a public notice if he elects to become a partner.
50. A minor need not give a public notice if he does not elect to become a partner.
51. If a minor on attaining majority, elects to become a partner, he becomes only personally liable to third parties for those acts of the firm which are done after the date of his becoming partner.
52. The mutual rights and duties of partners are governed by the partnership agreement only.
53. All partners are not bound to carry on the business of the firm to the greatest common advantage.
54. All partners are bound to be just and faithful to each other.
55. All partners are bound to render true accounts and full information of all things affecting the firm to any partner but not to his legal representative.
56. Every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm.
57. The contract between the partners cannot provide that a partner shall not carry on any business other than that of the firm while he is a partner.
58. Every partner cannot take part in the conduct of the business.

59. Every partner is bound to attend diligently to his duties in the conduct of the business.
60. Every partner has the right to express his opinion before the matter is decided.
61. Any difference arising as to ordinary matter connected with the business must be decided with the consent of all the partners.
62. A change in the nature of the business can be made with the consent of majority of the partners.
63. Every partner has a right to have access to and to inspect and copy only the accounts books of the firm.
64. Even in the absence of any contract between the partners, a working partner is entitled to receive or remuneration for taking part in the conduct of the business.
65. In the absence of any contract between the partners, the partners are entitled to share the profits and losses in the ratio of their capitals.
66. Where a partner is entitled to interest on capital, such interest shall be payable as a charge against the profits.
67. Where a partner makes advances to the firm over and above the amount of capital, he is entitled to claim the interest thereon at the rate of 6% p.m.
68. Every partner has a right to be indemnified by the firm in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of the business.
69. Every partner shall indemnify the firm for any loss caused to it by his wilful neglect in the conduct of the business of the firm.
70. Property belonging to a partner who enters into an existing partnership constitute firm's property.
71. Capital originally brought to the stock of the firm constitutes firm's property.
72. Any property used for the purpose of the business of the firm constitutes firm's property.
73. Property of the firm shall be held and used by the partner exclusively for the purposes of the business.
74. Subject to contract between the partners, if a partner carries on any business whether or not competing with that of the firm, he must account for and pay to the firm all profits made by him in that business.
75. Subject to contract between the partners, mutual right and duties of the partners in the reconstituted firm remain the same as they were immediately before the change.
76. A partner is the agent of the firm for the purposes of the business of the firm.
77. The authority of a partner to bind the third party is called his implied authority.
78. Implied authority of a partner does not empower him to file a suit on behalf of the firm.
79. Implied authority of a partner does not empower him to submit a dispute relating to the business of the firm to arbitration.
80. Implied authority of a partner does not empower him to acquire/transfer any movable property on behalf of the firm.
81. Implied authority can be restricted or extended by mutual agreement.

82. In case of an emergency, in order to prevent losses to the firm, a partner may exceed his implied or express authority.
83. In order to bind a firm, an act must be done in the firm name or in any other manner expressing or implying an intention to bind the firm.
84. An admission or representation made by a partner concerning the affairs of the firm is an evidence against the firm whether or not it is made in the ordinary course of business.
85. Notice to any partner, of any matter relating to the affairs of the firm operates as notice to the firm except in the case of fraud on the firm committed by or with the consent of the partner.
86. Every partner is jointly and severally liable to third parties.
87. For wrongful acts of a partner, the firm is liable to the same extent as the partner.
88. The transferee is bound to accept the account of profits agreed to by the partners.
89. During the continuance of the firm, the transferee is entitled to receive the share of the assets of the firm to which the transferring partner is entitled.
90. A person can be introduced as partner into a firm with the consent of majority of the partners.
91. A partner may retire with the consent of majority of the partners.
92. A partner in a particular partnership can retire from the firm by giving notice in writing to the Registrar of firms of his intention to retire.
93. A partner in a partnership at will can retire from the firm by giving notice in writing to any of the partners, of his intention to retire.
94. Public notice of retirement must be given by the retired partner only.
95. A partner can be expelled from a firm only with the consent of all other partners.
96. An insolvent partner ceases to be a partner on the date on which an application for insolvency is made.
97. The estate of an insolvent partner continues to be liable to third parties for firm's acts done after the date on which the orders of adjudication is made if public notice is not given.
98. The estate of a deceased partner continues to be liable to third parties for firm's acts done after the death if public notice is not given.
99. An outgoing partner may carry on a business competing with that of the firm and he may advertise such business.
100. A continuing guarantee is revoked as to the future transactions from the date of any change in the constitution.
101. Dissolution of the firm necessarily means the dissolution of partnership.
102. A firm may be dissolved with the consent of majority of the partners.
103. A firm is compulsorily dissolved by the adjudication of a partner as an insolvent even if there are other two partners who are solvent.
104. A firm carrying on more than one adventures is compulsorily dissolved by the illegality of at least one adventure.
105. Unless otherwise agreed, a firm is dissolved by the death of a partner.
106. Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to the Registrar of firms of his intention to dissolve the firm.



107. Where a partner has become of unsound mind, the suit for dissolution may be brought by a friend of that partner.
108. Where a partner has become permanently incapable of performing his duties as partner, he may file a suit for dissolution.
109. A partnership for a fixed term cannot be continued after the expiry of that term.
110. Partnership constituted for a particular venture is dissolved on the completion of such venture unless otherwise agreed.
111. When a partner has transferred the whole of his interest to a third party, the other partners can sue for dissolution.
112. In the event of continued losses, the court may dissolve any partnership other than partnership for a fixed term.
113. Partners continue to be liable to third party for firm's acts done after dissolution whether or not a public notice is given.
114. After the dissolution of a firm, the authority of each partner to bind the firm does not continue at all.
115. Losses, including deficiencies of capital shall be paid first out of capital.
116. Firm's assets shall be applied first in payment of private debts of a partner.
117. A partner's private assets shall be applied first in payment of firm's debts.
118. If a partner derives any profit for himself from any transaction of the firm undertaken after the firm is dissolved under any circumstance and before its affairs have been completely wound up, he must account for the profit and pay it to the firm.
119. If a partner starts any business of the same nature and competing with that of the firm, after the firm is dissolved on account of death of a partner and before its affairs have been completely wound up, he must account for and pay to the firm all profits made by him in that business.
120. Where a partner has paid a premium on entering into partnership for a fixed term, he is entitled to the repayment of proportionate premium on any premature dissolution.
121. Where the goodwill of a dissolved firm is sold, the partners of the dissolved firm cannot carry on a business competing with that of the buyer of goodwill.
122. Public notices relating to unregistered firm must also be communicated to Registrar of firms.
123. Public notices relating to unregistered firm must be published in Official Gazettes only.
124. Any surplus left after payment of firm's debts is divided among all the partners in their profit sharing ratio.
125. Any deficiency of partner's capital arising on the insolvency of a partner is shared by the solvent partners in the ratio of their Capital just standing prior to dissolution according to *Garner v. Murray Rule*.

### ANSWERS

1. False 2. False 3. False 4. True 5. True 6. False 7. False 8. False 9. False  
 10. False 11. True 12. True 13. False 14. False 15. False 16. True 17. False  
 18. True 19. False 20. False 21. True 22. True 23. True 24. True 25. False  
 26. False 27. False 28. False 29. False 30. True 31. False 32. False 33. True  
 34. True 35. True 36. True 37. True 38. False 39. False 40. False 41. True  
 42. False 43. False 44. True 45. False 46. False 47. False 48. True 49. False

50. False 51. False 52. False 53. False 54. True 55. False 56. True 57. False  
58. False 59. True 60. True 61. False 62. False 63. False 64. False 65. False  
66. False 67. False 68. True 69. True 70. False 71. True 72. False 73. True  
74. False 75. True 76. True 77. False 78. False 79. True 80. False 81. True  
82. True 83. True 84. False 85. False 86. True 87. True 88. True 89. False 90. False  
91. False 92. False 93. False 94. False 95. False 96. False 97. False 98. False  
99. True 100. True 101. True 102. False 103. False 104. False 105. True 106. False  
107. True 108. False 109. False 110. True 111. True 112. False 113. False 114. False  
115. False 116. False 117. False 118. False 119. False 120. False 121. False  
122. False 123. False 124. False 125. True

### VERY SHORT ANSWER TYPE QUESTIONS

1. Define partnership.
2. Is it necessary to have a partnership agreement?
3. Is it necessary to have a partnership agreement in writing?
4. Can a partnership agreement be implied by conduct of partners?
5. What is the minimum limit of persons to form a partnership?
6. What is the maximum limit on number of partners?
7. Can a partnership be formed for a charitable or religious purpose?
8. Can a partnership be formed to carry on profession?
9. Does the sharing of profits of a business imply sharing of its losses?
10. What is mutual agency relationship?
11. What is co-ownership?
12. Is co-ownership necessarily the result of an agreement?
13. Does co-ownership necessarily involve profit or loss?
14. Can one co-owner without the consent of the others, transfer his interest to a stranger?
15. Is co-owner an agent of the other co-owner?
16. Does co-ownership necessarily involve carrying on of a business?
17. What is the maximum limit of co-owners in co-ownership?
18. Does a co-owner have right to claim partition of property owned with other co-owner?
19. Does a co-owner have lien on the property owned in common for expenses incurred by him?
20. What is Hindu undivided family?
21. Who are called 'coparceners'?
22. What is an 'Ancestral property'?
23. Name the two schools of Hindu Law.
24. Name the school of Hindu Law which is applicable to West Bengal and Assam.

25. Name the school of Hindu Law under which an interest in the ancestral property is acquired by birth.
26. Does a Hindu undivided family arise from an agreement?
27. What is the maximum limit of coparceners?
28. Does a female become member merely by her birth in a Hindu undivided family?
29. Who has implied authority in case of Hindu undivided family?
30. What is the extent of liability of members in case of Hindu undivided family?
31. What is the effect of death of a coparcener on the status of a Hindu undivided family?
32. What is a 'Partnership deed'?
33. Why is it considered desirable to have a partnership deed in writing?
34. Is it necessary to have a 'Partnership deed'?
35. Is it necessary to have a 'Partnership deed' duly stamped?
36. Is it necessary to have a 'Partnership deed' duly signed by all the partners?
37. Does the change in the terms laid down in the 'Partnership deed' require the consent of all the partners?
38. What is meant by 'Registration of firm'?
39. When does the registration become effective?
40. Is the registration of firm compulsory?
41. What is 'Partnership at will'?
42. What is a 'Particular partnership'?
43. Who is called an 'Actual partner'?
44. Who is called a 'Sleeping or dormant partner'?
45. Who is called a 'Nominal partner'?
46. Who is called a 'Partner in profits only'?
47. Who is called a 'Sub-partner'?
48. Can a partnership be formed with a minor?
49. Can a minor be admitted as a partner?
50. On attaining majority, within what period a minor partner is required to exercise his option whether or not to become a partner?
51. Are the mutual rights and duties of partners governed by the partnership agreement only?
52. Can the duties of partner laid down under Sections 9 and 10 be changed by an agreement amongst the partners?
53. Define 'Authority of a partner'.
54. Define 'Express authority of a partner'.
55. Define 'Implied authority of a partner'.
56. Can the 'Implied authority of a partner' be restricted?

57. Is the third party bound by any restriction imposed on the 'Implied authority of a partner'?
58. Is an incoming partner liable for firm's acts done before his admission?
59. Is a retiring partner liable for firm's acts done after his retirement?
60. What is the right of a partner who has been wrongly expelled?
61. Is a public notice required on the expulsion of a partner?
62. Are the rights and liabilities of an expelled partner the same as those of a retired partner?
63. Is the estate of an insolvent partner liable for firm's acts done after the date of order of adjudication?
64. Is a public notice required on the insolvency of a partner?
65. Is the firm dissolved on the death of a partner?
66. Is the estate of the deceased partner liable for firm's acts done after the date of his death?
67. Is a public notice required on the death of a partner?
68. Can a partner transfer his interest partially?
69. During the continuance of the partnership, (a) Is a transferee entitled to require accounts? (b) Is a transferee bound to accept the account of profits agreed to by the partners?
70. Define sub-partnership.
71. Are the rights of a sub-partner same as those of a transferee of a partner's share?
72. What is a 'Continuing guarantee'?
73. What is the effect of the change in the constitution of the firm on continuing guarantee?
74. What is meant by 'Dissolution'?
75. What is meant by 'Dissolution of partnership'?
76. What is meant by 'Dissolution of firm'?
77. Does the illegality of one or more business but not all businesses necessitate the compulsory dissolution of a firm?
78. How can a partnership at will be dissolved?
79. Give the two examples of just and equitable grounds on which a court may order dissolution of the firm?
80. Can a return of the premium be claimed when the dissolution is due to the death of a partner?
81. Can the partner be held liable for any act done after dissolution?
82. Is a public notice required on dissolution of a firm?
83. Is the estate of a deceased partner liable for the acts done after the dissolution of firm?
84. Is the estate of an insolvent partner liable for the acts done after the dissolution of the firm?

85. Is a sleeping partner who has retired from the firm liable for acts done after the dissolution of firm?
86. Does the authority of a partner to bind the firm continue after the dissolution of a firm?
87. Can a partner being a seller of goodwill of a dissolved firm carry on a business competing with that of the buyer?
88. Is it necessary to give notice to the Registrar of Firms?

### SHORT ANSWER TYPE QUESTIONS

1. Comment on the following statements:
  - (a) Law of partnership is an extension of the law of agency.
  - (b) Sharing of profit is a *prima facie* evidence of existence of partnership but it is not the conclusive evidence.
  - (c) The relation of partnership arises from contract and not from status.
  - (d) The Indian Partnership Act has effectively ensured the registration of firms without making it compulsory.
2. Distinguish between the following:
  - (a) Partnership and Co-ownership
  - (b) Partnership and Hindu undivided family
  - (c) Registered firm and Unregistered Firm
  - (d) Partnership at will and Particular Partnership
  - (e) Active Partner and Sleeping Partner
  - (f) Dissolution of Partnership and Dissolution of Firm
  - (g) Firm's Debts and Partner's Private Debts
3. Write explanatory notes on the following:
  - (a) Test of partnership
  - (b) Partnership deed
  - (c) Procedure for registration of a firm
  - (d) Consequences of non-registration of a firm
  - (e) Duration of partnership
  - (f) Partner, firm and firm's name
  - (g) Dormant partner
  - (h) Partner in profits only
  - (i) Sub-partner
  - (j) Partner by estoppel or holding out
  - (k) Rights and liabilities of a minor partner before attaining majority
  - (l) Rights and liabilities of a minor partner on attaining majority
  - (m) Mandatory duties of partners

- (n) Property of the firm
- (o) Implied authority of a partner
- (p) Acts outside the implied authority of a partner
- (q) Partner's authority in an emergency
- (r) Effect of restriction of partner's implied authority by mutual agreement
- (s) Effect of admission or representation by a partner
- (t) Effect of notice to an acting partner
- (u) Liability of partners for acts of the firm
- (v) Liability of firm for wrongful acts of a partner
- (w) Liability of firm for misapplication by partners
- (x) Liability of an incoming partner for firm's acts done before his admission
- (y) Rights of a retiring partner
- (z) Expulsion of a partner
- (aa) Insolvency of a partner
- (ab) Rights of a transferee of partners' interest
- (ac) Compulsory dissolution
- (ad) Dissolution on the happening of certain contingencies
- (ae) Dissolution by an order of court
- (af) Liabilities of partners for acts done after dissolution
- (ag) Right to get return of premium on premature dissolution
- (ah) Settlement of Accounts
- (ai) Rights of a partner in case of sale of goodwill after dissolution of a firm

### **LONG ANSWER TYPE QUESTIONS**

1. (a) Define 'Partnership'.  
(b) Explain the essential elements of a partnership.  
(c) Also explain the terms "partner", "firm" and "firm name".  
(d) Is there any difference between "partnership" and "firm"?
2. Explain how you will determine whether a group of persons is a partnership or not.
3. (a) Is it compulsory for a partnership firm to get itself registered?  
(b) Explain briefly the procedure for registration of firms.  
(c) Explain the consequences of non-registration.
4. Enumerate the different types of partners and briefly explain the extent of their liabilities.
5. Explain the circumstances under which a person can be made liable as a partner even if he is not a partner.
6. (a) Can a partnership be formed with a minor partner?  
(b) Can a minor be admitted to partnership? If so, what are his rights and liabilities during minority and after he has attained majority?

7. (a) State the duties of partners which cannot be changed by an agreement amongst the partners.  
(b) State the duties of partners which can be changed by an agreement amongst the partners.  
(c) State the rights of partners in the absence of any express agreement.
8. In the absence of an express agreement, state the legal position regarding  
(a) interest on capital of partners,  
(b) interest on loan by a partner  
(c) remuneration of partners,  
(d) profit sharing ratio.
9. (a) What is partnership property?  
(b) If a partner's property is used for the purpose of the firm's business, does it automatically become the property of the firm?  
(c) State how far is the partnership property liable for the separate debts of partners.
10. (a) What is meant by 'implied authority of a partner?'  
(b) What are the statutory restrictions on the implied authority of a partner?  
(c) Can the implied authority of any partner be extended or restricted?  
(d) How far are third parties affected by the restrictions placed on such implied authority?
11. (a) How can a major person be admitted in an existing firm?  
(b) How can a minor person be admitted in an existing firm?  
(c) Is an incoming partner liable for firm's acts done before his admission? Are there exceptions?
12. (a) How can a partner retire from a firm?  
(b) Is a retiring partner liable for the firm's acts done before his retirement? If so, can he be discharged from his liability towards the third parties?  
(c) Is a retiring partner liable for firm's acts done after his retirement?  
(d) Is the public notice of the retirement of a partner required? Who can give public notice of retirement? What are the consequences of not giving public notice in case of retirement of (i) an acting partner (ii) a dormant partner?  
(e) State the rights of a retiring partner.
13. (a) Can a partner be expelled? If so, how?  
(b) What are the rights and liabilities of an expelled partner?  
(c) What are the rights of a partner who has been wrongly expelled?  
(d) Does expulsion necessarily result in dissolution of the firm?  
(e) What is meant by 'sub-partnership' and 'sub-partner'? State the rights of a 'sub-partner'.
14. (a) Does the insolvency of a partner necessarily result in dissolution of the firm?  
(b) Is the estate of an insolvent partner liable for firm's acts done after the date

on which the order of adjudication is made if no public notice of insolvency is given?

15. (a) Does the death of a partner necessarily result in dissolution of the firm?  
(b) Is the estate of deceased partner liable for firm's acts done after the date of his death if no public notice of death is given?
16. (a) Can a share in a partnership be transferred like any other property?  
(b) Does the assignee of a partner's interest by sale, mortgage or otherwise enjoy the same rights and privileges as the original partner?  
(c) Does the transfer of partner's interest necessarily result in dissolution of the firm?  
(d) State the rights of transferee of partner's interest (i) during the continuance of partnership, (ii) on the dissolution of firm or on the retirement of the transferring partner.
17. (a) What is meant by dissolution of a firm?  
(b) Under what circumstances a firm is compulsorily dissolved?  
(c) Under what circumstances a firm is dissolved on the happening of certain contingencies in the absence of any contract to the contrary?  
(d) Discuss the grounds on which a partnership firm may be dissolved by the court. Also state the person who can file a petition before the court.
18. Discuss the rights and liabilities of partners on dissolution of a firm.
19. Discuss the rights of a partner when the firm has been dissolved on the grounds of fraud or misrepresentation by a partner.
20. Discuss the provisions relating to the settlement of accounts of a firm after dissolution.
21. Who would bear and in which ratio the deficiency arising due to the insolvency of a partner?
22. (a) Can firm's assets be used to pay off partner's private debts?  
(b) Can partner's private assets be used to pay off firm's debts?
23. Where the goodwill of a dissolved firm has been sold, what are the rights of a partner of a dissolved firm?
24. (a) State the circumstances under which a public notice is required to be given under the Indian Partnership Act, 1932.  
(b) State the mode of giving public notice.  
(c) State the consequence if a public notice is not given.  
(d) Who can give a public notice?
25. State the circumstances under which unanimous consent of all partners is required.





# The Limited Liability Partnership Act, 2008

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## 1.0 INTRODUCTION

1. The Limited Liability Partnership Act, 2008 was published in the Official Gazette of India on January 9, 2009 and has been notified with effect from 31st March 2009. However, the Act, has been notified with limited sections only. The rules have been notified in the Official Gazette on April 1, 2009. The first LLP was incorporated in the first week of April 2009.
2. It extends to the whole of India.
3. The LLP Act, 2008 has 81 Sections and 4 Schedules.  
The First Schedule deals with mutual rights and duties of partners, as well limited liability partnership and its partners where there is absence of formal agreement with respect to them.  
The Second Schedule deals with conversion of a firm into LLP.  
The Third Schedule deals with conversion of a private company into LLP  
The Fourth Schedule deals with conversion of unlisted public company into LLP.
4. The Ministry of Corporate Affairs (MCA) and the Registrar of Companies (ROC) are entrusted with the task of administering The LLP Act, 2008.
5. The Central Government has the authority to frame the Rules with regard to The LLP Act, 2008, and can amend them by notifications in the Official Gazette, from time to time.
6. The Indian Partnership Act, 1932 is not applicable to LLPs.

### NEED FOR LIMITED LIABILITY PARTNERSHIP

A need was felt for a new corporate form that could provide the benefits of limited liability of a company and the flexibility of a traditional partnership to its members in organizing their internal structure based on a mutual agreement. Hence, a concept of LLP was introduced which combines the elements of both 'a corporate structure' (i.e. limited liability) as well as 'a partnership firm structure' (i.e. flexibility). The LLP is a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, the liability of its partners will be limited.

LLP framework could be used for many Professionals and enterprises, such as:

1. Professionals and enterprises providing multidisciplinary services of any kind (Legal, Accounting, Taxation, Scientific, Technical or Artistic) such as Chartered Accountants

- (CA), Cost and Management Accountants (CMA), Company Secretaries (CS) and Advocates, where corporation form of entity is not suited.
2. Venture Capital Funds where risk capital combines with knowledge and expertise.
  3. Professionals and enterprises engaged in any scientific, technical or artistic discipline, for any activity relating to research, production, design and provision of services.
  4. Small Sector Enterprises
  5. Producer Companies in Handloom, Handicrafts sector.

## 2.0 MEANING AND FEATURES OF LIMITED LIABILITY PARTNERSHIP

### MEANING OF LIMITED LIABILITY PARTNERSHIP

Limited Liability Partnership means a partnership formed and registered under this Act. [Sec 2(1) (n)]

### FEATURES OF LIMITED LIABILITY PARTNERSHIP

1. **Body Corporate:** A Limited Liability Partnership is a body corporate formed and incorporated under this Act.
2. **Separate Legal Entity:** It is a legal entity separate from that of its partners.
3. **Perpetual Succession :** It has perpetual succession. Any change in the partners of a Limited Liability Partnership shall not affect the existence, rights or liabilities of the limited liability partnership.
4. **Limited Liability:** The liability of the partners will be limited to their agreed contribution in the LLP.
5. **Minimum and Maximum number of Partners:** Every LLP must have least 2 partners and must also have at least 2 individuals as designated partners, of whom at least one shall be resident in India. There is no maximum limit on the partners in LLP.
6. **Business for Profit Only:** The LLP can be formed only for carrying on a lawful business with a view to earn profit. Thus, LLP cannot be formed for charitable or non-economic purpose.
7. **LLP Agreement:** Mutual rights and duties of the partners within a LLP are governed by an agreement between the partners. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of The LLP Act, 2008.
8. **An Artificial Person Created by Law:** LLP is called an artificial person because it does not take birth like a natural person but comes into existence through law. It may be noted that the LLP is an artificial legal person and not a fictitious person. Like a natural person—
  - (a) LLP can enter into contracts.
  - (b) LLP can enforce the contractual rights against others.
  - (c) LLP can sue in its own name.

- (d) LLP can be sued in its own name.
- (e) LLP can own and hold property in its own name.
- (f) LLP has nationality. The registration of a company in a country determines the nationality of that LLP to that country.
- (g) LLP has its own rights and liabilities.

Unlike a natural person—

- (a) LLP has no physical shape or form.
- (b) LLP can not shake by hand.
- (c) LLP can not marry.
- (d) LLP can not smile or weep.
- (e) LLP can not take oath.
- (f) LLP can not commit a crime like murder.
- (g) LLP has no citizenship because a citizen of a country is a personal right peculiar to human beings only.

9. **Non- Applicability:** The provisions of The Indian Partnership Act, 1932 (9 of 1932) shall not apply to a LLP unless otherwise provided.

### 3.0 ADVANTAGES OF LLP FORM

The Advantages of LLP form are as follows:

1. **Limited Liability:** Liability of Partner is limited, to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
2. **Flexibility:** LLP provides flexibility of a traditional partnership to its members in organizing their internal structure based on a mutual LLP Agreement.
3. **Separate Legal Entity :** LLP has separate legal entity.
4. **Perpetual Succession:** LLP has perpetual succession. The death, insolvency or unsoundness of its members does not affect its existence. Members may come and go but LLP goes forever.
5. **Easy to Form:** The formation of LLP is much easier than that of a Company.
6. **Easy to Dissolve:** The dissolution of LLP is much easier than that of a Company.
7. **Foreign National:** Foreign National can become a Partner in a LLP.
8. **Whistle Blowing:** Under The LLP Act, 2008 Provision has been made to provide protection to employees & partners, providing useful information during an investigation or convicting any partner or firm.

### 4.0 ESSENTIAL ELEMENTS TO INCORPORATE AN LLP

Under The LLP Act, 2008, the following elements are very essential to form a LLP in India:

1. **To decide about Partners and to appoint minimum two individuals as Designated Partners.** At least one of them should be resident in India. Each Designated Partner is required to have a DPIN before appointment. A prior consent

to act as designated partners is required to be obtained in the prescribed form and manner before the appointment.

2. **To have LLP Name:** The LLP cannot have the same name with any other LLP, Partnership Firm or Company.
3. **To have a Registered Office** to which all communications and notices may be addressed and where they shall be received.
4. **To execute a LLP Agreement** between the partners *inter se* or between the LLP and its partners. Where LLP Agreement is silent, the relevant provisions of First Schedule of LLP Act, 2008 will be applied. The First Schedule deals with mutual rights and duties of partners, as well limited liability partnership and its partners. LLP Agreement usually consists of :
  - (a) Name of LLP
  - (b) Address of Registered Office of LLP
  - (c) Name & Address of each of Partners & Designated Partners of LLP
  - (d) Proposed Business of LLP
  - (e) Form of Contribution & Interest on Contribution of Partners
  - (f) Profit Sharing Ratio of Partners
  - (g) Rights & Duties of Partners
  - (h) Remuneration of Partners
  - (i) Rules for governing LLP
5. **To complete and file Incorporation Document along with the Compliance Statement** in the prescribed form along with the prescribed fees with the Registrar electronically;
6. **To file LLP Agreement** with the Registrar within 30 days of incorporation of LLP.

### 5.0 STEPS TO INCORPORATE LLP

#### Step 1: Name Reservation

File **e-Form 1**, for ascertaining availability and reservation of the name of a LLP business.

#### Step 2: Incorporate LLP

- (i) File **e- Form 2** for incorporating a new Limited Liability Partnership (LLP) and obtain LLPIN (Limited Liability Partnership Identification Number)

**Note:** **e-Form 2** contains the details of LLP proposed to be incorporated, partners'/ designated partners' details and consent of the partners/designated partners to act as partners/ designated partners.

#### Step 3: File LLP Agreement

File LLP Agreement in **e- Form 3** with the Registrar within 30 days of incorporation of LLP.

### 6.0 DISTINCTION BETWEEN PARTNERSHIP FIRM AND LLP

A Partnership Firm and LLP may be distinguished as follows:

<b>Basis of Distinction</b>	<b>Partnership Firm</b>	<b>LLP</b>
<b>1. Regulating Law</b>	It is governed by ' <b>The Indian Partnership Act, 1932</b> '	It is governed by ' <b>The Limited Liability Partnership Act, 2008</b> '
<b>2. Body Corporate</b>	It is not a Body Corporate.	It is a Body Corporate.
<b>3. Separate Legal Entity</b>	It <b>has no</b> separate legal entity.	It <b>has</b> separate legal entity.
<b>4. Perpetual Succession</b>	It does <b>not have perpetual succession</b> . The death, insolvency or unsoundness of its members may affect its existence.	It <b>has</b> perpetual succession. The death, insolvency or unsoundness of its members does not affect its existence. Members may come and go but LLP goes forever.
<b>5. Liability of Partners</b>	Liability of Partner is <b>unlimited</b> . Partners are severally and jointly liable for actions of other partners and the firm and liability extend to their personal assets.	Liability of Partner is <b>limited</b> , to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
<b>6. Registration</b>	Registration is <b>optional</b> .	Registration is <b>compulsory</b> .
<b>7. Creation</b>	It is created <b>by agreement</b> .	It is created <b>by Law</b> .
<b>8. Designated Partners</b>	It <b>need not have</b> Designated Partners.	It <b>must have</b> at least 2 individuals as Designated Partners, of whom at least one must be resident in India. Each Designated Partner is required to have a DPIN before appointment.
<b>9. Digital Signature</b>	There is <b>no requirement</b> of obtaining Digital Signature	At least one Designated Partner <b>must have</b> Digital Signatures since e forms are filled electronically.
<b>10. Liability of Partners for Legal Compliance</b>	<b>All Partners</b> are liable for Legal Compliance.	<b>Only Designated Partners</b> are liable for Legal Compliance.
<b>11. Name of Entity</b>	It can have <b>any name</b> as per choice.	Its Name to contain ' <b>Limited Liability Partnership</b> ' or ' <b>LLP</b> ' as suffix.

#### 14.6 Tulsian's Business Laws for CA Foundation Course

<b>12. Mutual Agency</b>	Partners are <b>agents of the firm and other partners.</b>	Partners act as <b>agents of LLP and not of other partners.</b>
<b>13. Admission of Minor</b>	Minor <b>can be admitted</b> to the benefits of Partnership as per its Agreement.	Minor <b>can not be admitted</b> to the benefits of LLP.
<b>14. Can Foreign National become partner?</b>	Foreign National <b>can not become</b> a partner in a Partnership Firm in India.	Foreign National <b>can become a Partner</b> in a LLP.
<b>15. Number of Members</b>	Minimum <b>2</b> and Maximum <b>10</b> for Banking business & <b>20</b> for non- Banking business.	<b>Minimum 2</b> but there is <b>no limit on maximum</b> number of partners.
<b>16. Whistle Blowing</b>	<b>No such provision</b> is provided under The Indian Partnership Act, 1932	<b>Provision has been made</b> to provide protection to employees & partners, providing useful information during an investigation or convicting any partner or firm.
<b>17. Annual Filing with Registrar</b>	No Return is required to be filed with Registrar of Firms	1. Annual Statement of Accounts 2. Statement of Solvency 3. Annual Return required to be filed with Registrar of LLP every year.

#### 7.0 DISTINCTION BETWEEN LIMITED LIABILITY COMPANY AND LLP

A Limited Liability Company and a LLP may be distinguished as follows:

<b>Basis of Distinction</b>	<b>Limited Liability Company</b>	<b>LLP</b>
<b>1. Regulating Law</b>	It is governed by 'The <b>Companies Act, 2013</b> '	It is governed by 'The Limited Liability Partnership Act, 2008'
<b>2. Motive</b>	It can be formed for <b>Profit or Service motive.</b>	It can be formed <b>only for Profit motive.</b>
<b>3. Number of Members</b>	<b>Private Company :</b> Minimum <b>2</b> members(OPC1) & <b>maximum 200</b> members. <b>Public Company:</b> Minimum <b>7</b> members but there is <b>no limit on maximum</b> number of partners.	<b>Minimum 2</b> but there is <b>no limit on maximum</b> number of partners.

<b>4. Liability of Partners/ Members</b>	Generally <b>limited to</b> the amount remaining <b>unpaid</b> on each share.	Liability of Partner is Limited, <b>to the extent their contribution</b> towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
<b>5. Name of Entity</b>	Name of Public Co to contain ' <b>Limited</b> ' and Name of Private Co to contain ' <b>Private Limited</b> '.	Its Name to contain ' <b>Limited Liability Partnership</b> ' or ' <b>LLP</b> ' as suffix.
<b>6. Formalities of Incorporation</b>	1. Memorandum & Articles of Association 2. <b>Various e Forms</b> 3. <b>Prescribed Fee.</b> required to be filled with Registrar of Companies.	1. <b>LLP Agreement</b> 2. <b>Various e Forms</b> 3. <b>Prescribed Fee.</b> required to be filled with Registrar of LLP.
<b>7. Filing of Annual Statement of Solvency</b>	Annual Statement of Solvency is <b>not required</b> to be filed with the Registrar of Companies every year.	Annual Statement of Solvency is <b>required</b> to be filed with the Registrar of LLP every year.
<b>8. Minimum No. of Directors/ Designated Partners</b>	Public Co to have at least 3 directors. Private Co to have at least 2 directors.	LLP must have at least 2 Designated Partners.
<b>9. Whistle Blowing</b>	<b>No such provision</b> is provided under the Companies Act, 1956.	<b>Provision</b> has been <b>made</b> to provide protection to employees & partners, providing useful information during an investigation or convicting any partner or firm.
<b>10. Audit of Accounts</b>	Companies are required to get their accounts audited <b>annually</b> as per the provisions of the Companies Act, 1956.	An LLP is required to get their accounts audited annually as per the provisions of LLP Act 2008 <b>if its turnover exceeds ₹ 40 Lacs or its capital contribution exceeds ₹ 25 Lacs in any financial year.</b>

## 8.0 WHO CAN BECOME A PARTNER IN LLP? [SEC 5]

Any individual or body corporate may be a partner in a limited liability partnership.

## 9.0 DISQUALIFICATIONS OF AN INDIVIDUAL TO BECOME A PARTNER[SEC 5]

An individual shall not be capable of becoming a partner of a limited liability partnership, if—

1. he has been found to be of **unsound mind** by a Court of competent jurisdiction and the finding is in force;
2. he is an **undercharged insolvent**; or
3. he has **applied to be adjudicated as an insolvent** and his application is pending.

## 10.0 MINIMUM NUMBER OF PARTNERS [SEC 6]

### MINIMUM NO OF PARTNERS

Every LLP must have at least **2** partners.

### EFFECT OF REDUCTION IN MINIMUM NO OF PARTNERS

If at any time the number of partners of a LLP is reduced below 2 and the LLP **carries on business for more than 6 months** while the number is so reduced, the person, who is the only partner of the LLP during the time that it so carries on business after those 6 months and has the knowledge of the fact that it is carrying on business with him alone, shall be **personally liable** for the obligations of the LLP incurred during that period.

## 11.0 DESIGNATED PARTNERS [SEC 7]

<b>Meaning</b>	Designated Partner means any partner designated as such u/s Sec 7.
<b>Minimum No &amp; only Individual</b>	Every LLP must have <b>at least 2 individuals</b> as designated partners and at least 1 of them must be a <b>resident in India</b> . The term “resident in India” means a person who has stayed in India for a period of <b>at least 182 days</b> during the immediately preceding 1 year.  <b>Note:</b> Nominees (who must be individuals) of bodies corporate partners of LLP can act as designated partners.
<b>Who will be a Designated Partner? [Sec 7 (2)]</b>	Subject to Sec 7 (1), if the Incorporation Document- (a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; <i>or</i> (b) states that each of the partners from time to time of LLP is to be designated partner, every partner shall be a designated partner;
<b>Who can become / cease to be a Designated Partner?</b>	Any partner may become /cease to be a designated partner in accordance with the LLP agreement.



<b>Prior Consent [Sec 7 (3)]</b>	An individual must give his prior consent to act as a designated partner in prescribed form and manner before his appointment.
<b>Filing with the Registrar [Sec 7 (4)]</b>	Every LLP must file with the Registrar the particulars of every individual who has given his consent to act as designated partner in prescribed form and manner <b>within 30 days of his appointment.</b>
<b>Satisfy Conditions [Sec 7 (5)]</b>	An individual eligible to be a designated partner must satisfy prescribed conditions and requirements.
<b>Designated Partner Identification Number (DPIN) [Sec 7 (6)]</b>	Every Designated Partner of a LLP must obtain a Designated Partner Identification Number (DPIN) from the Central Government and the provisions of Sections 266A to 266G (both inclusive) of The Companies Act, 1956 shall apply <i>mutatis mutandis</i> for the said purpose.
<b>Liabilities [Sec 8]</b>	<p>Unless expressly provided otherwise in this Act, a designated partner shall be—</p> <p>(a) responsible for the doing of all acts, matters and things as are required to be done by the LLP in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the LLP agreement; and</p> <p>(b) liable to all penalties imposed on the LLP for any contravention of those provisions.</p>
<b>Changes in Designated Partners [Sec 9]</b>	<p>A LLP may appoint a designated partner <b>within 30 days of a vacancy</b> arising for any reason and provisions of Sec 7(4) &amp; (5) shall apply in respect of such new designated partner.</p> <p><b>Note:</b> <i>If No designated partner is appointed, or if at any time there is only one designated partner, each partner shall be deemed to be a designated partner.</i></p>
<b>Punishment for contravention of Sections 7, 8 and 9[Sec 10]</b>	<ol style="list-style-type: none"> <li>1. If the LLP contravenes the provisions of section 7(1), the LLP and its every partner shall be punishable with fine which shall not be less than ₹ 10,000 but which may extend to ₹ 5,00,000.</li> <li>2. If the LLP contravenes the provisions of Section 7(4) &amp; (5), section 8 or section 9, the LLP and its every partner shall be punishable with fine which shall not be less than ₹ 10,000 but which may extend to ₹ 1,00,000.</li> </ol>

## 12.0 INCORPORATION DOCUMENT [SEC 11]

<b>1. At least two Subscribers</b>	Two or more persons associated for carrying on a lawful business with a view to profit must subscribe their names to an incorporation document.
<b>2. Contents</b>	The incorporation document shall— (a) be in a form as may be prescribed; (b) state the name of the limited liability partnership; (c) state the proposed business of the limited liability partnership; (d) state the address of the registered office of the limited liability partnership; (e) state the name and address of each of the persons who are to be partners of the LLP on incorporation; (f) state the name and address of the persons who are to be designated partners of the LLP on incorporation; (g) contain such other information concerning the proposed LLP as may be prescribed.
<b>3. Filing</b>	The incorporation document must be filed along with the Compliance Statement in such manner and with such fees, as may be prescribed with the Registrar of the State in which the registered office of the LLP is to be situated.
<b>4. Compliance Statement</b>	A statement in the prescribed form, made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the LLP and by any one who subscribed his name to the incorporation document, that all the requirements of this Act and the rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.
<b>5. Penalty</b>	If a person makes a statement which he knows to be false; or does not believe to be true, shall be punishable with imprisonment for a term upto <b>2 years</b> and with fine which shall not be less than ₹ <b>10,000</b> but which may extend to ₹ <b>5,00,000</b> .

## 13.0 INCORPORATION BY REGISTRATION [SEC 12]

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

#### **14.0 EFFECTS OF REGISTRATION [SEC 14]**

On registration, a LLP shall by its name, be capable of—

- (a) suing and being sued;
- (b) acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible;
- (c) having a common seal, if it decides to have one; and
- (d) doing and suffering such other acts and things as bodies corporate may lawfully do and suffer.

#### **THEORETICAL QUESTIONS**

1. Define Limited Liability Partnership and state its basic features.
2. State the Need of new form of Limited Liability Partnership.
3. State the Advantages of LLP form.
4. State the Essential elements to incorporate LLP.
5. State the Steps to Incorporate LLP.
6. Distinguish between a Partnership Firm and LLP.
7. Distinguish between a Limited Liability Company and LLP.
8. Who can become a Partner in LLP? State the Disqualifications of an Individual to become a Partner. Also state the minimum number of Partners to form LLP.
9. State the provisions relating to Designated Partner of a LLP
10. State the provisions relating to Incorporation Document of a LLP.
11. State the effects of registration of a LLP.





# Meaning, Nature and Types of Company

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## 1.0 MEANING OF A COMPANY

The company is one of the forms of organisation. It has its distinctive characteristics and advantages which make it suitable for different purposes.

1. **Literary Meaning:** The term 'Company' implies an association of a number of persons formed for some common object or objects.
2. **Legal Meaning:** As per section 2(20) of the Companies Act, 2013 "company" means a company incorporated under Companies Act, 2013 or under any previous company law."

The above definition is not exhaustive because it does not reveal the characteristics of the company.

Let us analyse some other definitions given in various judicial decisions to ascertain the characteristics of the company.

### 3. Meaning as per Judicial Pronouncements

- (a) **According to Lord Justice Lindley:** *"By a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit and loss (as the case may be) arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to who it belongs, are called members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted."*
- (b) **According to Chief Justice Marshall:** *"A company is person, artificial, invisible, intangible and existing only in the eyes of law. Being a mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."*
- (c) **According to Lord Haney:** *"A company is an incorporated association which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal."*

From the above definitions, it is clear that a company has a corporate and legal personality. It is an artificial person and exists only in the eyes of law. It has an independent legal entity and perpetual succession.

## 2.0 CORPORATION SOLE, BODY CORPORATE AND CORPORATION

### MEANING OF CORPORATION SOLE

Corporation Sole refers to a single person constituted as a Corporation in respect of some function or office enjoying perpetual succession and separate legal entity. *For example,* The President of India, Governor of a State, The Prime Minister of India,

### MEANING OF BODY CORPORATE/ CORPORATION

Generally speaking, the term 'Body Corporate' or 'Corporation' refers to an association of persons incorporated under any law enjoying perpetual succession and separate legal entity. The words 'corporation' and 'body corporate' are both used in the Companies Act, 2013.

As per Section 2(11) "Body Corporate" or "Corporation" **includes** a company incorporated outside India, but **does not include** –

- (i) a co-operative society registered under any law relating to co-operative societies; and
- (ii) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf;

**Note:** The term 'Body Corporate' also **does not include**:

- (i) a Corporation Sole
- (ii) a Society registered under the Societies Registration Act 1860 [*Board of Trustees Ayurvedic and Unani Tibbia College Delhi vs State of Delhi(SC)*]

### DISTINCTION BETWEEN A COMPANY AND A CORPORATION/ BODY CORPORATE)

The term Body Corporate is much wider in concept than the term 'Company' since the term Body Corporate **includes** a company incorporated outside India but the term 'Company' **does not include** such a company.

## 3.0 CHARACTERISTICS OF A COMPANY

On analysing the various definitions the following characteristics of a company are revealed:

1. **An Artificial Person Created by Law:** A company is called an artificial person because it does not take birth like a natural person but comes into existence through law. Being the creation of law, the company possesses only those properties which are conferred upon it by its charter (i.e., Memorandum of Association). Within the limits of powers conferred by its charter, it can do all acts as a natural person can do. It may be noted that the company is an artificial legal person and not a fictitious person.

***Like a natural person—***

- (a) The company can enter into contracts.
- (b) The company can enforce the contractual rights against others.
- (c) The company can sue in its own name.

- (d) The company can be sued in its own name.
- (e) The company can own and hold property in its own name.
- (f) The company has nationality. The registration of a company in a country determines the nationality of that company to that country.
- (g) The company has its own rights and liabilities.

**Unlike a natural person—**

- (a) The company has no physical shape or form.
- (b) The company can not shake by hand.
- (c) The company can not marry.
- (d) The company can not smile or weep.
- (e) The company can not take oath.
- (f) The company can not commit a crime like murder.
- (g) The company has no citizenship because a citizen of a country is a personal right peculiar to human beings only.

2. **Separate Legal Entity:** The case of *Salomon v. Saloman & Co. Ltd.* (1897) (AC) (22) clearly established the concept of corporate personality as distinct and different from that of its members individually and collectively (known as the Doctrine of Corporate veil).

In case of ***Saloman v. Salomon and Company Ltd.*** Mr. Saloman was running a shoe business in England as a sole proprietor. He formed a company known as 'Saloman and Co. Ltd.' It consisted of Saloman himself, his wife, his four sons and a daughter. The shoes business of Mr. Saloman was sold to the company for £30,000. Mr. Saloman received from the company purchase price in the form of £20,000 fully paid shares of £1 each and £10,000 in debentures which carried a floating charge over the assets of the company. One share of £1 each was subscribed for in cash by each member of Saloman's family. Saloman was the managing director of the company. During the course of business, the company became liable for some unsecured loan. The company ran into financial difficulties after some time and went into liquidation within a year. On winding up, the assets realised £6,000. The company owed £10,000 to Mr. Saloman and £7,000 to unsecured creditors. Thus, after paying off the debenture- holder. (Mr. Saloman), nothing was left for unsecured creditors. The creditors claimed priority over the debentures contending that Mr. Saloman and Saloman and Co. Ltd. were one and the same person, the company was only a facade to defraud the innocent creditors. Mr. Saloman should not therefore, be treated as a secured creditor. *The House of Lords held* that the company had been validly constituted and it had an independent existence distinct from its members. Therefore, Mr. Saloman was entitled to be paid his dues first as a secured creditor. It was observed that the business belonged to the company and not to Mr. Saloman. The company and Mr. Saloman enjoyed separate legal entities. The fact that the members were from one single family had no bearing upon the validity of the company.

The legal status of a company has been aptly described by the Supreme Court of India in **Tata Engineering & Locomotive Co. Ltd. v. State of Bihar**, as follows:

"The corporation in law is equal to natural person and has a legal entity of its own. The entity of the corporation is entirely separate from that of its shareholder; it bears its own name and has seal of its own; its assets are separate and distinct from those of its members; it can sue and be sued exclusively for its own purpose".

**Lee v Lee's Air Farming Ltd.** Lee was a qualified pilot. He virtually owned all the shares and he was the director also. He was also receiving salary from the company for being a chief pilot under the company. He was killed in an air accident while working for the company. It was held that Lee was a separate person for the company he had formed. Therefore, he could be legitimately employed under the company. As he was killed in the course of employment under the company, his widow was entitled to compensation.

**Bacha F. Guzdar v CIT:** A shareholder received dividend income from a company carrying on agricultural business. The income from agriculture business was exempt for tax. The shareholder contended that her dividend income should be treated as agricultural income and therefore exempt from tax. The court held that the company was a separate person from its members, having its own business, and its own income. The income received by the shareholders was not the same income as earned by the company.

#### **Effects of Separate Legal Entity**

- (a) The company may enter into contracts with its members and *vice versa*. Thus, a member can be a debtor, a creditor, a director, and an employee of the company at the same time.
  - (b) Its member can not be held liable for the acts of the company even if he holds virtually the entire share capital.
  - (c) Its members cannot claim ownership right in company's assets during its lifetime or even on its winding up since they are not owners.
  - (d) Its members can not have any insurable interest in the company's properties.
  - (e) Its creditors' remedy for the recovery of their debts lie only against the company and not against its members or directors.
3. **Perpetual Succession:** The term '*perpetual succession*' means the continued existence. The continued existence of the company is not affected by a continuous change in its membership. The death, insolvency or unsoundness of mind of its members or transfer of shares by its members does not in any way affect the existence of the company. Members may come and members may go but the company goes on forever. The company can be compared with flowing river where water (members) keeps on changing continuously, still the identity of the river (company) remains the same. The company continues to exist even if all its human members die. **According to Gower, 'even a hydrogen bomb cannot destroy a company'. Since it is created by law, it can be brought to an end by the process of law.**



Thus, a company being a creation of law continues to exist for an indefinite period till it is wound up in accordance with the provisions of the Companies Act.

4. **Common Seal:** The term '*Common Seal*' means the official signature of the company. Since the company being an artificial person can not sign its name on a document, every company is required to have its common seal with its name engraved on the same. This seal acts as the official signature of the company. However, as per the Companies (Amendment) Act, 2015, the requirement of affixing of Common Seal has been dispensed with. It has been provided in the Act that in case a company does not have a common seal, the authorisation shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.
5. **Limited Liability:** This specific characteristic of '**Limited Liability**' is possessed by limited companies and not by unlimited companies. In case of a *company limited by shares*, the liability of a member is limited upto the amount remaining unpaid (if any) on the shares held by a member. In case of a *company limited by guarantee*, the liability of a member is limited upto the amount guaranteed by a member. In case of company limited by guarantee and having share capital, the liability of a member is limited upto the aggregate of amount unpaid on shares held by him and amount guaranteed by him.
6. **Free Transferability of Shares:** This specific characteristic of '**Free Transferability of Shares**' is possessed by public companies and not by private companies.

The shares of a public company are freely transferable transferable in the manner provided in the Articles [Sec 44]. A shareholder can transfer his shares to any person without the consent of other members. Under the articles of association, even a public limited company can put certain restrictions on the transfer of shares but it cannot altogether stop it. A shareholder of public company possessing fully paid up shares is at liberty to transfer his shares to anyone he likes in accordance with the manner provided for in the articles of association of the company.

It may be noted that although restriction on the right to transfer may be placed in certain cases (e.g. in case of partly paid up shares) but absolute right of members to transfer shares cannot be restricted and any provision in the Articles to that affect shall be void.

Section 2(68) requires a private company to put restriction on transferability of its shares.

#### 4.0 ADVANTAGES OF A COMPANY

A company has the following advantages as compared to other forms of organisation:

1. **Separate Legal Entity:** A company has a separate legal entity quite distinct from its members.
2. **Perpetual Succession:** A company has *perpetual succession* [Sec 9]. The term '*perpetual succession*' means the continued existence. The continued existence

of the company is not affected by a continuous change in its membership. Since a company is created by law, it continues to exist for an indefinite period till it is wound up in accordance with the provisions of the Companies Act.

3. **Limited Liability:** The liability of a member of a *company limited by shares*, is limited upto the amount remaining unpaid (if any) on the shares held by a member.
4. **Free Transferability of Shares:** The shares of a public company are freely transferable in the manner provided in the Articles[Sec 44].
5. **Capacity to own & hold Property:** The company can acquire and hold any property (whether movable/Immovable/Tangible/Intangible) in its own name. [Section 9]
6. **Capacity to sue & be sued:** The company can sue others in its own name and be sued by others. [Section 9]
7. **Flexibility and Autonomy:** The company has an autonomy and independence to form its own policies and implement them, subject to the general principles of law, equity and good conscience and in accordance with the provisions contained in the Companies Act, Memorandum and Articles of Association. The company form of management of business disassociates the “ownership” from the “control” of business, and helps promote professional management and efficiency. The Key Managerial Personnel can carry on the business activities with freedom, authority and accountability in accordance with the Company Law. The Companies Act, 2013 has for the first time recognized the concept of Key Managerial Personnel. As per section 2(51) “Key Managerial Personnel”, in relation to a company, means –
  - (i) the Chief Executive Officer or the Managing Director or the Manager;
  - (ii) the Company Secretary;
  - (iii) the Whole-time Director;
  - (iv) the Chief Financial Officer; and
  - (v) such other officer as may be prescribed.

## 5.0 DISADVANTAGES OF A COMPANY

Some of the disadvantages of a company form of organisation are as follows:

1. **Detailed legal formalities in Incorporation and Expensive:** Incorporation of a company is coupled with complex, cumbersome and detailed legal formalities and procedures, involving considerable amount of time and money.
2. **Filing of Documents with ROC:** Various Returns and Documents are required to be filed with the Registrar of Companies together with the prescribed fees.
3. **Maintenance of Books and Registers:** Various Books and Registers are compulsorily required to be maintained by a company.
4. **Requirements of Approval of NCLT etc:** Approval of the National Company Law Tribunal/the Government, the Court, the Registrar of Companies or other appropriate authority, as the case may be, is necessarily required to be obtained for certain corporate activities such as corporate meetings, accounts, audit, borrowings, lending, investment, issue of capital, dividends etc

5. **Penal Consequences:** Any breach of the legal provisions is followed by severe penal consequences.
6. **Restricted Accessibility of Members:** The members of a company are having comparatively restricted accessibility to its internal management and day-to-day administration of corporate working.
7. **Separation of Control from Ownership:** The company form of management of business disassociates the “ownership” from the “control” of business. Members of a company are not having an active and complete control over the company’s working as one can have in other forms of business organisation, say, a partnership firm. The affairs of a company are managed by the Key Managerial Personnel. Thus, the position of ownership of members is more passive in nature.
8. **Greater Social Responsibility:** The companies are called upon to show greater social responsibility in their working and, for that purpose, are subject to greater control and regulation than that by which other forms of business organisation are governed and regulated. As per Sec 135, Every company having net worth of ₹ 500 crore or more, or turnover of ₹ 1000 crore or more or a net profit of ₹ 5 crore or more during any financial year is required to constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The Board of every such company is required to ensure that the company spends, in every financial year, at least 2% of the Average Net Profits of the company made during the 3 immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.
9. **Greater Tax Burden in Certain Cases:** The tax burden on a company is more than that on other forms of business organization since (a) No Basic Exemption taxable limit is available (b) its income is taxable at a flat rate.
10. **Detailed Winding-up Procedure:** The procedure for winding-up of companies is more detailed, expensive and time consuming than that which is applicable to other forms of business organisation.

## 6.0 LIFTING THE CORPORATE VEIL

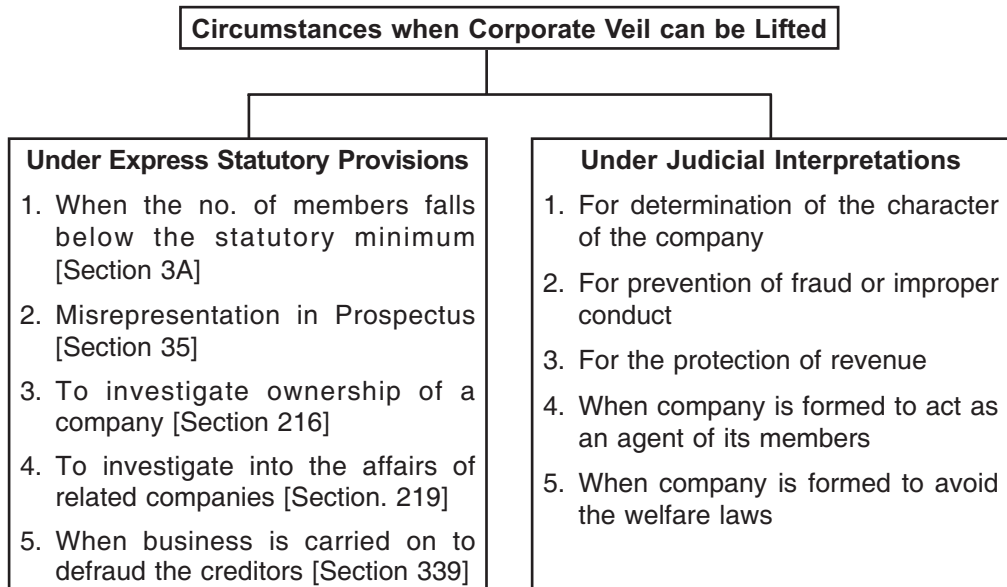
### MEANING OF LIFTING THE CORPORATE VEIL

Lifting the corporate veil means ‘disregarding (or Ignoring) the corporate entity and paying regard to the individual members behind the legal facade’.

When the company starts using the corporate veil for improper conduct, or to protect fraud or to justify wrongs, the law ignores the separate legal entity of the company and looks at the real persons behind and treat the company and its members as same person.

### CIRCUMSTANCES WHEN THE CORPORATE VEIL CAN BE PIERCED/LIFTED

The circumstances and cases in which the corporate veil can be lifted may broadly be classified as follows:



### CASES UNDER EXPRESS STATUTORY PROVISIONS

#### 1. When the Number of Members Falls Below Statutory Minimum [Section 3A]

If the company carries on business for more than 6 months with the number of members reduced below the statutory requirement (i.e. 2 in case of private company and 7 in case of public company), every person who was a member of the company during the time when it carried on business after those 6 months and who was aware of this fact, shall be severally liable for all debts of the company **contracted after those 6 months**.

Although the company continues to enjoy its distinct personality but loses the important feature of limited liability of the members of the company. Such a situation entitles the creditors to disregard the separate entity of the company, and the creditors can take action against the members directly.

#### 2. Misrepresentation in Prospectus [Sections 35]

Where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in Sec 35(1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

#### 3. To Investigate Ownership of a Company [Section 216]

As per Sec 216, where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons—

- (a) Who are or have been financially interested in the success or failure, whether real or apparent, of the company; *or*
- (b) Who are or have been able to control or to materially influence the policy of the company

This will be done by lifting the corporate veil so as to find out the true persons controlling it.

#### 4. To Investigate into Affairs of Related Companies [Section 219]

As per Sec 219, if an inspector is appointed by the Central Government to investigate the affairs of a company, he shall also have the power to investigate into the affairs of related companies in the same management. The power to do so may thus lift the corporate veil.

#### 5. When Business is Carried on to Defraud the Creditors [Section 339]

As per Sec 339, if in the course of the winding up of a company, it appears that any business of the company has been carried on with the intention to defraud its creditors or any other persons, in such a case the persons who were knowingly parties to such acts shall be personally responsible without any limitation of liability, for all or any of the debts/other liabilities of the company as the Tribunal may direct.

6. **Ultra Vires Acts:** The directors of a company shall be personally liable for the *ultra vires* acts done by them on behalf of the company.

### CASES UNDER JUDICIAL INTERPRETATIONS

Besides the above-mentioned circumstances, the courts have allowed the lifting of corporate veil for proper administration of taxation laws, wealth tax law, etc. and also in some other circumstances. Let us now study some of the cases where the corporate veil was lifted.

1. **For Determination of the True Character of the Company:** Sometimes, particularly during the war between countries, it becomes necessary to ascertain the character of certain companies. At such times the courts are justified in lifting the corporate veil of a company which is controlled by alien enemy. In this way a company registered in India may be declared alien enemy if it is found that the persons controlling such a company are citizens of an enemy country.

In case of ***Daimler Co. Ltd. v. Continental Tyre and Rubber Co. Ltd.***, [(1916) 2 A.C. 207]. A company with the name Continental Tyre and Rubber Co. Ltd. was registered in England. The object of this company was to sell tyres in United Kingdom, which were manufactured in Germany by a German company. Majority of the shares of this company were held by Germans. Besides this, all the directors of the company were German residents. When the First World War broke out, the company filed a suit to recover a trade debt. The court came to the conclusion that the company was an enemy company because the effective control of the company was in the hands of Germans who were alien enemy. Hence, the claim of the company was disallowed on the ground that it was against public policy to allow alien enemies to trade by using the corporate veil.

Similarly in case of **Connors Bros. v. Connors**, [(1940) 4 All E.R. 197] the principle was applied against the managing director who made use of his position contrary to public policy. In this case the House of Lord determined the character of the company as “enemy” company, since the persons who were *de facto* in control of its affairs, were residents of Germany, which was at war with England. The alien company was not allowed to proceed with the action, as that would have meant giving money to the enemy, which was considered as monstrous and against “public policy”.

2. **For the Prevention of Fraud or Improper Conduct:** The courts may lift the corporate veil if the company has been formed to avoid legal obligations or to defraud the creditors.

In the case of **Gilford Motor Co. Ltd. v. Horne** [(1933) 1 Ch. 435], Horne was appointed as a managing director of Gilford Motor Co. with the condition that he would not solicit or entice away the customers of the company, so long as he was in the employment of the company and afterwards. After leaving the company, Horne formed another company which was to carry on the same business. This new company of Horne solicited the customers of Gilford Motor Co. Ltd. In a suit filed by Gilford Motor Co. Ltd. against Horne to restrain him from soliciting the business, the court came to the conclusion that Horne had created the company for his own benefit and to solicit the customers of his employer's company. The court issued an injunction against Horne and his new company and held that the new company was a mere cloak for the purpose of enabling the defendant to commit a breach of his contract that he would not solicit the business of his employer's company.

Similarly, in case of **Jones v. Lipman**, (1962), I.W.L.R. 832, A agreed to sell certain land to B. Pending completion of formalities of the said deal, A sold and transferred the land to a company which he had incorporated with a nominal capital of \$100 and of which he and a clerk were the only shareholders and directors. This was done in order to escape a decree for specific performance in a suit brought by B. The court held that the company was the creature of A and a mask to avoid recognition and that in the eyes of equity A must complete the contract, since he had the full control of the limited company in which the property was vested, and was in a position to cause the contract in question to be completed.

3. **For the Protection of Revenue:** The court may lift the corporate veil if the company has been formed to evade the tax. In case of **Re Sir Dinshaw Manekjee Petit**, AIR 1927 Bombay 371, the assessee, Sir Dinshaw who was a very rich man, was earning huge dividend and interest income. He formed four private companies and entered into an agreement with each company to hold a block of investment as his agent. Under the arrangement the income received was credited in company's account and the company handed the amount back to him as a loan (which was never repaid). In this way he divided his income in four parts in order to reduce his tax liability. The court ignored the corporate entity of these companies and held that the company was nothing more than the assessee himself. Sir Dinshaw was held the owner of total income and liable to pay tax.

4. **Where Company is formed to Act as an Agent of its Members:** Where a company is regarded as an agent or trustee of its members or of another company, for the acts done by the company, it will be the members who would be responsible and not the company.

**In case of Re F.G. Films Ltd.** an American company financed and produced a film 'Mansoon' in India. But, technically, the film was made in the name of a company incorporated in England. This British company had only a capital of \$100 divided into 100 shares of \$1 each, of this, 90 shares were held by President of the American company. The Board of trade declined to register the film as a British film. The view of the Board of Trade was upheld by the court. The court held that the British company acted only as an agent of the American company which was the true maker of the film.

5. **When a Company is formed to avoid Welfare Laws:** The courts have disregarded the separate legal personality of the company when the company's independent status was being used as a device to reduce the amount payable by the company to defeat the provisions of welfare laws, such as payment of bonus to its workmen.

**In the case of Workmen Employed in Associated Rubber Industries Ltd., Bhavnagar v. The Associated Rubber Industries Ltd., Bhavnagar and Others,** a new company was formed with no assets of its own except those transferred to it by the principal company. The new company had no business of its own, it received dividend on shares transferred to it by the principal company. Thus, the principal company was able to reduce its gross profits and consequently the amount of bonus payable to workman was also reduced. The Supreme Court rejected the independent status of the new company and directed that the amounts paid to the new company as dividend shall also be taken into account while determining the gross profits of the principal company.

The court held that *"in every case where ingenuity is expected to avoid taking and welfare legislations, the court will go behind the smoke-screen and discover the true state of affairs."*

*Thus, in all circumstances, 'honest enterprises by means of companies are allowed but the public are protected against kiting and humbuggery.'*

6. **For the Protection of Public Policy:** The Court shall lift the corporate veil to protect the public policy and to prevent the transaction contrary to public policy.

## 7.0 DISTINCTION BETWEEN A PARTNERSHIP AND A COMPANY

A partnership differs from a company in the following respects:

Basis of Distinction	Partnership	Company
1. <b>Separate Legal Entity</b>	A firm has <b>no separate legal existence</b> . Partners are collectively termed as a firm and individually as partners.	It <b>has</b> a separate legal existence. A company is separate from the members.



<b>2. Nature of Liability</b>	The liability of partners is <b>unlimited</b> .	Liability of its members is <b>limited</b> to the extent of unpaid amount on shares held by them in case of Company Ltd. by Shares.
<b>3. Perpetual Existence</b>	It does not enjoy perpetual existence. Death, sickness, retirement of partners may affect its existence so as to dissolve it.	It enjoys perpetual existence. Even an atom bomb cannot destroy a company unless it is wound up under the due process of law.
<b>4. Minimum No. of Members</b>	<b>Minimum</b> No. of partners is 2.	<ul style="list-style-type: none"> <li>• A public Co. – 7.</li> <li>• A Pvt. Co. – 2</li> <li>• One Person Company – 1</li> </ul>
<b>5. Maximum No. of Members</b>	<ul style="list-style-type: none"> <li>• Banking business: 10</li> <li>• Non-banking business: 20.</li> </ul>	<ul style="list-style-type: none"> <li>• Public Co. – no limit.</li> <li>• Pvt. Co. – 200</li> <li>• One Person Company – 1</li> </ul>
<b>6. Transfer of interest</b>	A partner <b>cannot transfer</b> his share without the consent of other partners.	A member of a public company <b>may transfer</b> his shares as and when he likes without any absolute restriction on transfer of shares.
<b>7. Mutual Agency</b>	A partner is an agent and principal of other partners and hence, partners bind each other with their actions.	A member is <i>neither</i> an agent <i>nor</i> a principal of other members and hence, Members do not bind each other with their actions.
<b>8. Distribution of Profit</b>	Profits are distributable among partners as per the partnership deed.	There is no such compulsion that profits must be distributed. Only when the dividends are declared that the members get a share of profits.
<b>9. Management</b>	Partners <b>Participate</b> in management.	Members <b>cannot participate</b> in management unless appointed as directors. However, members may attend and vote at meetings while making the appointment of Directors, Auditors, etc.



10. Property	Property of the firm is the <b>joint property of all its partners.</b>	Property of the company is <b>not the property of its members</b> as the company has separate legal existence.
11. Remedy of Creditors	The creditors of a firm can proceed <b>against the partners</b> jointly and severally.	The creditors of a company can proceed <b>only against the company</b> and not against its members.
12. Whether Creditors bound by Restriction on authority	Restriction on a partner's authority contained in partnership deed <b>do not</b> bind outsiders.	Restriction on authority of directors contained in Articles <b>bind</b> the outsiders because they are deemed to have the knowledge of Articles.
13. Compulsory Audit	Audit of a firm is <b>not compulsory</b> under The Indian Partnership Act.	Audit of a company is <b>compulsory</b> under The Companies Act.
14. Dissolution	Firm can be dissolved at any time by <b>mutual agreement.</b>	A company, being the creature of law, can only be <b>dissolved by law.</b>

## 8.0 DISTINCTION BETWEEN COMPANY AND LLP

<i>Basis of Distinction</i>	<i>Company</i>	<i>LLP</i>
<b>Prevailing Law</b>	It is governed by 'The Companies Act, 2013'	It is governed by 'The Limited Liability Partnership Act, 2008'
<b>Motive of Formation</b>	It can be formed for Profit or Service motive.	It can be formed only for Profit motive.
<b>Charter Document</b>	Memorandum of Association is the charter of the company which defines its scope of operations.	LLP Agreement is a charter of the LLP which defines its scope of operations.
<b>Number of Members</b>	<b>Private Company:</b> Minimum 2 members & Maximum 200 members. One person Company 1 member.  <b>Public Company:</b> Minimum 7 members but there is no limit on maximum no. of partners.	Minimum 2 but there is no limit on maximum number of partners.

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<b>Liability of Partners/ Members</b>	The liability of a member of a <i>company limited by shares</i> , is limited upto the amount remaining unpaid (if any) on the shares held by a member.	Liability of Partner is Limited, to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
<b>Formalities of Incorporation</b>	1. Memorandum & Articles of Association 2. Various e Forms 3. Prescribed Fee. required to be filled with Registrar of Companies.	1. LLP Agreement 2. Various e Forms 3. Prescribed Fee. required to be filled with Registrar of LLP.
<b>Filing of Annual Statement of Solvency</b>	Annual Statement of Solvency is <b>not required</b> to be filed with the Registrar of Companies every year.	Annual Statement of Solvency is <b>required</b> to be filed with the Registrar of LLP every year.
<b>Whistle Blowing</b>	No such provision is provided under the Companies Act, 2013.	Provision has been made to provide protection to employees & partners, providing useful information during an investigation or convicting any partner or firm.
<b>Transfer of Share/ Partnership rights in case of death</b>	Shares are transmitted to the legal heirs.	Legal heirs will not become partners. The legal heirs have the right to get the refund of the capital contribution + Share in Accumulated Profits, if any.
<b>Audit of Accounts</b>	Companies are <b>required</b> to get their accounts audited annually as per the provisions of the Companies Act, 2013 <b>irrespective of Turnover/Share Capital.</b>	An LLP is <b>required</b> to get their accounts audited annually as per the provisions of LLP Act 2008 <b>if its Turnover exceeds ₹ 40 Lacs or its capital contribution exceeds ₹ 25 Lacs in any financial year.</b>
<b>Cost of Formation</b>	Minimum Statutory Fee for incorporation of Private Company and Public Company is Nil if Authorised Capital is upto ₹ 10 lakhs.	Minimum Statutory Fee for incorporation of LLP is ₹ 800 only if Capital Contribution is upto ₹ 1 lakhs.

## 9.0 DISTINCTION BETWEEN COMPANY AND HINDU JOINT FAMILY BUSINESS

1. A company consists of heterogeneous members, whereas a Hindu Undivided Family Business consists of homogenous members since it consists of members of the joint family itself.
2. In a Hindu Joint Family business the Karta (manager) has the sole authority to contract debts for the purpose of the business, other coparceners cannot do so. There is no such system in a company.
3. A person becomes a member of Joint Hindu Family business by virtue of birth. There is no provision to that effect in the company.
4. No registration is compulsory for carrying on business for gain by a Hindu Joint Family even if the number of members exceeds hundreds [**Shyamlal Roy v. Madhusudan Roy, AIR 1959 Cal. 380 (385)**]. Registration of a company is compulsory.

## 10.0 DISTINCTION BETWEEN A COMPANY AND A CLUB

1. A company is a trading association. A club, on the other hand, is a non-trading association.
2. Registration of a company is compulsory. Registration of a club is not compulsory.

## 11.0 TYPES OF COMPANIES

As per Sec.3(2), on the basis of liability, an incorporated company may *either* be

1. A company limited by shares, *or*
2. A company limited by guarantee, *or*
3. An unlimited company.

An incorporated company may further be classified as:

4. Private Company;
5. Public Company;
6. One Person Company
7. Company with charitable objects, etc. under Section 8 of the Companies Act, 2013;
8. Small Company
9. Government Company;
10. Foreign Company;
11. Holding Company and Subsidiary Company.
12. Producer Company

Let us discuss the various types of companies one by one.

## 12.0 COMPANY LIMITED BY SHARES [SECTION 2(22)]

1. A company limited by shares is a company in which the liability of its members is limited by its Memorandum to the amount (if any) unpaid on the shares respectively held by them.

2. If a member has paid the full amount of shares, then his liability shall be nil.  
*For example*, suppose Mr. X buys 1000 shares of a company of the face value of ₹ 10 each. In this company his liability is fixed to the tune of ₹ 10,000 only. If he paid (when called by the company) ₹ 6,000 to the company. He is now liable to pay the only ₹ 4,000, being the amount remaining unpaid on his shares. When he has paid the entire amount of ₹ 10,000 (which means when his shares have been fully paid up) his liability shall be nil.
3. A company limited by shares may be *either* public company *or* private company.
4. Thus, the two main features of a company limited by shares are as follows:
  - (a) The liability of its members is limited to the amount (if any) remaining unpaid on the shares held by them.
  - (b) Such liability can be enforced *either* during the life time of the company (by the board of Directors) *or* during the winding up of the company (by the liquidator)

### 13.0 COMPANY LIMITED BY GUARANTEE [SECTION 2(21)]

1. A company limited by guarantee is a company in which the liability of its members is limited by its Memorandum to the amount that the member has guaranteed to pay in the event of winding up of the company.
2. Such companies are generally formed for the promotion of commerce, art, science, religion, charity or any other useful object.
3. A company limited by guarantee may be *either* private company *or* public company.
4. Such a company may or may not have share capital.
5. The main features of such company are as follows:

<b>Types of Company Limited by Guarantee</b>	<b>Liability</b>
<b>(i) Company Limited by Guarantee not having share capital</b>	(a) The liability of its members is limited to the amount guaranteed by them. (b) Such liability can be enforced only by the liquidator after the commencement of winding up of the company and not during the life time of the company.
<b>(ii) Company limited by guarantee having share capital</b>	(a) The liability of its members is limited to following two amounts: <ol style="list-style-type: none"> <li>(i) The amount (if any) remaining unpaid on the shares held by them.</li> <li>(ii) The amount guaranteed by them.</li> </ol> (b) The liability in respect of guaranteed amount can be enforced only at the time of winding up of the company and not during the life time of the company.

**Note:** The Articles of a company limited by guarantee must state the number of members with which the company is to be registered.

#### 14.0 SIMILARITY BETWEEN COMPANY LIMITED BY SHARE AND COMPANY LIMITED BY GUARANTEE

Both the companies are required to state in the Memorandum that the members' liability is limited.

#### 15.0 DISTINCTION BETWEEN COMPANY LIMITED BY SHARE AND COMPANY LIMITED BY GUARANTEE

1. Members of company limited by share may be called upon to discharge their liability either during the company's life time or during its winding up.
2. Members of company limited by guarantee not having share capital may be called upon to discharge their liability only after the commencement of the winding up.

#### 16.0 UNLIMITED COMPANY [SECTION 2(92)]

1. An unlimited company is a company in which the liability of its members is not limited by its memorandum. In other words, the liability of members is unlimited i.e., there is no limit on the liability of members.
2. The members of unlimited companies may be required to pay company's losses from their personal property.
3. Since unlimited companies have separate legal entity, its creditors cannot file a suit against the members directly. The creditors will have to apply to the court for the winding up of the company and then the liquidator will direct the members to contribute to the assets of the company to pay-off its liabilities.
4. An unlimited company may also be *either* public company *or* private company.
5. An unlimited company may or may not have a share capital.

#### Notes:

- (i) An unlimited a company must have its own Memorandum and Articles of Association.
- (ii) The Articles of an unlimited company must state the number of members (**at least 100**) with which the company is to be registered.
- (iii) The Articles of an unlimited company having a share capital must also state the amount of share capital with which the company is to be registered.
- (iv) An unlimited company having share capital may alter its share capital without any restriction. [Section 61(1)]
- (vi) An unlimited company having share capital may reduce its share capital without any restriction. [Section 66(1)]
- (vii) The liability of each member extends to the whole amount of the company's debts and liabilities but he will be entitled to claim contribution from other members.

- (viii) So long as the company is a going concern the liability on the shares is the only liability which can be enforced by the company, though the liability of the members is unlimited so far as creditors are concerned.

**[Re Mayfair Property Co. Bartlett v. Mayfair Property Co. [1898] 2 Ch. 28].**

- (ix) An unlimited company can register itself as a limited company if a resolution is passed to that effect [Section 65]. If the unlimited company has share capital, (a) it may increase the nominal value of its shares provided that no part of such increase shall be capable of being called up except in the event and for the purpose of the company being wound-up, or (b) to provide that a specified portion of its uncalled share capital shall not be capable of being called up except in the event and for the purposes of the company being wound-up [Section 65].

## 17.0 PRIVATE COMPANY [SECTION 2(68)]

A Private Company means a company which by its articles—

- (a) restricts the right to transfer its shares, if any,
- (b) limits the number of its members to 200(except in case of One Person Company),

**Note:** For the purposes of limit of 200, **present employees** who are members and **ex-employees** who were members while in that employment and have continued to be members after the employment ceased, are **excluded** and the **joint shareholders** are counted as a **single member**.

- (c) prohibits any invitation to the public to subscribe for any securities of the company.

### Notes:

- (i) Since the above-mentioned **three restrictions** must be contained in the Articles of every private company, it is necessary for a private company to frame its own articles. However, the articles of a private company not having share capital is not required to contain the restriction regarding the transfer of shares.
- (ii) A private company may be (a) a company limited by shares, or (b) a company limited by guarantee, or (c) an unlimited company.
- (iii) In case a private company is a limited company, then it must add the words '*Private Limited*' at the end of its name.
- (iv) The moment a private company fails to comply with any of the statutory restrictions to be contained in its articles or it becomes a subsidiary of a public company, it ceases to enjoy special privileges granted to it.
- (v) A private company must have at least 2 members and 2 directors.
- (vi) An offer of shares by the directors to their friends by a document marked "private and confidential not for publication" is not an invitation to the public.  
**[Sharewell vs. Combined Incandescent Metals Syndicate, [1907] 23 T.L.R. 482]**
- (vii) **Restriction on Transfer of Shares:** The articles can not impose absolute prohibition on transferability of shares. The restriction must be applied uniformly on the members of the company. The right of transfer is generally restricted in the following manner:
  - (a) By authorising the directors to refuse transfer of shares to persons whom they

do not approve or by compelling the shareholder to offer his shareholding to the existing shareholders first. It may be noted that it can only restrict the right of sale to a member. On this consideration, the articles usually provide that before selling or transferring his share, the directors must be communicated in writing of such intention of the shareholder.

- (b) By specifying the method for calculating the price at which the shares may be sold by one member to another. Generally, it is left to be determined either by the auditor of the company or by the company at a general meeting.
- (c) By providing that the shareholders who are employees of the company shall offer the shares to specified persons or class of persons when they leave the company's service.

## 18.0 PUBLIC COMPANY [SECTION 2(71)]

Public company means a company which is *either*

- (a) not a private company; *or*
- (b) is a private company which is subsidiary of a public company.

### Notes:

- (i) There is no restriction on the maximum number of members. However, the maximum number of members depends upon the number of shares allotted.
- (ii) A public company may be (a) a company limited by shares, or (b) a company limited by guarantee, or (c) an unlimited company.
- (iii) In case a public company is a limited company, then it must add the words '*Limited*' at the end of its name.
- (iv) A public company must have at least 7 members.
- (v) A public company must have at least 3 directors.

## 19.0 DISTINCTION BETWEEN PRIVATE COMPANY AND PUBLIC COMPANY

A private company differs from a public company in the following respects:

<i>Basis of Distinction</i>	<i>Public company</i>	<i>Private company</i>
<b>1. Transferability of shares</b>	The right to transfer the shares is not restricted by the Articles of Association.	The right to transfer the shares is restricted by the Articles of Association.
<b>2. Maximum no. of members</b>	There is no restriction on the maximum number of members.	The maximum limit of member is 200 (except in case of One Person Company).
<b>3. Invitation to the public to subscribe Securities</b>	It can invite public to subscribe for its Securities.	It cannot invite public to subscribe for its Securities.

<b>4. Use of the word 'Private'</b>	The name of the public company is not required to use the word 'Private'.	The name of the private company must use the word 'Private'.
<b>5. Minimum no. of members</b>	The minimum number of members required to form a public company is 7.	The minimum number of members required to form a private company is 2.
<b>6. Minimum No. of Directors</b>	It must have at least 3 directors.	It must have at least 2 directors.
<b>7. Articles of association</b>	It can either frame its own Articles of Association or adopt Table 'F' as its Articles of Association.	It has to compulsorily frame its own articles of associations so as to include three statutory restrictions.
<b>8. Special privileges</b>	A public company enjoys no such privileges.	A private company enjoys some special privileges.

## 20.0 PRIVILEGES OF AN INDEPENDENT PRIVATE COMPANY

Privileges available only to an independent private company (i.e. a private company which is *not* a subsidiary of a public company) are as follows:

- 1. Definition of Related Party relaxed u/s 2(76):** Private company is not required to comply with provisions of the section 188 for transactions entered into by a private company with its holding company, the subsidiary company, the associate company or a fellow subsidiary company or an Investing Company/ Venturer of the Company.
- 2. Free to Issue any kind of shares :** Private limited company is free to issue any kind of shares if its articles of association or the memorandum of association provides so [ Sec 43 & 47].
- 3. Power to reduce Time Limits in Right Issue u/s 62:** Sending of offer letter Minimum 3 days period before opening of offer and Minimum & maximum offer period of 15 & 30 days respectively can be reduced, if 90% members give their consent in writing/electronic mode.
- 4. Need not comply with conditions of Sec 73(2)(a) to (e):** Private Companies accepting deposits from members upto 100% of Paid-Up Share Capital & Free-Reserves need not to comply with conditions mentioned in section 73(2)(a) to (e).
- 5. Right to frame own rules for General Meetings:** Private company can frame own rules for General Meetings.
- 6. Not included in Max Audit Limit:** Maximum No. of Audit Limit of 20 Companies u/s 141(3)(g) does not include one person company, a dormant company, small companies; and private limited companies which are having a paid up share capital of less than ₹ 100 Crore.
- 7. Directorship without Notice & Deposit:** An individual for directorships in private companies can stand in for directorship without serving the notice of 14 days and a deposit of ₹1 lakh [ Sec 160].



8. **Appointment of Directors of a Private limited company need not to be voted individually:** No approval as provided u/s 162 is needed for the appointment of directors of a Private limited company.
9. **Need not file MGT-14:** Private Companies are exempted from filing MGT-14 with the ROC on various provisions under section 179(3) and Rule 8 of the amended Companies (Meetings of Board & its powers) Rules, 2014.
10. **No Restrictions on Board Power:** Restrictions on powers of Board u/s 180 do not apply to a Private company.
11. **Participation of an Interested Director:** An Interested Director of a private limited company can participate in the board meeting after disclosing interest {Sec 184(2)}
12. **Power to grant Loans etc. to Director etc. u/s 185:** Loans/Guarantee/Security can be given to Director and person in whom he is interested by a private Company which has:-
  1. No Body Corporate Shareholder
  2. Not borrowed money from Bank/ Financial Institution/ Body Corporate exceeding lower of the following:-
    - (i) 200% of its Paid up capital
    - (ii) ₹ 50 crore
  3. No repayment default subsisting of such borrowings at time of giving loan
13. **No Restriction on Related Party's Voting Right [2nd Proviso to 188(1)] :** Member although being related party to the concerned resolution can still cast his vote at GM.
14. **No Approval for Appointment of MD/WTM u/s 196(4) & (5):** No Approval is required for the appointment or the remuneration of the Managing Director, Whole time Director or the Manager even if the conditions for the appointment are not as per the requirements of Schedule V of the Act.  
**Note:** The moment a private company fails to comply with any of the statutory restrictions to be contained in its articles or it becomes a subsidiary of a public company, it shall lose these special privileges.

## 21.0 ONE PERSON COMPANY (OPC) [SECTION 2(62)]

The introduction of OPC in the legal system is a move that would encourage corporatisation of micro businesses and entrepreneurship.

### MEANING OF ONE PERSON COMPANY [OPC]

As per section 2(62) of the Companies Act, 2013, "One Person Company" means a company which has only one person as a member.

### CONDITIONS FOR ONE PERSON COMPANY [OPC]

1. The memorandum of One Person Company is required to indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of

the company and the written consent of such person shall be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.[Proviso to Sec 3 (1)]

2. Only a natural person who is an Indian citizen and resident in India –
  - (a) shall be eligible to incorporate a One Person Company;
  - (b) shall be a nominee for the sole member of a One Person Company.

**Note:** “Resident in India” means a person who has stayed in India for at least 182 days during the immediately preceding one calendar year.

3. No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company.
4. No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.
5. Such Company cannot be incorporated or converted into a Licensed company u/s 8
6. Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporates.
7. No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of One Person Company, except threshold limit (paid up share capital) is increased beyond ₹ 50 lakh or its average annual turnover during the relevant period exceeds ₹ 2 crore .

## 22.0 LICENSED COMPANY OR ASSOCIATION NOT FOR PROFIT [SECTION 8]

### MEANING OF ASSOCIATION NOT FOR PROFIT

In the case of ‘association not for profit’ the Central Government may by license allow a person or an association of persons to be registered as a limited liability company without using the words ‘limited’ or ‘private limited’ as part of its name.

### PROVISIONS RELATING TO ASSOCIATION NOT FOR PROFIT [SECTION 8]

1. **Conditions for obtaining licence u/s 8 (1):** The Central Government will grant the license only if it is satisfied that a person or an association of persons proposed to be registered as a limited liability company:
  - (i) has in its objects the promotion of commerce, art, science, religion, charity or any other useful object;
  - (ii) intends to apply its profits, if any, or other income in promoting its objects; and
  - (iii) prohibits the payment of dividend to its members.
2. The company registered u/s 8 shall enjoy all the privileges and be subject to all the obligations of limited companies.[Sec 8(2)]
3. A firm may be a member of the company registered u/s 8.[Sec 8(3)]
4. A company registered u/s 8 shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.[Sec 8(4)(i)]
5. A company registered u/s 8 may convert itself into company of any other kind only

after complying with such prescribed conditions.[Sec 8(4)(ii)]

6. **Conditions for Revocation of Licence u/s 8 (6):** The Central Government may, by order, revoke the licence granted to a company registered u/s 8 and direct the company to convert its status and change its name to add the word “Limited” or the words “Private Limited”, as the case may be, to its name if :
  - (i) the company contravenes any of the requirements or any of the conditions subject to which a licence is issued or
  - (ii) the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest,
7. **Effect of Revocation of Licence u/s 8 (7)** Where a licence is revoked , the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section. No such order shall be passed unless the company is given a reasonable opportunity of being heard.
8. Such companies may be public or private companies and may or may not have share capital.

## 23.0 SMALL COMPANY[SECTION 2(85)]

### MEANING OF SMALL COMPANY

Small company is a new form of private company based on paid up capital and turnover. In other words, such companies are small sized private companies.

As per Section 2(85) “small company” means a private company –

- (i) paid-up share capital of which does not exceed ₹ 50 lakh or prescribed higher amount which shall not be more than ₹ 10 crore ; or
- (ii) turnover of which as per its last Profit and Loss Account does not exceed ₹ 2 crore or prescribed higher amount which shall not be more than ₹ 100 crore:

### NON APPLICABILITY OF SEC. 2(85)

The provisions of Sec. 2 (85) are not applicable to:

1. a holding company or a subsidiary company;
2. a company registered u/s 8; or
3. a company or body corporate governed by any Special Act;

**Note:** Small Companies enjoy some special privileges, which other private companies do not have.

## 24.0 GOVERNMENT COMPANY [SECTION 2(45)]

### MEANING OF GOVERNMENT COMPANY

As per Section 2(45) of the Companies Act, a government company means “**any company in which at least 51% of the paid-up share capital is held:**”

- (a) **by the Central Government, or**
- (b) **by any State Government, or Governments, or**
- (c) **partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a government company as thus defined". For example,** Indian Telephone Industry, Hindustan Aeronautics Ltd. Even a subsidiary company of a government company is regarded as a Government company. A government company registered under this Act is a non-statutory company and is not an agent of the government. It may be registered as a public company or a private company.

#### **ANNUAL REPORT ON GOVERNMENT COMPANY [SEC 394 & 395]**

Where the Central Government/ State Government(s) /both Central and State Governments is/are a member(s) of a Government company, the Central Government/ State Government shall cause an annual report on the working and affairs of that company to be prepared within 3 months of its annual general meeting, and laid before both Houses of Parliament /before the House or both Houses of the State Legislature/ both together with a copy of the audit report and comments upon or supplement to the audit report, made by the Comptroller and Auditor-General of India (CAG).

### **25.0 FOREIGN COMPANY [SECTION 2(42)]**

#### **MEANING OF FOREIGN COMPANY**

As per section 2(42) of the Companies Act, 2013 "Foreign Company" means any company or body corporate incorporated outside India which –

- (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- (b) conducts any business activity in India in any other manner.

#### **PROVISIONS APPLICABLE TO FOREIGN COMPANY [SECTION 379 TO 395]**

Where **at least 51% of the paid-up share capital** (whether equity or preference or partly equity and partly preference), of a foreign company is held by **at least** one Indian Citizen or by **at least** one company or body corporate incorporated in India, or by both whether singly or in the aggregate, such company shall comply with the provisions of Chapter XXIII [Sections 379 to 395] and such other prescribed provisions of the Companies Act, 2013 as may be with regard to the business carried on by it in India as if it were a company incorporated in India.

#### **DOCUMENTS TO BE FILED WITH ROC BY FOREIGN COMPANY [SECTION 380]**

A Foreign Company is required to file the following documents with the Registrar of companies within 30 days from the date of establishment of business in India:

1. A certified copy of the charter or statutes under which the company is incorporated, or the memorandum and articles of the company translated into English,

2. The full address of the registered or principal office of the company,
3. A list of directors and secretary of the company,
4. The names and address of any person(s) resident in India who is/are authorised to accept, on behalf of the company, service of legal process and any notice served on the company, and
5. The full address of the company's principal place of business in India.
6. Particulars of opening and closing of a place of business in India on earlier occasion or occasions;
7. Declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and
8. any other prescribed information .

## 26.0 HOLDING COMPANY [SEC 2(46)]

As per Section 2(46) of the Companies Act, 2013, holding company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

## 27.0 SUBSIDIARY COMPANY [SEC 2(87)]

Section 2(87) of the Companies Act, 2013 provides that subsidiary company or subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the **total voting power** either at its own or together with one or more of its subsidiary companies:

**Two Layers of Subsidiaries only permitted:** Such class or classes of holding companies, shall not have layers of subsidiaries beyond the prescribed limit. A holding company can create up to two layers of subsidiaries only. However, on layer which consists of one or more wholly-owned subsidiary or subsidiaries would not be taken into account for computing the number of layers.

For the above purpose—

- (a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) / (ii) is of another subsidiary company of the holding company;
- (b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if **that other company** by exercise of some power exercisable by it at its discretion **can appoint or remove all or a majority of the directors**;
- (c) the expression "company" includes any body corporate;

**Meaning of Control:** As per Sec. 2 (27), Control shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their

share holding or management rights or shareholders agreements or voting agreements or in any other manner.

**Example 1:** The Share Capital of S Ltd. is ₹ 5,00,000 divided into 50,000 Equity Shares of ₹ 10 each. If H Ltd. acquires 25,000 equity shares on 1.4.2018 and 5000 equity shares on 1.7.2018. S Ltd. becomes the subsidiary of H Ltd. on 1.7.2018 and not on 1.4.2018 because H Ltd. holds more than 50% of the share capital of S Ltd. on 1.7.2018.

**Example 2:** The Share Capital of S Ltd. is ₹ 6,00,000 divided into 50,000 Equity Shares of ₹ 10 each and 1,000 Convertible Preference Shares of ₹ 100 each. If H Ltd. acquires 29,000 equity shares and 100 Convertible Preference Shares. S Ltd. does not become the subsidiary of H Ltd because H Ltd. does not hold more than 50% of the total share capital of S Ltd. (i.e. ₹ 5,00,000 + ₹ 1,00,000).

**Example 3:** If US Ltd. is a subsidiary of S Ltd. which is subsidiary of H Ltd. then US Ltd. would also be the subsidiary of H Ltd. Here, H Ltd. is the ultimate holding company in relation to US Ltd. and US Ltd. is the ultimate subsidiary company in relation to H Ltd.

#### ILLUSTRATION

<i>Particulars</i>	<i>A Ltd.</i>	<i>B Ltd.</i>	<i>C Ltd.</i>	<i>D Ltd.</i>
Paid up Capital	₹ 5 Crore	₹ 4 Crore	₹ 3 Crore	₹ 2 Crore
Equity Shares of ₹ 10 each	40,00,000	30,00,000	20,00,000	10,00,000
10% Pref. Shares of ₹ 10 each	10,00,000	10,00,000	10,00,000	10,00,000

**Required:** State the relationship between the companies in the following cases:

**Case (a):** A Ltd. holds 10,00,000 Equity shares in B Ltd. and can appoint or remove majority of directors of B Ltd. without the consent of any other person.

**Case (b):** A Ltd. holds 15,10,000 equity shares in B Ltd. which holds 10,00,000 equity shares in C Ltd.

**Case (c):** A Ltd. holds 15,10,000 equity shares in B Ltd. which holds 10,10,000 equity shares in C Ltd.

**Case (d):** A Ltd. holds 15,10,000 equity shares in B Ltd. which holds 10,10,000 equity shares in C Ltd. which also holds 5,05,000 equity shares in D Ltd.

**Case (e):** A holds 15,10,000 equity shares in B Ltd. which holds 10,10,000 equity shares in C Ltd. and holds 1,00,000 equity shares in D Ltd. C Ltd. holds 1,05,000 equity shares in D Ltd.

**Solution:**

**Note:** Unless otherwise stated, the preference shares are assumed to be non-convertible.

**Case (a):** As per Sec. 2(87), B Ltd. is subsidiary of A Ltd. since A Ltd. can appoint or remove majority of directors of B Ltd.

**Case (b):** As per Sec 2(87), B Ltd. is subsidiary of A Ltd. since A Ltd. holds more than

half in nominal value of equity share capital of B Ltd.

C Ltd. is not subsidiary of B Ltd. since B Ltd. does not hold more than half in nominal value of equity share capital of C Ltd.

**Case (c):** As per Sec 2(87), B Ltd is subsidiary of A Ltd. since A Ltd. holds more than half in nominal value of equity share capital of B Ltd.

As per Sec. 2(87), C Ltd. is subsidiary of B Ltd. since B Ltd. holds more than half in nominal value of equity share capital of C Ltd.

As per Sec 2(87), C Ltd. which is subsidiary of B Ltd., is also subsidiary of A Ltd.

**Case (d):** As per Sec 2(87), B Ltd is subsidiary of A Ltd. since A Ltd. holds more than half in nominal value of equity share capital of B Ltd.

As per Sec. 2(87), C Ltd. is subsidiary of B Ltd. since B Ltd. holds more than half in nominal value of equity share capital of C Ltd.

As per Sec 2(87), C Ltd. which is subsidiary of B Ltd., is also subsidiary of A Ltd.

As per Sec 2(87), D Ltd. which is subsidiary of C Ltd., is also subsidiary of B Ltd. and A Ltd.

**Case (e):** As per Sec 2(87), B Ltd is subsidiary of A Ltd. since A Ltd. holds more than half in nominal value of equity share capital of B Ltd.

As per Sec. 2(87), C Ltd. is subsidiary of B Ltd. since B Ltd. holds more than half in nominal value of equity share capital of C Ltd.

As per Sec 2(87), D Ltd. is subsidiary of B Ltd since B Ltd. along with its subsidiary (C Ltd.) holds more than half in nominal value of equity share capital of D Ltd.

As per Sec 2(87), C Ltd. and D Ltd. which are subsidiaries of B Ltd. are also subsidiaries of A Ltd.

## 28.0 SUBSIDIARY COMPANY NOT TO HOLD SHARES IN ITS HOLDING COMPANY [SEC 19]

### CAN A SUBSIDIARY COMPANY BECOME A MEMBER OF HOLDING COMPANY?

1. No company shall, *either* by itself *or* through its nominees, hold any shares in its holding company.
2. Any allotment or transfer of its shares by holding company to any of its subsidiary companies shall be **void**.

### NON-APPLICABILITY OF SECTION 19(1) [PROVISO TO SEC 19(1)]

Section 19 (1) does not apply in the following cases:

1. Where the subsidiary company holds such shares **as the legal representative** of a deceased member of the holding company; or
2. Where the subsidiary company holds such shares **as a trustee**; or
3. Where the subsidiary company is a shareholder even **before it became a subsidiary** company of the holding company:

**Right to vote:** The subsidiary company shall have a right to vote at a meeting of the holding company only in respect of the shares held by it as a legal representative or as a trustee.

**Note:** A subsidiary company may buy shares in its holding company under a scheme of amalgamation sanctioned by the Court. [*Himachal Telematics v. Himachal Futuristic Communication Ltd., (1996) 86 Comp. 325 (Delhi)*].

## 29.0 MEANING OF PRODUCER COMPANY

According to Section 581A of The Companies Act, 1956, a producer company is a body corporate having objects or activities specified in Section 581B of The Companies Act, 1956, and which is registered as such under the provisions of the Act. The membership of producer companies is open to such people who themselves are the **primary producers**, which is an activity by which some agricultural produce is produced by such primary producers.

### Notes:

- (i) Sec 465(1) provides that the Companies Act, 1956 and the Registration of Companies (Sikkim) Act, shall stand repealed.
- (ii) However, Proviso to Sec 465(1) provides that the provisions of Part IX A of the Companies Act, 1956 shall be applicable *mutatis mutandis* to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a Special Act is enacted for Producer Companies.
- (iii) In view of the above provision, Producer Companies are still governed by Sections from 581A to 581ZT of the Companies Act, 1956.

## 30.0 COMPANY AS A PARTNER IN A FIRM

### CAN A COMPANY BECOME A PARTNER IN A FIRM?

A company can become a partner in a firm since it is a separate legal entity in the eyes of law. It has contractual capacity to enter into any valid contract.

### CAN A LIMITED LIABILITY COMPANY HAVE UNLIMITED LIABILITY AS A PARTNER IN A FIRM?

A limited liability company can have unlimited liability as a partner in a firm since it is the liability of the members of a limited company which is limited and not that of the company itself. A company can become a partner only if its Memorandum of Association specifically allows it to do so.

## 31.0 ILLEGAL ASSOCIATION [SECTION 464]

### MEANING OF ILLEGAL ASSOCIATION [SECTION 464(1)]

As per Sec 464, No association or partnership consisting of **more than 100 persons** shall be formed for the purpose of carrying on any business that has for its **object** the



acquisition **of gain** by the association or partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force.

**Notes:**

- (i) Every person (natural or otherwise) who holds an independent position in law and is capable of entering into contract shall be counted as one person.
- (ii) Two or more persons holding a share jointly are treated as a single member.

**NON-APPLICABILITY OF SECTION 464 [SECTION 464(2)]**

Section 464 (1) does not apply in the following cases:

1. **A Hindu Undivided Family carrying on any business :** A Joint Hindu Family may carry on any business, even for earning profits and with any number of members without being registered in pursuance of any Indian Law as required by Section 464 and yet it will not be an illegal association.

**Note:** Where two or more joint Hindu families join hands to carry on business, the provisions of Section 464 become applicable. However, while computing the number of members of such an association, the minor members of such families shall not be included. Accordingly, the No. of members of the purposes of Section 464, would consist of not only the Kartas but also other adult members of the joint families.

**[Shayam Lal v. Madhusudan Ray 1959 Cal.]**

**Example I:** A Hindu undivided family consisting of 111 persons (1 Karta, 100 other adult members and 10 minors) carries on a banking business with a view to acquire gain for itself or its members without itself being registered under the Banking Regulation Act, 1949. Such association would not become an illegal association because Sec 464(1) is not applicable to Hindu undivided family.

**Example II:** Ten Joint Hindu Families carry on together a business as joint owners. These families consist of 110 persons (101 adult members and 9 minors). Here, total persons (excluding minors) are 101. Such association would become an illegal association because where two or more joint Hindu families join hands to carry on business, the provisions of Section 464 become applicable.

**Example III:** Ten Joint Hindu Families carry on together a business as joint owners. These families consist of 110 persons (100 adult members and 10 minors). Here, total persons (excluding minors) are 100. Such association would not become an illegal association because the number of its members does not exceed 100 (excluding minors).

2. **An Association or Partnership, if it is formed by professionals who are governed by special Acts.**

**Example:** An association consisting of 101 Chartered Accountants carries on a profession without itself being registered under The Companies Act, 2013. Such association would not become an illegal association because Sec 464(1) is not applicable to such associations.

3. **Non-Profit Earning Associations** All religions, charitable, literary, social, sports and other associations whose object is not to make profit are also not covered by Section 464.
4. **Stock Exchange** A stock exchange is not covered by Section 464 as it is not formed for the purpose of carrying on any business.

### CONSEQUENCES OF AN ILLEGAL ASSOCIATION [SECTION 464(3)]

The consequences of an illegal association are as follows:

1. **Personal Liability:** Every member of an Illegal Association shall be personally liable for all the liabilities incurred in carrying on the business.
2. **Punishable with Fine:** Every member of Illegal Association shall be punishable with fine not exceeding Rs. 1,00,000.
3. **Cannot Sue:** Neither Illegal Association nor its members in their individual capacity can sue any outsider who has dealt with it.
4. **Cannot be sued:** Illegal Association can not be sued by its members or outsiders.
5. **Can not be wound up:** An Illegal Association can not be wound up under the provisions of Companies Act relating to winding up of unregulated companies as well as through court because there is nothing to dissolve at all. [*Mewa Ram v. Ram Gopal*]
6. **Cannot be made legal by subsequent reduction:** Once the association contravened the provision of Section 464, it remains illegal even if there is subsequent reduction in the number of its members. In other words, the illegality of an Illegal Association can not be cured by subsequent reduction in the number of its members. [*Madanlal v. Janki Parshad*]

**Example :** An association of 110 persons starts a banking business without being registered. Ten members retire and thereafter a suit is instituted by one of the continuing members for the partition of the assets of the business. Is the suit maintainable?

In *Mewa Ram v. Ram Gopal*, High Court of Allahabad held that No suit either for administration or partition of assets of an illegal association can be filed by any member of Illegal Association. Such partition of assets of an illegal association is not possible at all because a decree for partition would amount to be in substance a direction for winding up or a decree for dissolution and accounts. The illegality of an Illegal Association can not be cured by subsequent reduction in the number of its members.

7. Illegal Association can not enter into any contracts since it has no legal existence.
8. No member of Illegal Association can sue another member in respect of any matter connected with such association.
9. Outsiders can sue the members but not Illegal Association.
10. Contracts made before the registration can not be validated and issued upon by subsequent registration. [*Gujarat Trading Co. v. Tricumji*]
11. Illegality or invalidity in the constitution of an association does not affect its liability

to tax or its chargeability as a unit of assessment. [*Kumaraswamy Chettiar v. I.T.O., 1957*]

12. No suit either for administration or partition of assets of an illegal association can be filed by any member of Illegal Association.

In *Mewa Ram v. Ram Gopal*, High Court of Allahabad held that such partition of assets of an illegal association is not possible at all because a decree for partition would amount to be in substance a direction for winding up or a decree for dissolution and accounts.

13. A member of an Illegal Association who has paid any money to such association would be able to recover it from the director or agents or association before the money so paid has been applied to an illegal purpose. [*Greenpur v. Co-operatives (1926)*]
14. Members of an Illegal Association have a beneficial interest in the property belonging to such association. [*Queen v. Tankard, (1894)*]

### 32.0 IS COMPANY A CITIZEN?

1. **A Company is not a Citizen:** No company can be a citizen of India since Citizenship under the Citizenship Act is available only to an individual.
2. **No Rights of Citizens:** The fundamental rights which are available only to a citizen, are not available to a company since a company is not a citizen.
3. **A Company has other Fundamental Rights:** The constitution of India grants certain fundamental rights to every person, whether a citizen or not. Thus, a company registered in India can enjoy all the fundamental rights which are available to all persons.

### 33.0 'RELATIVE' [Sec 2(77)]

#### MEANING OF RELATIVE

“Relative”, with reference to any person, means any one who is related to another, if –

- (i) they are members of a Hindu Undivided Family;
- (ii) they are husband and wife; or
- (iii) one person is related to the other in such manner as may be prescribed.

#### LIST OF RELATIVES

A person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely:-

- (a) Father including Step-Father
- (b) Mother including Step-Mother
- (c) Son including Step-Son
- (d) Son's Wife
- (e) Daughter

- (f) Daughter's Husband
- (g) Brother including Step-Brother
- (h) Sister including Step-Sister

**Note:** It means that the following **are not relatives**:

- (a) Step-Daughter and her husband
- (b) Brother's Wife
- (c) Sister's husband
- (d) Children of Son, Daughter, Brother & Sister

#### 34.0 PUBLIC FINANCIAL INSTITUTIONS [SECTION 2(72)]

Public Financial Institution" means—

- (i) the Life Insurance Corporation of India,
- (ii) the Infrastructure Development Finance Company Limited (IDFC),
- (iii) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal Act, 2002);
- (iv) institutions notified by the Central Government u/s 4A(2) of the Companies Act, 1956 so repealed under section 465 of this Act;
- (v) such other institution as may be notified by the Central Government in consultation with the RBI: The Central Government by notification in the Official Gazette is empowered to specify any other institution as Public Financial Institution if:
  - (a) It is constituted under any Central/State Act or
  - (b) At least 51% of its paid up capital is controlled or held by the Central/State Government(s)/or **partly by the Central Government and partly by one or more State Governments.**

#### VERY SHORT ANSWER TYPE QUESTIONS

1. Define Company.
2. Define Corporation Sole.
3. Define Corporation.
4. Define Body Corporate.
5. What is a Corporate Veil?
6. What is meant by 'Perpetual Succession'?
7. What is Common Seal?
8. What is meant by 'Limited Liability'?
9. What is meant by 'Free transferability of shares'?
10. Can a company acquire citizenship?
11. Can a company become partner in a partnership firm?
12. Can a firm become a member in a company?
13. What is a Private Company?

14. What is a Public Company?
15. What is meant by: 'Company limited by shares'?
16. What is meant by 'Company limited by Guarantee'?
17. What is an 'Unlimited Company'?
18. What is an 'Association not for profit' or 'Licensed Company'?
19. Define a Government Company.
20. Define a Foreign Company.
21. Define Holding and a Subsidiary Company.
22. Define Producer Company.
24. What is an Illegal Association?

### SHORT ANSWER TYPE QUESTIONS

1. Why is a company called an 'Artificial person'?
2. What are the acts which a company can do like a natural person?
3. What are the acts which a company cannot do like a natural person?
4. The term 'Body Corporate' is much wider concept than the term 'Company'. Explain.
5. Distinguish between the following:
  - (a) Body Corporate and Company
  - (b) Corporation Sole and Corporation Aggregate
  - (c) Partnership and Company
  - (d) Limited Liability Partnership (LLP) and A Company
  - (e) A Private Company and Public Company
  - (f) Company Limited by share and Company Limited by Guarantee.
  - (g) A Company and HUF.
  - (h) A Company and a Club.
6. State the meaning of and conditions for 'One Person Company'.
7. State the provisions relating to Association not for profit u/s 8.
8. State the meaning of small company. List the companies which can not enjoy the special privileges of a small company.
9. State the meaning of Government Company. Can a government company be registered as a private company? Can it be called an agent of government.
10. Define Foreign Company. List of the documents required to be filed by the foreign company.
11. Define Holding and Subsidiary Company.
12. Can a subsidiary hold shares in its Holding Company?
13. Define Producer Company.
14. Define the terms 'Relative' and Public Financial Institutions.
15. List any five privileges available to an independent private company only.

16. What is an Illegal Association? What are its consequences?

### LONG ANSWER TYPE QUESTIONS

1. Define a company. Explain its characteristics.
2. "A company is a legal entity quite distinct from its members." Explain.
3. "A company is an artificial person created by law with a perpetual succession and a separate legal entity." Explain.
4. What do you understand by the concept of corporate personality? Under what circumstances is a lifting of corporate veil possible?
5. Comment on the following:
  - (a) A limited company can be formed without the word 'limited' as the last word of its name'.
  - (b) "Members of a limited company may nevertheless have unlimited liability".
  - (c) A limited liability company can become a partner in a firm.
  - (d) A firm can become a member in a company.
  - (e) The law not only recognises a private company but also perform its benedictions on the same.
  - (f) A subsidiary company can be the member of its holding company.
6. Write short notes on the following:
  - (a) One Person Company(OPC)
  - (b) Small Company
  - (c) Perpetual Succession
  - (d) Lifting of corporate veil
  - (e) An Unlimited Company
  - (f) A Licensed Company
  - (g) A Government Company
  - (h) A Foreign Company

### PRACTICAL PROBLEMS

1. An English company was formed for selling in England tyres produced by a German company in Germany. The bulk of English company's shares were held by the German company. The overwhelming majority of the shareholders and all the directors were German nationals residing in Germany. The English company filed a suit during the World War I to recover a trade debt. Could the company be allowed to proceed with the action? [No]
2. H was appointed the managing director of A&Co. on the term that he must not, at any time during the tenure of his office as such, or afterwards, entice away the customers of A&Co. Subsequent to the cessation of H's employment under an agreement he set up a business in the name of H&Co. which solicited the customers of A&Co. Evidence

showed that H&Co. was formed to enable H to commit a breach of his covenant against solicitation. Could H&Co. and H be restrained from doing so? [Yes]

3. X, having huge dividend and interest income, formed four private companies. He agreed with each of such companies to hold a block of investment as an agent for the company. The income received was credited to the accounts of the company but the company gave it back to X as a pretended loan. In this way, X divided his income with a view to reduce his tax-burden. In a legal proceeding against X, the court ignored the company and concerned itself directly with X. Could the court do so? [Yes]
4. X Ltd. was incorporated with 10 members (A to J). On 1st April 2018, the number of members reduced to 6. The debts of the company on that date were ₹ 3,00,000. On 1st May 2018, the number of members increased to 9. The debts of the company increased to ₹ 4,50,000 and ₹ 4,80,000 on 30th Sept. 2018 and on 31st Dec 2018 respectively. Out of Six members, two members Mr. A and Mr. B were not aware of the fact that the number of members reduced to 6. Discuss the legal position [As per Sec. 3A, four members (other than Mr. A and Mr. B). who were aware of reduction in No. of members are personally liable for ₹ 30,000 (₹ 4,80,000 – ₹ 4,50,000) contracted after those 6 months,]
5. An association of 101 persons starts a banking business without being registered. Four members retire and thereafter a suit is instituted by one of the continuing members for the partition of the assets of the business. Is the suit competent?[No]
6. Ten joint Hindu families carry on together a business as 105 joint owners (including 4 minors). Is the association illegal? [Yes]
7. The paid up share capital of ABC (Pvt.) Limited is Rs. 50 lakhs consisting of 5,00,000 shares of Rs. 10 each fully paid, XYZ (Pvt.) Ltd and its subsidiary PQR (Pvt.) are holding 1,50,000 and 1,20,000 shares in ABC (Pvt.) Limited. Examine with reference to the provisions of the Companies Act, 2018, whether ABC (Pvt.) Ltd., is a subsidiary of XYZ (Pvt.) Ltd. Would your answer be different if PQR (Pvt.) Ltd. is holding 2,70,000 shares in ABC (Pvt.) Limited and no shares are held by XYZ (Pvt.) in ABC (Pvt.) Limited.  
[(i) ABC (Pvt.) Ltd. subsidiary of XYZ (Pvt.) Ltd. as per Sec. 2(87),  
(ii) ABC (Pvt.) Ltd. subsidiary of XYZ (Pvt.) Ltd. as per Sec. 2(87)]
8. A Hindu undivided family consisting of 101 persons carries on banking with a view to acquiring profit for itself or its members without itself being registered under the Banking Regulation Act, 1949 (a) Will it be a legal association? (b) Will your answer be the same, if two undivided families consisting of 101 persons would have carried on the said business? [(a) Yes (b) Yes it will be an Illegal Association]







# Incorporation of a Company

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## 1.0 PROMOTION

### MEANING OF PROMOTION

“Promotion” is the process of conceiving an idea and developing it into a concrete proposition or project and taking steps to implement it through the formation of a Company.

Promotion stage comprises the following activities to be undertaken:

1. Identification of business idea .
2. Carrying out SWOT analysis (Strength, Weakness, Opportunities and Threats Analysis)
3. Organisation of Resources (Both Physical & Human Resources).
4. Securing the cooperation of the required number of persons willing to associate themselves with the project.
5. Obtaining the consent of persons willing to act as First directors.
6. Appointing Legal Advisors.
7. Application for Proposed Name of the company.
8. Preparation of necessary documents like Memorandum of Association, Articles of Association.
9. Entering into Preliminary Contracts.
10. Filing of the necessary documents with the Registrar for Incorporation.

### MEANING OF PROMOTERS

As per Sec 2 (69) the term “Promoter” means a person –

- (a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in Sec 92; or
- (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- (c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act. But a person who is acting merely in a professional capacity shall not be deemed as a promoter.

Thus, a **promoter is one who identifies a business opportunity or idea, analyses its prospects and takes the necessary steps to implement it through the formation of a company.**

A company may have more than one promoter. The promoter may be an individual, firm, an association of persons or a body corporate. *For example*, J.R.D. Tata was promoter of Tata Group, G.D. Birla was promoter of Birla Group, Dhirubhai Ambani was the promoter of Reliance Group.

The true test to describe a person as a promoter lies in finding out whether he is keen to form a company and take steps to give it a concrete shape. Thus, whether a person is a promoter, in any particular case depends on the facts having regard to the nature of person's role and his relationship to the company that is being formed.

### **IS A DIRECTOR/OFFICER/EMPLOYEE OF THE ISSUER A PROMOTER?**

A director/officer/employee who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise is considered as a promoter. As per Section 2 (27), "**Control**" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

However, a director or officer or employee of the issuer or a person, if acting as such merely in his professional capacity, shall not be deemed as a promoter.

### **WHO ARE NOT PROMOTERS?**

Everyone who is associated with the process of the formation of a company cannot be called a promoter. The following persons cannot be called promoters:

#### **1. Persons acting only in a professional capacity**

**For Example:** A solicitor who draws up the documents of the proposed company in his professional capacity is not a promoter in the eyes of law. Similarly, an engineer who advises on the selection of site or a valuer who helps with drawing the estimates would not be regarded as a promoter.

#### **2. Merely Signatories to the Memorandum/Financier for formation expenses:** A person cannot be held as promoter merely because he has signed at the foot of the memorandum or that he has provided money for the payment of formation expenses.

**[G. Tiruvengadacharir v. Value Mualiar, (1838) I.L.R. Mad. 192]**

#### **3. Merely Vendors of Property:** Individuals do not become promoters because they buy property, subsequently sold by them to a company at a profit even though the consideration consists of shares in the same company. But where certain persons buy property with a view to selling it later to a company to be formed by them, such persons will be regarded as promoters from the moment they took first step to carry out that object.

**[Gluckstein v. Barnes, (1900) A.C. 240]**

## FUNCTIONS OF A PROMOTER

The various functions performed by the promoters include the following:

1. **To Conceive Business Idea:** First of all the promoters conceive the idea of business.
2. **To make Detailed Investigation:** After conceiving the idea of business, they make detailed investigations to find out the weakness and strong points of the idea.
3. **To Organize the Resources:** After satisfying about the profitability and feasibility of the idea, they organize the resources to convert the idea into a reality by forming a company. The steps to be taken in this regard include the following:
  - (a) Securing the co-operation of the required number of persons willing to associate themselves with the project [**Note:** 7 persons are required to form public company, and 2 persons are required to form a private company and 1 person is required to form one person company].
  - (b) Appointing Legal Advisors and other experts.
  - (c) Entering into Preliminary Contracts.
  - (d) Preparing detailed Financial Plan.
4. **To Obtain the Consent of Persons willing to act as First Directors:** The first directors are generally appointed by the promoters. The promoters seek the consent of some individuals whom they deem appropriate so that they agree to be the First Directors.
5. **To Decide about the Name of the Company:** The promoters have to seek the permission of the Registrar of companies for selecting the name of the company. The promoters should ensure that the name of the company should not be identical with or should not too closely resemble the name of another existing company or should not be undesirable in the opinion of the Central Govt.
6. **To Get the Necessary Documents prepared:** The promoters on the advice of legal experts get the Memorandum of Association and Articles of Association prepared.
7. **To Arrange for Filing of the Necessary Documents with the Registrar:** The promoters are required to pay the stamp duty, filing fee and other charges for registration of the company. The promoters are to see that the various legal formalities for incorporating the company are duly complied with.

## LEGAL POSITION OF PROMOTERS

The promoter's legal position is that he is **neither an agent nor a trustee** of the company he promotes because there is no company in existence.

The legal position of a promoter can be correctly described by saying that **he stands in a fiduciary position (relationship of trust and confidence) in relation to the company he promotes. The fiduciary relation of a promoter really begins when the company is formed.**

Lord Cairns has rightly stated the position of promoter in *Erlanger v. New Sombrero Phosphate Co.*, "The promoters of company stand undoubtedly in a fiduciary

**position.** They have in their hands the creation and moulding of the company. They have the power of defining how and when and in what shape, and under whose supervision, it shall come into existence and begin to act as a trading corporation.” In fact, the promoters occupy a fiduciary position in regard to the company they promote and also the original allottees whom they induce to buy shares of the company.

### DUTIES OF PROMOTERS

The fiduciary obligation of a promoter begins as soon as he sets out to act for or promote the company. **The fiduciary obligation of promoters means an obligation of promoters to disclose fully all material facts relating to the nature and extent of contract and profit made by them either directly or indirectly.** Such disclosure must be express and actual and not merely constructive.

The promoters in their fiduciary capacity has the following important duties:

- 1 Not to make Secret Profit:** A promoter cannot make any direct or indirect profits out of the promotion of the company. Since he occupies a position of a trust, it is his duty to be honest and uphold the trust of his position. The law prohibits only the making of **secret profits** by promoter (i.e. the profits not disclosed to the company) and not the disclosed profits. The promoters of a company are perfectly free to make a profit provided they disclose this fact to an independent Board of Directors. If there is no independent Board of Directors, then he must disclose the profits to the intended shareholders.

**Remedies in case of secret profit:** When a promoter makes a secret profit, the company has the following **remedies against him:**

- (a) Recession of the Contract:** The company may on learning of the secret profit, rescind the contract even though the company had adopted the contract. However, rescission must be made within a reasonable time.
  - (b) Recovery of Secret Profit:** The company may require the promoter to refund the amount of secret profit.
  - (c) Suit for Breach of Trust:** The company may sue the promoter for misfeasance, as the promoter, by making the secret profit, has defaulted in his duty towards the company.
- 2. To make Full Disclosure to the Company of all Relevant Facts:** Since the promoter stands in fiduciary capacity, he must make full and fair disclosure of his personal interest in a transaction with company. If he contracts to sell his own property to the company without making a full disclosure, the company may *either* repudiate the contract *or* affirm the contract and recover the profits made by the promoter. Such disclosure is ineffective if made merely to directors who are nominees of the promoters. Disclosure may be made *either* to an independent board, *or* by means of a prospectus to the prospective shareholders. If the promoter makes a secret profit the company can rescind the contract and compel him to account for it. Where all the members of a private company are aware of these facts, the rule would not apply.

In the case of ***Erlanger v. New Sombrero Phosphate Co.***, (1878) 3 A.C. 1218.

'A' was the owner of some land. He and some of his friends, decided to form a company to manufacture microchips. They appointed the first directors of the company and 'A' sold his own land to the company at a price higher than the actual valuation of the land. When the company was formed, the purchase agreement of land was approved at the meeting of the shareholders but the fact of A's ownership and the profit made by him were not disclosed at the meeting. Subsequently when the company went into liquidation, the liquidator filed a suit against 'A' to recover the profits made by him in the sale of land. You would observe that in this case 'A' had defaulted in his duty to make full disclosure of all material facts and had made a secret profit out of promotion. As there was no disclosure by the promoters of the profits they were making, the company is entitled to rescind the contract. 'A' could have retained the profit made by him if he had made a full disclosure to the directors of the company or to the shareholders of the company, all the relevant facts of the transaction including his personal interest and the profits made.

**In case of *Gluckstein V Barnes*:** A syndicate of some persons was formed with the purpose of taking over a company already in existence, named 'Olympia'. The members of the syndicate purchased the debentures of 'Olympia' at a discount, and thereafter purchased the whole company of £ 1,40,000. Afterwards, 'Olympia' redeemed the debentures at par, and so the members of the syndicate made a gain of £ 20,000. Afterwards, the members of the syndicate incorporated a new company to which 'Olympia' was sold at a profit of £ 40,000. The members of the syndicate disclosed the profit of £ 40,000 made by them, but did not disclose the profit of £ 20,000. Since, disclosure was not made to the shareholders, the promoters were held liable to pay back the profit of £ 20,000 to the new company incorporated by them.

3. **To give the Benefit of Negotiations to the Company:** The promoter must pass on to the company, the benefit of any negotiation or agreement that he has carried on in his capacity of a promoter. *For example*, when he has negotiated a certain price for some land for the company, he must sell the property to the company at the negotiated price. If he charges a price higher than the negotiated price, the company may rescind the contract on discovering the truth of the matter. If, due to some reason, the contract could not be rescinded, the company is entitled to claim damages from the promoters and the amount of damages shall be equal to the amount of profits made by promoters. However, it should be remembered that secret profits on the sale of property can be recovered from the promoter only when the property was bought and sold to the company while he was acting as a promoter. The promoter must act honestly and diligently to escape liability with respect to dealing with the future company and the outsiders.
4. **Duty of Promoters Towards Future Allottees:** The promoters stand in a fiduciary position towards the company. It does not mean that they stand in such relation only to the company but they also stand in this position to the future allottees of shares. The promoters must ensure that the prospectus issued at their instance contains all materials facts and particulars and does not contain any mis-statements.

### LIABILITIES OF PROMOTERS

The liabilities of the promoters under the various provisions of The Companies Act are discussed below:

1. **Liability for not Complying with the Provisions of Section 26:** Section 26 explains the matters that should be stated and the reports that should be set out in the prospectus. If this provision is not complied with, the promoter may be held liable by the shareholders.
2. **Criminal Liability for Mis-statements in a Prospectus [Section 34]:** The promoter who authorised the issue of prospectus containing Mis-statement(s) may be held criminally liable.
3. **Civil Liabilities for mis-Statements in the Prospectus [Section 35]:** The promoter may be held liable to pay compensation to every person who subscribes for shares or debentures for any loss or damage sustained by him on account of the mis- statement made in the prospectus.
4. **Liabilities for Public Examination [Section 300]:** If in the event of winding up of the company the liquidator's report alleges a fraud in the promotion or formation of the company, the promoter may also be held liable for public examination by the Court like any other director or officer of the company.
5. **Liability for Misfeasance or Breach of Trust by Misapplication of Funds [Section 340]:** Like any other director or officer of the company, a promoter can also be held liable if he had misapplied or retained any of the property of the company or is found guilty of breach of trust or misfeasance in relation to the company.
6. **Personally Liability for Pre-incorporation Contracts** Even the death of the promoter does not relieve him from this liability.

### LEGAL POSITION OF PROMOTER'S CLAIM AS TO EXPENSES INCURRED AND REMUNERATION

1. Promoters **can not claim** remuneration and reimbursement of expenses incurred by them in promotion—
  - (a) as a matter of right
  - (b) even if they have already entered into a contract with the prospective Directors
  - (c) even if the articles provide for it. Provision in articles merely gives the directors an authority to make such payment but does not give the promoters a right to claim remuneration or to sue the company for the same.
2. Promoters **can claim** remuneration and reimbursement of expenses incurred by them in promotion **if the company after incorporation makes a contract** with promoters to that effect.
3. **Modes of Giving Remuneration:** The remuneration may be paid to the promoters in any one/more of the following ways:
  - (a) **Property/Business:** He may be allowed to sell his own property/business to the company for cash at a price higher than the valuation, after he has made

a full disclosure about the valuation and the profit earned to an independent Board of Directors.

- (b) **Shares:** He may be allotted fully paid up shares of the company at par or discount.
  - (c) **Lumpsum:** He may be paid a lump-sum remuneration.
  - (d) **Commission:** He may be given a commission at fixed rate on the shares sold by him.
  - (e) **Future Option:** He may be given an option to subscribe for a certain number of the company's unissued shares in future at fixed price.
4. **Disclosure of Promoters' Remuneration in Prospectus:** Whatever is the manner in which the company chooses to compensate for the services of the promoter, **the amount of remuneration and the manner of payment must be disclosed in the prospectus, if the remuneration is paid within two years preceding the date of the prospectus.**

## 2.0 PRELIMINARY CONTRACTS OR PRE-INCORPORATION CONTRACTS

### MEANING OF PRELIMINARY CONTRACTS

**Preliminary contracts are those contracts which are entered into by the promoters for and on behalf of the proposed company before its incorporation.** These contracts are generally entered into by the promoters to acquire some property or some rights for the proposed company. *For example*, contract with the vendor to sell his running business to the proposed company, contract for the purchase of property for the proposed company, contract for the grant of a lease for the proposed company.

### LEGAL POSITION OF PRELIMINARY CONTRACTS

The legal position of preliminary contracts can be explained as follows:

1. **The Company is not bound by the Preliminary Contracts:** A company is not bound by the preliminary contracts even if (a) the company has taken the benefit of the work on its behalf under the contract (b) the contract stipulates that the company, after incorporation shall be bound by it.  
In case of ***Re English and Colonial Produce Ltd.***, (1906) 2 Ch. 435, a solicitor was appointed by the promoters of the company and was instructed by them to prepare the articles and the memorandum of the company. The solicitor also paid the necessary registration fee of the company. These promoters later became the directors of the company. The solicitor sued for his expenses and the fees paid by him. It was held that since the company was not in existence when these expenses were incurred, the company is not bound to pay.
2. **The Company cannot enforce Preliminary Contracts:** The company cannot enforce preliminary contracts. The company does not get a right to sue the third party for fulfilment of a preliminary contract.

In case of ***Natal Land Co. v. Pauline Colliery Syndicate*** (1904) A.S. 120, the



owner of a piece of land agreed to lease it to a company to be formed by promoters. The promoters later on formed a company. On some prospecting of the land, it was discovered that there was a definite possibility of striking oil in that land. Subsequently 'owner' refused to grant the lease to the company. It was held that the company cannot sue 'owner' and cannot claim specific performance as it was not even in existence when the lease was signed.

Thus, preliminary contracts can not be enforced by or against the company.

**Exception to above Principles:** The provisions of **Sections 15(h) and 19(e) of The Specific Relief Act, 1963** provide an important exception to the general principle 'preliminary contracts can not be enforced by or against the company'.

According to Sections 15(h) and 19(e) of the Specific Relief Act, 1963, where the promoters of the company have entered into contracts before its incorporation, specific performance may be obtained by or against the company if—

(a) Such contracts are for the purposes of the company.

The term "*contracts for the purposes of the company*" means contracts which are necessary for the incorporation and working of the company. *For example*, contracts for the preparation and printing of the memorandum and articles or contracts for the supply of necessary raw material for the production work in the company are contracts for the purposes of the company.

(b) Such contracts are warranted by terms of incorporation (i.e. the contract must fall within any of the clauses contained in object clause)

(c) Such contracts are accepted by the company after its incorporation.

(d) The acceptance of such contracts is communicated by the company to the other party to the contract.

However, the above provisions are not applicable for:

(a) **Contract to take shares**

(b) **Contract to render personal services.**

3. **The Company cannot ratify the Preliminary Contracts:** The company cannot ratify the preliminary contracts after incorporation because for valid ratification of a contract, the principal must have been in existence on the date when the contract is originally entered into. In case of **Kelner v. Baxter**, it was held as the company was not in existence when the preliminary contracts were made, it could not be bound by a purported ratification. What the company can do is to enter into a new contract with the vendors after incorporation to give effect to the terms of the contract made before incorporation.
4. **The Company cannot adopt Preliminary Contracts:** The company cannot adopt preliminary contracts after its incorporation *either* by passing a special resolution *or* by making adoption of such contract as one of the objects of company in its memorandum of association. [*North Sydney Investment Company v. Higgins* (1999) A.C. 263]
5. **Personal Liability of the Promoter for Preliminary Contracts:** The promoters are personally liable for the preliminary contracts. The reason for this is that the



preliminary contract is made for a company which, as known to both the contracting parties, is as yet non-existent. The contract, therefore, is deemed to be personally entered into by the promoters and they will be held personally liable for the performance of these contracts. The promoters will continue to be personally liable until the company after its incorporation adopts preliminary contracts by entering into new contracts with the third parties on the same terms as were embodied in the original contracts.

The preliminary contracts made by the promoters generally contain a provision that if the company adopts the agreements on incorporation, the liability of the promoters shall come to an end and if the company does not adopt the preliminary contract within a specified period *either* party may rescind the contract. In such a case liability of the promoter will cease on the expiry of the specified period.

### 3.0 HOW TO FORM A COMPANY

The various steps involved in the formation of a company are given below:

**Step 1: Obtain Digital Signature Certificate (DSC)**

**Step 2 Obtain the Name Approval**

**Step 3: Get e-MoA and e-AoA prepared**

**Step 4: Fill Form SPICe INC-32**

**Step 5 Apply for Company's PAN and TAN**

Let us discuss these STEPS in detail as follows:

**STEP 1: Obtain DSC (Digital Signature Certificates):** Digital signatures are required to file the forms for company formation. The registration process is online and the forms require a digital signature. DSC is mandatory for all subscribers and witnesses in the Memorandum and Articles of Association. The Digital Signature Certificates (DSC) of class 2 or class 3 category are required to be obtained from government recognized certifying agencies. Under Class 2 category, the identity of a person is verified against a pre-verified database whereas, under class 3 category, the person needs to be present himself before registering authority to prove their identity.

**STEP 2: Obtain the Name Approval**

To obtain the name approval, there are following two options:

**Option 1: Apply for the Proposed Name through RUN (Reserve Unique Name) Web Form:**

To apply for name using RUN web-form, the Entrepreneur must first create a free MCA Account. **You can apply for the two proposed names through RUN Web Form.** In case of rejection due to non-approval of the proposed names, the applicant will get a second chance of re-submission (RSUB) without any further charges. On submission of the RUN form with a Rs.1000 fee, the requested name would be checked by MCA personnel at the Central Registration Centre (CRC) against a registered company, an LLP and trademarks

for tests of similarity. If the name is unique and conforms to the Companies Act 2013, name approval would be provided by the MCA and the applicant would be intimated through the email address mentioned on the MCA account. In case of failure to get the name approved even in re-submission (RSUB), the applicant has to re-file another RUN Form with the prescribed fee.

**Notes:**

- (i) This Option 1 is recommended for those Entrepreneurs who wish to incorporate a company with a name that could be similar to an existing company or LLP or trademark.
- (ii) **DSC and DIN are not required for filling of RUN web Form for Reservation of Name.**
- (iii) MCA RUN system only checks for identical LLP and Company names. However, Companies Incorporation Rules, 2014 state that a company or LLP cannot be registered with an identical or similar name to that of an existing company, LLP or trademark. Hence, the quick check system, even if it shows a name is available does not guarantee name approval.

**SPECIMEN OF RUN (RESERVE UNIQUE NAME) WEB FORM  
(SEE NEXT PAGE)**

**Option 2: Apply for the Proposed Name through SPICe(INC-32) Web Form: You can apply only for one proposed name through SPICe(INC-32).** In case of rejection due to non-approval of the name, the applicant will get a second chance of refilling the same SPICe form without any further charges. In case of failure to get the name approved in the second go, the applicant has to re-file the SPICe Form again from scratch.

**Note:** This Option 2 is recommended for those Entrepreneurs who wish to incorporate a company with a unique name.

**STEP 3: Get e-MoA(INC-33) and e-AoA (INC-34) prepared, stamped, signed and witnessed:** e-MoA refers to an Electronic Memorandum of Association and eAoA refers to Electronic Articles of Association. Memorandum of Association represents the charter/constitution of the company while Articles of Association contain the internal rules and regulations of the company.

Both these forms must be digitally signed by subscribers and witnesses to the Memorandum and Articles of Association. **e-MoA(INC-33) and e-AoA (INC-34)** forms are filed online on MCA portal as a linked form with SPICe (INC-32).

**STEP 4: Fill Form SPICe (INC-32):** Form SPICe (INC-32) is a Simplified Proforma for Incorporating a Company Electronically. It serves the following purposes with a single application:

1. **Reservation of Company Name** [If Name Approval has not been obtained using **RUN (Reserve Unique Name) Web Form**]
2. **Application for DIN (Director Identification Number)**



## Reserve Unique Name

**Company Details**

☐ New Request
 ☐ Resubmission

**SRN**

Enter SRN which is under RSUB status
 Pre-fill

**Entity Type**

Select if you are reserving the name for a Company to be incorporated.

**CIN**

Enter CIN only if you are applying for change of name for an existing company.

**Proposed Name 1**

Enter your proposed name.

**Proposed Name 2**

Enter your proposed name.

Auto Check

**Comments**

Please make sure to mention the objects of the proposed company and any other relevant comments. Please attach Sectoral Regulatory approvals, NOCs or any other required documents below, if applicable.

Choose File

 No file chosen

Once you have submitted the name reservation request it will then be checked and, if found feasible, approved by the Central Registration Centre (CRC). You will receive an email from the CRC advising the outcome of the name reservation request.

**Submit**

DIN is an identification number for a director. It has to be obtained by anyone who wants to be a director in a company. One DIN is enough to be a director in any number of companies. Through SPICe (INC 32) DINs can be applied for maximum of 3 proposed directors who do not have a DIN giving all the required basic details of the proposed director(s) along with identity proof (like PAN, Aadhaar Card, etc)

and address proof. On incorporation of a company, DIN would be allotted for each of the Directors who did not have DIN. If an applicant wants to incorporate Company with more than 3 Directors and more than 3 persons do not have DIN, he has to first incorporate Company with 3 Directors and after incorporation he has to file Form DIN 3 (applicable for existing companies only) giving all the required basic details of the proposed director(s) along with identity proof (like PAN, Aadhaar Card, etc) and address proof.

3. **Incorporation of a new company: e-MoA(INC-33) and e-AoA (INC-34)** Forms are filed online on MCA portal as a linked form with SPICe (INC-32). The digital signature of a professional is required to file Form INC-32. The professional must certify that all the information given in the form is correct. The professional can be Chartered Accountant, Company Secretary, Cost Accountant or advocate. There is no ROC fees for Incorporation of Company up to Authorized Capital of Rs 10 lakhs.

**Notes:**

- (i) A major drawback for using SPICE Form is that Entrepreneurs or Professionals have to redo incorporation documentation, in case of rejection of name.
  - (ii) Though zero fees has been announced for the SPICE Form, eMOA and eAOA – stamp duty would still be applicable for incorporation as before depending on the State of incorporation.
4. Application for PAN and TAN

**STEP 5: Application for Company's PAN and TAN:** One can also apply for company's PAN and TAN by using SPICE (INC-32).

1. Download the system generated Forms 49A for PAN and 49B for TAN after the submission of SPICE Form.
2. Affix Digital Signatures on these forms.
3. Upload both these forms on MCA portal. If all the details in the Forms are duly filled in along with the required documents, MCA will approve the registration and a CIN (Corporate Identity Number) will be allocated.

#### 4.0 DOCUMENTS REQUIRED TO BE FILED WITH SPICE (INC-32)

##### **Application for Incorporation of Companies [Section 7(1) & Rule 12]**

An application for incorporation shall be filed with ROC of the State in which the registered office is proposed to be situated along with the prescribed fees and the following documents and information namely:

1. **Memorandum and Articles of Association of the company duly signed** by each subscriber to the Memorandum and **duly witnessed by** at least one witness.  
[Section 7(1)(a) & Rule 13]
2. **Declaration from the Professional [Section 7(1)(b) & Rule 14]**

A declaration in the prescribed form by an advocate, a chartered accountant, cost accountant or company secretary in practice, who is engaged in the formation of

the company, and by a person named in the Articles as a director, manager or secretary of the company, that all the requirements of this Act and the rules made thereunder in respect of registration and matters precedent or incidental thereto have been complied with;

**3. Affidavit from each of the Subscribers to the Memorandum and each of the First Directors [Section 7(1)(c) & Rule 15]**

An Affidavit in Form No.INC.9 from each of the Subscribers to the Memorandum and each of the First Directors that he is not convicted of any offence in connection with the promotion, formation or management of any company, or that he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the preceding five years and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief;

**4. Address for correspondence till its registered office is established [Section 7(1)(d)]**

**Notes: Furnishing verification of Registered Office [Section 12 & Rule 25]**

(i) As per Section 12, a company is required:

- (a) to have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it, on and from the 15th day of its incorporation and at all times thereafter,
- (b) to file verification of registered office in Form No INC 22. within 30 days of incorporation in the manner prescribed.

(ii) Where the location of the registered office is finalised prior to Incorporation of a company by the promoters, the promoters can also file along with the Memorandum and Articles, the verification of its registered office in Form no INC 22.

**5. Particulars of each of the Subscribers [Section 7(1)(e) & Rule 16]**

Section 7(1)(e) requires the filing of the particulars of name, including surname or family name, residential address, nationality and such other particulars of every subscriber to the memorandum along with proof of identity, as may be prescribed, and in the case of a subscriber being a body Corporate, such particulars may be prescribed;

**6. Particulars of each of the First Directors along with their consent to act as Directors [Section 7(1)(f) & Rule 17]**

Section 7(1)(f) requires filing of the particulars of the persons mentioned in the articles as the first directors of the company, their names, including surnames or family names, the Director Identification Number, residential address, nationality and such other particulars including proof of identity as may be prescribed.

Section 7(1)(g) requires the filing of particulars of the interests of **each of the First Directors** in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

## 5.0 CERTIFICATE OF INCORPORATION

### MEANING OF CERTIFICATE OF INCORPORATION

As per Sec 7(2), the Registrar on the basis of documents and information filed u/s 7 (1) , shall register all the documents and information in the Register and issue a Certificate of Incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

### ALLOTMENT OF CORPORATE IDENTITY NUMBER

As per Sec 7(3), on and from the date mentioned in the Certificate of Incorporation issued, the Registrar shall allot to the company a Corporate Identity Number (CIN), which shall be a distinct identity for the company and which shall also be included in the certificate.

Each Indian company (Listed or Unlisted) has a unique 21 Digits(alpha-numeric) CIN. This is required to be quoted on all forms. Once this number is filled, company details are automatically filled in E-Forms issued by MCA by using pre-fill function. CIN No. Code has 21 digits code with six parts as follows:

<b>First Character 'L' / 'U'</b>	indicates "Listed" company/"Unlisted" company.
<b>Next 5 Numeric Digits</b>	indicate the Category of the Industry to which the company belongs. MCA has their own categorization in this regard.
<b>Next 2 Alphabets indicate</b>	the State Code of the registered office
<b>Next 4 Numeric Digits</b>	indicate the Year of Incorporation.
<b>Next 3 Alphabets</b>	indicate the Classification of the Company. i.e., public limited or private limited or etc.
<b>Last 6 Numeric Digits</b>	indicate the Registration Number.

### EFFECTS OF REGISTRATION/INCORPORATION [SECTION 9]

1. **Body Corporate:** From the date of incorporation, the original subscribers to the memorandum as well as the other persons who may, from time to time, become members of the company, shall constitute a body corporate by the name contained in the Memorandum of Association.
2. **Power to exercise all the Functions:** The company shall be capable of exercising all the functions of an incorporated company.
3. **Perpetual Succession:** The company shall have perpetual succession which means that a company's existence persists irrespective of the change in the composition of its membership. Since it is created by law, it can be put to an end only by the process of law. Thus, a company shall continue to exist indefinitely till it is wound up in accordance with the provision of the Companies Act.
4. **Power to acquire, hold and dispose of property:** The company shall have power to acquire, hold and dispose of property (both movable and immovable, tangible and intangible).

5. **Power to Contract:** The company shall have power to contract.
6. **Power to sue and be sued:** The company shall have power to sue others and be sued by others.

### JUDICIAL RULINGS

1. A company on registration acquires a separate existence and the law recognises it as a legal person separate and distinct from its members  
[*State Trading Corporation of India v. Commercial Tax Officer*, AIR 1963 SC 1811].
2. Merely because a company purchases all shares of another company it will not serve as a means of putting an end to the corporate character of another company because each company is a separate juristic entity.  
[*Spencer & Co. Ltd. Madras v. CWT Madras*, [1969] 39 Comp. Case 212].
3. Even if the entire share capital is held by the President of India it does not make a company an agent either of the President  
[*Heavy Electrical Union v. State of Bihar*, AIR 1970 SC 82].

## 6.0 CONTENTS OF CERTIFICATE OF INCORPORATION

The certificate of incorporation contains:

- (a) the name of the company,
- (b) the date of its issue, and
- (c) the signature of the Registrar with his seal.

This certificate is literally the **birth certificate of the company** evidencing that the company is born with its name on the date mentioned in the certificate.

**Note:** A print of this certificate is to be a part of all copies of Memorandum and Articles of association.

## 7.0 CONCLUSIVENESS OF CERTIFICATE OF INCORPORATION

1. **Certificate of incorporation given by the Registrar of Companies in respect of any association shall be conclusive evidence that—**
  - (a) all the requirements of Companies Act have been complied with in respect of its registration as well as matters precedent and incidental thereto,
  - (b) the association is a company authorized to be registered and duly registered under the Act.
2. **Meaning of 'Conclusive Evidence'** The term 'conclusive evidence' means that no inquiry shall be allowed to be made regarding the correctness or incorrectness of any particulars contained in the certificate of incorporation.  
In other words, once issued, the certificate of incorporation cannot be challenged in any Court or Tribunal on any grounds whatsoever.

3. **Undisputed Validity** The certificate of incorporation shall remain valid and corporate status shall remain unaffected even in the following cases :
- (a) Where one person has signed on behalf of all the subscribers.
  - (b) Where all the signatories to memorandum are minors
  - (c) Where all the signatures on the memorandum are forged
  - (d) Where the memorandum was altered after signing by subscribers, but before its registration
  - (e) Where illegal objects are incorporated in the object clause.

4. The certificate of incorporation is also a conclusive proof of the fact that the company came into existence from the date mentioned in the certificate. The validity of the registration cannot be questioned after the issue of the certificate.

In the case of **Jubilee Cotton Mills Ltd. v. Lewis**, the company delivered to the Registrar of Companies documents required for the registration of the company on 6th January. On 8th January, the Registrar registered the company and issued the certificate of incorporation but dated it January 6. The company allotted few shares to Mr. Lewis of 6th January. The allotment was challenged and the court was requested to declare the allotment as void. The court held that the certificate of incorporation is conclusive evidence of all that it contains. Hence, the company shall be deemed to have been formed on 6th January and allotment of shares was valid.

5. In **Peer's case**, the memorandum was found materially altered after the signatories had signed but before registration. It was held that the corporate status remained unaffected and the certificate of incorporation was valid. Highlighting the necessity of this rule, Lord Cairns observed as follows:

"When once the memorandum is registered and the company holds out to the world as a company undertaking business, willing to receive shareholders and ready to contract engagement, then, it would be of the most disastrous consequence if after all that has been done, any person was allowed to go back and enter into an examination of the circumstances attending the original registration and the regularity of the execution of the documents."

6. In **Moosa Goolam Arif v. Ebrahim Goolam Arif**, the memorandum of association of a public limited company was signed by 2 adult persons and guardians of other 5 minor persons. The Registrar registered the company and issued the certificate of incorporation. The incorporation of the company was challenged and the plaintiff prayed that the certificate of incorporation should be declared void. The Privy Council rejected the plea of the plaintiff and held that the certificate of incorporation was valid. Thus, the certificate prevents anyone from alleging that the company does not exist".

7. **Not a Conclusive Proof with respect to the Legality of the Objects:** Certificate of incorporation is not the conclusive proof with respect to the legality of the objects of the company, mentioned in the objects clause of the Memorandum of Association. As such, if a company has been registered whose objects are illegal,



the incorporation does not validate the illegal objects. In such a case the only remedy available is to wind up the company. [**Performing Right Society Ltd. v. London Theatre of Varieties (1992)**].

### VERY SHORT ANSWER TYPE QUESTIONS

1. What is meant by 'Promotion of a Company'?
2. Who are called 'Promoters'?
3. What is meant by 'Preliminary Contracts'?
4. What is meant by 'Certificate of Incorporation'?
5. From which date is a company said to be incorporated?

### SHORT ANSWER TYPE QUESTIONS

1. Everyone who is associated with the process of the formation of a company is called 'promoter.' comment.
2. Enumerate the functions performed by the promoters.
3. State the legal position of promoters.
4. Enumerate the duties of promoters.
5. Enumerate the liabilities of promoters.
6. (a) Can the promoters claim as a matter of right any remuneration from the company?  
(b) Can the promoters claim remuneration if they have already entered into a contract with the prospective directors before the incorporation?  
(c) Can the promoters claim remuneration if the Articles provide that a specified sum may be paid to the promoters as remuneration?  
(d) State the various modes of giving remuneration to the promoters.  
(e) What are the disclosure requirements in respect of remuneration to promoters in prospectus?
7. Mention the steps for incorporation of a company.
8. Mention the documents which are filed with the registrar for incorporation.
9. (a) State the meaning and contents of Certificate of Incorporation.  
(b) What is meant by 'conclusiveness of Certificate of Incorporation'?
10. State the effects of Registration.
11. Comment on the following:
  - (a) A promoter is *neither* a trustee *nor* an agent of the company but he stands in a fiduciary position towards it.
  - (b) The validity of a certificate of incorporation cannot be disputed on any ground whatsoever.
  - (c) The services of a promoter are very peculiar.
  - (d) Promoters can demand remuneration if the Articles provide for the payment thereof.

### **LONG ANSWER TYPE QUESTIONS**

1. Explain the various functions performed by the promoters.
2. (a) Explain the duties and liabilities of promoters.  
(b) How can promoters be remunerated by the company for his work?
3. (a) What is meant by preliminary contracts?  
(b) Discuss the legal position of preliminary contracts?  
(c) Can a company rectify such contracts?
4. Enumerate the practical steps involved in the incorporation of a company.



# Memorandum & Articles of Association

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## 1.0 MEANING OF MEMORANDUM OF ASSOCIATION

### LEGAL DEFINITION

As per Sec. 2(56) of The Companies Act, Memorandum means “**the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company laws or of this Act**”. But this definition is not sufficient to explain its meaning. Let us look at some of the observations made in various judicial cases.

### JUDICIAL DEFINITIONS

1. “*Memorandum of Association of a company contains the fundamental conditions upon which alone the company is allowed to be incorporated. These conditions are introduced for the benefit of the creditors and the outside public as well of the shareholders*”. [**Guinness v. Land Corporation of Ireland**, (1882) 22 Ch. D. 359]
2. **Lord Cairns** observed “*Memorandum of association of a company is its charter and defines the limitations on the powers of the company established under the Act, that it contains in it, both that which is affirmative and that which is negative and that it states affirmatively, the ambit and extent of vitality and power which by law are given to the corporation and it states negatively that nothing shall be done beyond that ambit*”. [**Ashbury Rly. Carriage and Iron Co. v. Riche**, (1875) LR 7HL 653]
3. *Memorandum of Association defines its relations with the outside world and the scope of its activities. Its purpose is to enable the shareholders, creditors and those who deal with the company to know that is its permitted range of activities* [**Egyptian Salt and Soda Co. Ltd. v. Portsaid Salt Association**, 1931 A.C. 677].

### To sum up

- (a) **Memorandum of Association is the constitution of the company which lays down the fundamental conditions upon which alone the company is allowed to be formed.**
- (b) **It defines as well as confines the powers of the company.** It not only shows the objects of formation but also determines the utmost possible scope of its operations beyond which its action cannot go. If it enters into a contract which is beyond the powers conferred on it by the memorandum, such contract will be *ultra vires* the

company and hence void. Even the unanimous consent of the entire body of its members cannot ratify such contract.

- (c) It is the company's charter defining its constitution and scope of the powers with which it has been established under the Act.

## 2.0 PURPOSE OF MEMORANDUM OF ASSOCIATION

The Memorandum of Association is a public document which is open for inspection by any member of the public on payment of prescribed fees [Section 399]. Therefore, every person who deals with the company is presumed to have the knowledge of its contents.

The purpose of Memorandum is two-fold.

- (a) First, **to enable the intending shareholders** to know the purpose for which their money is going to be used and within what field they are taking risk in making the investment.
- (b) Second, **to enable the persons intending to deal** with the company to know with certainty as to whether the contractual relationship which they intend to enter into with the company is within its corporate objects or not [**Cotman v. Broughman, (1918) A.C. 514**].

Thus, Memorandum gives protection not only to the shareholders but also to persons who intend to deal with the company.

## 3.0 FORM OF MEMORANDUM OF ASSOCIATION [SECTION 4 (6)]

As per Sec 4(6), the Memorandum of Association of a company must be in respective form specified in Table A,B,C,D and E in Schedule I as may be applicable to such company .

**Table A:** Memorandum of Association of a Company Limited by Shares.

**Table B:** Memorandum of Association of a Company Limited by Guarantee and not having a share capital.

**Table C:** Memorandum of Association of a Company Limited by Guarantee and having a share capital.

**Table D:** Memorandum of Association of an Unlimited Company and not having a share capital.

**Table E:** Memorandum of Association of an Unlimited Company and having a share capital.

## 4.0 SIGNATURE OF MEMORANDUM [SECTION 7(1)]

The memorandum must be signed by each of the subscribers to the Memorandum in the presence of at least one witness who must attest the signature and add his address, description and occupation (if any).

## 5.0 CONTENTS OF MEMORANDUM [SECTION 4(1)]

The memorandum of association of a company must state the following clauses:

1. **Name Clause:** The Memorandum of every company must state the name of the company with the last word “**Limited**” in the case of a Public Limited Company or with the last word “**Private Limited**” in the case of a private limited company.  
[Section 4(1)(a)]

### RESTRICTIONS ON THE SELECTION OF NAME OF THE COMPANY

1. The name of the company **must not be identical** with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; [Sec 4(2)].
2. The name of the company **must not constitute an offence** under any law for the time being in force [Sec 4(2)].
3. The name of the company **must not be undesirable** in the opinion of the Central Government [Sec 4(2)].
4. The name of the company **must not contain any word or expression** which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force [Sec 4(3)].
5. The name of the company **must not contain such word or expression**, as may be prescribed, unless the previous approval of the Central Government has been obtained for the use of any such word or expression [Sec 4(3)].

#### **When shall the name of the company be considered as undesirable in the opinion of Central Government**

The name shall be considered as undesirable **in the opinion of Central Government** if—

- (i) It is **identical with or too nearly resembles the name of an existing company** or a registered trademark, or a trade mark which is subject of an application for registration of any other person under the Trade Marks Act 1999. However the Central government before deeming a name as undesirable consult the Registrar of Trade Mark.

In case of ***Society of Motor Manufacturers and Traders Ltd. v. Motor Manufacturers and Traders Mutual Assurance Co. Ltd.***, (1925) 1 Ch. 675, where a company was incorporated to conduct the business of motor vehicle assurance under a name somewhat similar to that of a motor dealer's trade protection association, the court refused an injunction to the association because the difference between the activities of the company and the association precluded any possibility of confusion.

In ***Ewing v. Buttercup Margarine Co.***, (1917) 2 Ch. 1, Ewing was carrying on business under the name of Buttercup Dairy Company as a wholesale and retail provision merchant. A new company, Buttercup Margarine Co., was formed with the object of manufacturing and selling margarine in wholesale. Ewing applied to the court for restraining the new company from using the name, contending

that it was calculated to deceive and that people were likely to be confused into thinking of both companies as one or closely related. The court granted an injunction.

The court, however, will not grant an injunction to prevent the use of a purely descriptive word with a definite meaning and in common use.

In case of ***Aerators Ltd. v. Tollit***, (1902) 2 Ch. 319, the business of the plaintiff was the sale of apparatus by which small quantities of liquids could be aerated. The defendant proposed to register a company to be called Automatic Aerators Limited, the object of which was to work under patents in respect of aeration of liquids in large quantities. The court did not grant the injunction as both companies had different patents and apparatus although the main object of both was to manufacture apparatus for the instantaneous, automatic aeration of liquids.

- (ii) It is **prohibited by the Emblems and Names (Prevention of Improper Use) Act, 1950**. This Act prohibits the use of the name and emblems of the United Nations and the World Health Organisation, the official seal and emblems of the Central and State Governments, the Indian National Flag, the name and pictorial representation of Mahatma Gandhi and the Prime Minister of India.
  - (iii) It is in the **contravention of the name guidelines** issued by the Department of Company Affairs (Govt. of India).
2. **Registered Office Clause:** The Memorandum of every company must state the name of the State in which the registered office of the company is to be situated. It may be noted that the exact complete address of the registered office need not be stated in the Memorandum.
3. **Objects Clause:** The Memorandum of every company must state the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

#### **Restrictions on the Selection of Objects**

The subscribers to the memorandum may choose any 'objects' for the purposes of their company subject to the following restrictions:

- (a) The objects must **not include anything** which is **illegal or contrary** to general law e.g. floating a company for dealing in lotteries [***Ex-parte More***, (1931) 2 K.B. 197].
- (b) The objects must **not include anything** which is **against public policy** e.g. trading with alien enemies [***Daimler & Co. v. Continental Tyre Co.***, (1916) 2 A.C. 307] or objects which are in restraint of trade [***Mac. Ellis v. Calligot etc. Company***, (1919) A.C. 459].
- (c) The objects must **not include anything** which is **prohibited by the Companies Act, 2013**.

#### **Importance of Objects Clause**

The objects clause is of fundamental importance to its members as well as its non-members. In the *first place*, it gives protection to subscribers (members) who learn

from it the purposes to which their money can be applied. In the *second place*, it gives protection to outsiders dealing with the company who learn from it what its powers are and what is the range of its activities. The narrower the objects appended in the memorandum, the lesser is the subscribers' risks, the wider these objects, the greater is the security of those who transact business with the company.

4. **Liability Clause:** The Memorandum of every company must state the nature of the liability of members as follows:

Type of company	Legal requirement
(a) <b><i>In case of a company limited by shares</i></b>	Liability clause must state that the liability of a member is limited to the amount that remains unpaid if any on shares held by him. <i>For example</i> , a shareholder holds a ₹ 10 share and has paid ₹8 on it so far. He can be called upon to pay ₹ 2 and nothing more. In this example, if he holds a fully paid-up share, then his liability is nil.
(b) <b><i>In case of a company limited by guarantee</i></b>	Liability clause must state that the liability of a member is limited to the amount up to which each member undertakes to contribute – (A) to the assets of the company in the event of its being wound-up while he is a member or within 1 year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and (B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;

**Note:** In case of an unlimited company, liability clause is not mandatory.

5. **Capital Clause:** In the case of a company having a share capital the Memorandum of every company must state:
- the ***amount of share capital*** with which the company is to be registered
  - the ***division thereof*** into shares of fixed amount.
  - the number of shares which the subscribers to the memorandum agree to subscribe which must be at least 1 share; and
  - the number of shares each subscriber to the memorandum intends to take, indicated opposite his name

**Notes:**

- Capital stated in Capital Clause is called '*Authorised*' or '*Nominal*' or '*Registered*' capital.
- The fixed amount of a share is known as '*Par*' or '*Nominal*' value of a share.

- (iii) **In case of company having no share capital, the capital clause is not required in its memorandum.**
  - (iv) Division of the authorised capital into different classes of shares (if any) and the rights of various clauses of shareholders need not be stated in the capital clause. Instead, these details may be given in the Articles of the company.
  - (v) The effect of capital clause is that the company cannot issue more shares than are authorised for the time being by the memorandum.
  - (vi) The stamp duty and registration fee are payable on the basis of amount of authorised capital.
6. **Nominee Clause:** In the case of a One Person Company the Memorandum of every company must state the name of the person who, in the event of death of the subscriber shall become the member of the company. [Sec 4(1) (f)]

## 6.0 DOCTRINE OF ULTRA VIRES

### MEANING OF ULTRA VIRES

The term '*ultra*' means '*beyond*' and the term '*vires*' means the '*powers*', Thus, *ultra vires* a company means '**beyond the powers of a company**'. Any act which is beyond the objects stated in the memorandum is *ultra vires* the company and, therefore, **null and void**. The company shall not be bound by such acts which are *ultra vires* the company. The purpose of the doctrine of *ultra vires* is to protect the interests of members, outsiders and creditors.

In order to protect the interest of the shareholders and the third parties which enter into contracts with the company's activities are confined to the objects given in the Memorandum of Association. It cannot do anything beyond the objects clause and if it does, it will be considered *ultra vires* (beyond capacity) and *void ab-initio*. Thus, in case of a company whatever is not permitted expressly or by implication, by the constituting instrument, is prohibited not by any express prohibition of the legislature, but by the doctrine of *ultra vires*.

### MEANING OF DOCTRINE OF ULTRA VIRES

The term '*ultra vires*' means beyond one's power or authority. Where exercises of powers vested in a person arises, the question as to the scope of such powers becomes the matter for consideration as to whether a person is acting within the limits of authority conferred on him. If the person exercising the power goes beyond the jurisdiction of his powers, the person is said to have acted *ultra vires*. The doctrine of *ultra vires* thus contemplates two things:

1. that the person exercising the power is not having an unlimited or infinite power to do all acts or things at his will and pleasure; and
2. that the person exercising the power derived the same from some other person or persons on behalf of whom the person acts. The power may be delegated to him by an express or implied act of the said person or persons.

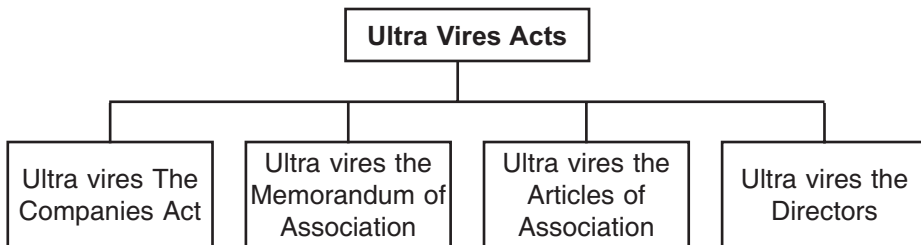


As far as a company is concerned, any act beyond the objects mentioned in the Memorandum of Association is *ultra vires* and void. This important rule of law was laid down in **Ashbury Railway Carriage Co. v. Riche**, (1875) [L.R. 7 H.L. (653)].

The acts of the company are subject to the provisions contained in the Act in terms of which it is incorporated and its two-constitutional documents, namely, the Memorandum and Articles of Association.

### TYPES AND VALIDITY OF ULTRA VIRES ACTS

Ultra vires acts can be divided into the following four categories:



Let us discuss, these *ultra vires* acts one by one.

1. **Acts Ultra Vires The Companies Act:** Any act done contrary to or in excess of the scope of The Companies Act will be *ultra vires* the Act. Such an act shall be void and cannot be ratified even by an unanimous resolution of all the shareholders.

A few examples of such acts are as follows:

- (a) Payment of dividend out of capital,
- (b) Free distribution of bonus shares, and
- (c) Reducing the share capital without complying with the legal formalities.

2. **Acts Ultra Vires the Memorandum:** The Memorandum defines and confines the powers of the company. The object of the company is determined by the Memorandum. A company cannot do anything which is beyond the purview of the objects clause. **Any act done in contravention of the object clause shall be *ultra vires* the Memorandum and shall be void and it cannot be ratified even by an unanimous resolution of all the shareholders.**

The doctrine of *ultra vires* was first applied in the famous case of **Ashbury Railway Carriage and Iron Co. v. Riche**. In this case the company was incorporated to make, and sell, or lend on hire, railway carriages and wagons and to carry on the business of mechanical engineers and general contractors.

The directors of the company entered into a contract with *Riche*, a firm of Railway contractors to finance the construction of a railway line in Belgium. The contract was ratified by the company by passing a special resolution at a general meeting. Later, the contract was repudiated by the company on grounds of its being *ultra vires* and it was sued for breach of contract. The House of Lords held that the contract

was *ultra vires* the Memorandum and therefore void. It could not be ratified by the shareholders, as the contract was *ultra vires* the objects clause.

In case of **Simpson v. West Minister Palace Hotel Co.**, (1861) 20 Beav. 40, a hotel company temporarily let part of its premises not required for its business. This was held to be *ultra vires*.

In case of **Attorney General v. G.N. Railway Co.**, (1860) 1 Dr. & Sm. 154, a railway company was working coal mines and selling coal at a profit. This was held to be *ultra vires*.

In case of **London Country Council v. Attorney General**, (1902) A.C. 165, the council having a statutory power to work tramway, proposed to run omnibuses in connection with the tramways, however beneficial it might prove the original business. It was considered *ultra vires*.

In case of **A. Laxmanswami Mudaliar v. LIC of India**, contribution to a trust for promoting technical and business knowledge was held to be *ultra vires*. The court held that the power to make charitable contribution available to the company in its Memorandum does not entitle it to make grant of every kind. Such grant will be valid when it is *bona fide*, relating to company's business or welfare of employees and useful for attainment of company's own objects.

3. **Acts Ultra Vires the Articles:** Acts which are *ultra vires* the Articles of Associations but are within the power of the company are termed as *ultra vires* the articles. *For example*, payment of interest on 'advance calls' at a rate higher than allowed by the articles. Such act shall also be void, but the company in General Meeting may alter the articles by a special resolution and ratify unauthorised acts with retrospective effect in accordance with the provisions of Section 14.
4. **Acts Ultra Vires the Director:** Acts which are beyond the powers of the directors but are within the powers of the company are termed as acts *ultra vires* the director. Such acts are not altogether void. Such acts can be ratified and made valid by altering its Articles by a special resolution at its general meeting with retrospective effect so as to give directors the powers beyond which they have exceeded. When the acts are so ratified the company becomes liable for such acts. *For example*, if the company has power to borrow, but it restricts the authority of the directors to borrow upto a certain sum. If the directors exceed their authority and borrow more than what they are authorised to borrow, then the company may, if it wishes, ratify the directors' act, in which case the loan binds both the lender and the company as if it had been made with the company's authority in the first place.

### EFFECTS OF ULTRA VIRES TRANSACTIONS

The effects of *ultra vires* transaction are summarised as under:

1. Act which is *ultra vires* the company shall be *void-abinitio* and cannot be ratified even by an unanimous resolution of all the members.
2. The company *cannot be sued* on an *ultra vires* transactions.
3. The company *cannot sue* on an *ultra vires* transactions.

4. **Injunction** Any member can bring injunction against the company to restrain it from doing *ultra vires* acts.
5. **Personal Liability of Directors** The directors of the company can be held personally liable for any loss caused by an *ultra vires* transaction. If a director makes an *ultra vires* payment, he can be compelled to make good the funds used [*Re Sharpee*, (1892) 1 Ch. 154]. But the directors who refunded the money could get indemnity as against the person who received the payment with the knowledge that payment to him was *ultra vires*. [*Russell v. Wakefield Water Works Co.* (1975) L.R. 20 Eq. 474]

6. **Liability for Breach of Warranty of Authority** The directors can be held personally liable for breach of warranty of authority if it can be established that their act amounts to an implied misrepresentation of facts and not of law.

Where the Memorandum of Association of a non-trade company did not give any power to borrow but its directors borrowed, directors are not personally liable since their act amounts to an implied misrepresentation of law as a non-trading company has no implied power to borrow.

Where the Memorandum of Association of a trading company did not give any power to borrow but its directors borrowed, directors are personally liable since their act, amounts to an implied misrepresentation of fact as a trading company has implied power to borrow.

In case of *Weeks v. Property*, (1873): LR 8 CP 427, the directors having power to borrow up to £ 60,000, further borrowed £ 500. Loan of £500 was held to *ultra vires* and void and therefore not binding on the company. The directors were held personally liable for breach of warranty of authority.

7. **On Ultra Vires Lending by Company** If money is lent by a company having no power to lend, the company can sue the debtors for the recovery of loan since the debtors will be estopped from taking the plea that the company had no power to lend. [*Re. Coltman* (1818) 119 Ch. D. 64]
8. **On Ultra Vires Borrowing by the Company** The effect on *ultra vires* borrowing by company depends upon whether the money borrowed has been expended or not.

Where the company has no borrowing power, any borrowing and where the memorandum fixes a limit on borrowing powers of the Board of Directors of a Company, any borrowing in excess of that limit is known as *ultra vires borrowing*. Such borrowings are void and the securities given for them are inoperative. In such a case the lender cannot sue the company because it does not create any relation of debtor and creditor. The borrowings which are *ultra vires* cannot be ratified by a resolution passed at a general meeting.

Case	Effect
(a) <i>If ultra vires borrowings have not been used.</i>	<b>Right of Restitution</b> The lender may bring injunction against the company to restrain it from using the amount of loan since the lender remains the owner of the money which is <i>ultra vires</i> the company, he can take back the property in specie. (i.e. in the same form) [ <i>Sinclair v. Borughman</i> , (1914) A.C. 398]
(b) <i>If ultra vires borrowings have been used to pay-off lawful debt of the company.</i>	<b>Right of Subrogation</b> The lender steps into the shoes of paid off creditor and consequently he would be entitled to recover his loan to that extent from the company [ <i>Naeth Building Society v. Luce</i> (1889) 43 Ch. D. 158] But he cannot claim any right to any securities held by the original creditor. [ <i>Re. Wrexham Rly. Co.</i> (1889) 1 Ch. 440].
(c) <i>If ultra vires borrowings have been used for the purchase of any asset or assets.</i>	The lender may claim repayment of his money out of the asset or assets purchased out of his money. In addition to aforesaid rights, the lender can sue the directors for breach of warranty of authority.

**9. On Ultra Vires Torts:** A company will be liable for tort of its employees if—

- (a) the tort is committed in pursuance of its stated objects, and
- (b) the tort is committed by employees within the course of their employment.

In other words, a company will not be liable for any torts committed outside its objects. *For example*, a company having power to run tramways, started operating omnibuses and a driver of one such bus negligently injured a person who sued the company for damages. It was held that the company could not be held liable for damages because having no existence outside the Memorandum, it could not have appointed the driver.

**THE DOCTRINE OF ULTRA VIRES IS AN ILLUSORY PROTECTION  
TO THE SHAREHOLDERS AND PITFALL TO OUTSIDERS**

The doctrine of *ultra vires* is intended to protect the shareholders who invest money in the capital of the company and the creditors who deal with it on the basis of range of company's permitted activities as set out in the Memorandum of Association. Any act beyond the permitted area of operation is void and has no legal effect. But the corporations have always endeavoured to escape the limitations imposed by the doctrine of *ultra vires* by drafting the objects clause of Memorandum in very wide terms be as to incorporate all conceivable objects. Along with the objects, they usually spell out several powers which companies will be entitled to exercise in carrying out its objects. The result is the every form of conceivable activity and power is included in the memorandum somewhere beneath the mass of words. This protects the acts of company from challenged as *ultra vires*.

Further, where any acts of the company is *ultra vires* the Articles but is *intra vires* the memorandum the company may alter its Articles and ratify the act, if the act of directors is *ultra vires* the authority delegated to them, the company may ratify such act by an ordinary or special resolution, as the case may be, provided such acts are not *ultra vires* the company.

Consequently, the protection afforded by the doctrine of *ultra vires* to the shareholders and the third parties dealing with the company has become illusory to some extent.

## 7.0 MEANING OF ARTICLES OF ASSOCIATION

### LEGAL DEFINITION

Section 2(5) of the Companies Act defines Articles “**as the Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act**”. This definition is not sufficient to explain its meaning. Let us look at some of the observations made in judicial cases.

### JUDICIAL DEFINITIONS

1. “*The Articles of Association of a company are the internal rules and regulations to the management of its internal affairs.*”  
[**Guinness v. Land Corporation of Ireland**, (1882) 22 Ch. D. 349]
2. “*The articles play a part subsidiary to memorandum of association. They accept the memorandum of association as the Charter of Incorporation of the company and so accepting it, they proceed to define the duties, rights and powers of governing body as between themselves and the company at large and the mode and form in which the business of the company is to be carried on and the mode and form in which changes in the internal regulation of the company may from time to time be made.*”  
[**Ashbury Railway Carriage Co. Ltd. v. Riche**, (1875) L.R. 7. H.L. 653, p. 670]
3. “*The document containing the articles of association of a company is a business document; hence it has to be construed strictly. It regulates domestic management of a company and creates certain rights and obligations between the members and the company.*” [**S.S. Rajkumar vs. Perfect Castings (P.) Ltd.**, [1968] 38 Camp. Case 187]
4. The Articles of Association are in fact the bye-laws of the company according to which director and other officers are required to perform their functions as regards the management of the company, its accounts and audit.

**To sum up the Articles are the internal rules and regulations which govern the internal management of the company and bind the company and members thereof.**

## 8.0 CONTENTS OF ARTICLES OF ASSOCIATION

1. The Articles of Association of a company must contain:
  - (a) the regulations for management of the company ,[Sec 5(1)]

- (b) also such matters as may be prescribed,[Sec 5(2)]
2. The articles of a company must be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company.[Sec 5(6)]
  3. A company may adopt **all or any** of the regulations contained in the model articles applicable to such company.[Sec 5(7)]
  4. The Articles of Association may contain any regulation for the attainment of objects stated in the Memorandum subject to the following restrictions:
    - (a) The Articles must not include anything which is illegal or contrary to general law.
    - (b) The Articles must not include anything which is against public policy.
    - (c) The Articles must not include anything which is prohibited by the Companies Act.
  5. Articles usually contain provisions relating to the following matters:

Interpretation	General Meeting and proceedings thereat
Share Capital,Allotment of Shares,Variation of these rights and Shares Certificates	Adjournment of meeting
Lien on Shares	Voting Rights, Voting and Poll and Proxies
Calls on Shares	Board of Directors, Board Meeting and Proceedings thereat
Transfer of Shares	Chief Executive Officer, Manager, Company Secretary or Chief Financial Officer
Transmission of Shares	Seal
Forfeiture of Shares	Dividend and Reserves
Alteration of Capital	Accounts, Audit and borrowing powers
Capitalisation of Profits	Winding up
Buy back of Shares	Indemnity

## 9.0 SPECIFIC REGULATION REQUIRED IN THE ARTICLES OF SPECIFIC COMPANIES

The specific regulations required in the Articles of specific companies are given below:

### 1. *In case of a company limited by guarantee and having share capital*

- (a) The number of members with which the company proposes to be registered is 100, but the Board of Directors may, from time to time, register an increase of members.
- (b) All the articles of Table F in Schedule I annexed to the Companies Act, 2013 shall be deemed to be incorporated with these articles and to apply to the company.

**Note:** Its Articles must be in the Form given in **Table G**.

**2. In case of a company limited by guarantee and not having share capital**

The number of members with which the company proposes to be registered is 100, but the Board of Directors may, from time to time, register an increase of members.

**Note:** Its Articles must be in the Form given in **Table H**.

**3. In case of an unlimited company and having share capital**

- (a) The number of members with which the company proposes to be registered is 100, but the Board of Directors may, from time to time, register an increase of members.
- (b) All the articles of Table F in Schedule I annexed to the Companies Act, 2013 shall be deemed to be incorporated with these articles and to apply to the company.

**Note:** Its Articles must be in the Form given in **Table I**.

**4. In case of an unlimited company and not having share capital**

- (a) The number of members with which the company proposes to be registered is 100, but the Board of Directors may, from time to time, register an increase of members.
- (b) All the articles of Table H in Schedule I annexed to the Companies Act, 2013 shall be deemed to be incorporated with these articles and to apply to the company.
- (c) The subscribers to the memorandum and such other persons as the Board shall admit to membership shall be members of the company.

**Note:** Its Articles must be in the Form given in **Table J**.

**5. In case of a Private Company having share capital**

Its Articles must contain the following **three restrictions** as contained in Section 2(68)—

- (a) Restricting the right to transfer its shares,
- (b) limiting the number of its members to 200 (except in case of One Person Company) excluding the past and present employees of the company.
- (c) prohibiting any invitation to the public to subscribe for any securities of the company.

**6. In case of a Private Company not having share capital**

Its Articles must contain the following **restriction** as contained in Section 2(68)—

- (a) limiting the number of its members to 200 (except in case of One Person Company) excluding the past and present employees of the company

**10.0 SIGNATURE OF ARTICLES [SECTION 7(1)(A)]**

The Articles must be signed by each of the subscribers to the Memorandum in the presence of at least one witness who must attest the signature and add his address, description and occupation (if any).



## 11.0 ALTERATION OF ARTICLES OF ASSOCIATION

Section 14 empowers the company to alter or add to its Articles. This fundamental power of the company to alter its Articles is subject to the following limitations:

1. **Special Resolution:** Subject to the provisions of this Act and the conditions contained in its Memorandum, if any, a company may, by a **special resolution**, alter its articles including alterations having the effect of conversion of—
  - (a) a private company into a public company; or
  - (b) a public company into a private company.

A copy of the special resolution authorising Articles' alteration must be filed with the Registrar within 30 days of passing the resolution. The effect of change must be incorporated in all copies of articles of association issued after the date of alteration.

2. **Approval of Tribunal in Case of Conversion of Public Company into Private Company:** No alteration having the effect of converting a public company into a private company shall have effect unless approved by the **Tribunal** [Proviso to Sec 14(1)]. In this case, a copy of the order of the Tribunal approving the alteration together with printed copy of the altered articles must be filed with the Registrar within 15 days of the date of receipt of the order of approval [Sec 14(2)]
3. **Valid as if Originally Contained:** Any alteration made in the Article shall subject to the provisions of this Act, as valid as if originally contained in the Articles. [Sec 14(3)]
4. **Not inconsistent with Any Act:** The alteration must not be inconsistent with any provisions of the Companies Act or any other statute.
5. **Not Inconsistent with Memorandum:** The alteration must not be inconsistent with any provisions of the Memorandum of Association. Articles being subordinate to the memorandum must not override.
6. **Not Inconsistent with Tribunal Order:** The alteration must not be inconsistent with an order of **Tribunal**.
7. **Not Permit any Illegal Thing:** The alteration must not permit anything which is illegal.
8. **Retrospective Effect:** The alteration may be regarded as having a retrospective effect so long as it does not affect the things already done by the company and alteration is for the benefit of the company as whole [**Allen v. Gold Reef of West Africa** (1909) S.C. 732]. In the case of **Allen v. Gold Reefs of West Africa**, the original Articles gave the company a lien on all shares "not fully paid-up" for calls due to the company. 'S' was the only member holding some fully paid-up shares, but he also owned money to the company for calls due on other shares. 'S' died and his shares were inherited by his legal representatives. The company, thereafter, altered its Articles enabling the company to exercise lien on all shares—whether fully paid or not. Now the question arose whether the company could exercise lien even on fully paid-up shares. It was held that company could do so as it was done *bona fide* for the benefit of the company as a whole.
9. **Bona Fide:** The alteration must be *bona fide* for the benefit of the company as a whole. Such alteration shall be valid even though the private interests of some members may be affected adversely. In case of **Sidebottom v. Kershaw, Leese**



**& Co., Ltd.** (1920) 1 Ch. 154], the alteration of articles empowered the directors to require any member who carried on a business competing with that of the company to sell his shares at a fair price to persons nominated by the directors. The validity of the resolution was challenged on the ground that the alteration will not be for the benefit of the company as a whole.

The court held that it was in the interest of the company as a whole to be protected against competition and upheld the resolution. The court was of the view that it was very much in the interest of the company as a whole to get rid of such members who were carrying on a competing business as they always had the chance to exploit the company's secrets for their personal benefit and at its cost.

10. **Must Not Constitute a Fraud on Minority:** The alteration must not constitute a fraud on minority. An alteration the effect of which is to discriminate between the majority shareholders and minority shareholders so as to give the former an advantage of which the latter have been deprived, would constitute a fraud on minority.

In case of **Menier v. Hooper's Telegraph Works Ltd.**, (1874) 9 Ch. App. 350, Two Companies A and B were in rivalry. The Majority shareholders of company A were also the shareholders of Company B. Company A had filed a suit against Company B. Later, shareholders of company A passed a resolution to compromise the action against Company B in such manner that the terms of compromise were favourable to Company B and unfavourable to Company A. The minority shareholders questioned the power of the majority to make the said compromise and the court set aside the same. It observed: "It would be a shocking thing, if that could be done and that majority should have nothing to do with it, then the majority have put something in their pockets at the expense of the minority".

**Re Cook v. Deeks**, (1916) A.C. 554, the directors of railway construction company obtained a contract in their own names to construct a railway line. The contract was obtained under circumstances which amounted to breach of trust by the directors who then used their voting powers to pass a resolution of the company declaring that the company had no interest in the contract. It was held that the benefit of the contract belongs in equity to the company and that the directors could not benefit themselves at the expense of the minority. If it were not checked, this would be tantamount to allowing a majority to oppress the minority.

**In Brown v. British Abrasive Wheel Co.**, (1919) 1 Ch. 290, the majority shareholders holding 98% of the shares were willing to subscribe further capital which the company badly needed but only if they were able to acquire the shareholdings of the minority. They passed a special resolution to alter the articles to enable them to purchase the minority shares compulsorily on certain terms. The plaintiff refused to sell its shares and challenged the validity of the majority resolution. It was decided that the alteration was not for the benefit of the company but for the benefit of the majority and accordingly an injunction was granted against the company prohibiting it from carrying out the resolution.

11. **Not Cause Breach of Contract with an Outsider** Alteration must not cause a breach of contract with an outsider. The company shall remain liable for damages for its breach.

**Murac Rubber Syndicate v. Alpertan Rubber Co. Ltd.** (1915) Ch. 186. In this case an agreement was made between Company A and Company B. Company A had the right to nominate two directors on Company B's board as long as Company A held 5,000 shares in Company B. This was incorporated in the articles. Company A nominated two persons as directors and they were disapproved by Company B. Company B also made an attempt to alter the clause of articles which provided Company A the right of nomination. The court granted an injunction restraining Company B from making the said alteration on the ground that it would constitute a breach of contract with an outsider.

But later in case of **Chittambam Chettiar v. Krishan Aiyanger**, I.L.R. 30 Mad. 36, it was held that a company may alter its articles even if it causes breach of contract with the outsider. It has statutory power to do so. Where the contract with the outsider is wholly dependent on articles, alteration would be operative, and accordingly, the person accepting appointment purely on the terms of the articles takes the risk of those terms being altered, and will be bound by the altered article.

But the situation will be different if apart from the articles, there is an independent contract. In **Southern Foundries Ltd. v. Shirlaw**, 'S' was appointed Managing Director in a company for ten years by an agreement dated 21.12.1933. Subsequently, the company was amalgamated with another company and new articles were adopted. The latter gave power to the company to dismiss a director and accordingly S was removed from office as director and the company treated him as having ceased to be one. He sued the company for wrongful repudiation of the contract. It was held that dismissal was breach of contract and therefore the company was liable for damages.

- 12. Not to take Away Statutory Power to Alter:** The powers to alter articles of association is a statutory power and it cannot be taken away by any provision in the memorandum or articles. [**Walker v. London Tramways Co.**, (1879) 12 Ch. D. 705]

## 12.0 DISTINCTION BETWEEN MEMORANDUM AND ARTICLES OF ASSOCIATION

The Memorandum of Association differs from the Articles of Association in the following respects:

Basis of Distinction	Memorandum of Association	Articles of Association
<b>1. Contents</b>	It contains the fundamental conditions upon which alone the company is allowed to be incorporated.	It contains the internal rules and regulations relating to management of internal affairs.
<b>2. Fundamental/ Subordinate document</b>	It is a fundamental document.	It is subordinate to the Memorandum.

<b>3. Compulsory or optional</b>	Every company must have its own memorandum.	A public company limited by shares need not have its own Articles. It may adopt Table A as its articles.
<b>4. Relationship defined</b>	It defines the relationship between the company and outsiders.	It defines the relationship between the company and its members as members only and as members inter se.
<b>5. Alteration whether easy or difficult</b>	The memorandum cannot be so easily altered. The company has to follow the strict procedure for the alteration of its clauses. In some cases alteration requires the approval of the Company Law Board.	Articles can be easily altered by passing a special resolution.
<b>6. Binding Effect of ultra vires act</b>	An act which is beyond the powers given in the Memorandum is ultra vires and void and it cannot be ratified even by the unanimous consent of all the members.	An act which is intra vires the Memorandum but ultra vires the Articles may be ratified by shareholders by passing a special resolution.
<b>7. Outsider's Remedy in case of ultra vires contracts</b>	In case of the contracts ultra vires the memorandum, outsiders have no remedy against the company.	In case of contracts ultra vires the Articles, outsiders can enforce the contract against the company provided they had no knowledge of irregularity.

### 13.0 BINDING EFFECTS OF MEMORANDUM AND ARTICLES [SECTION 10]

Section 10 provides that the Memorandum and Articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member, and contained covenants on its and his part to observe all the provisions of the Memorandum and of the Articles. Thus, the Memorandum and Articles constitute a binding contract between the company and each of its members. The legal effects can be studied under the following headings:

- 1. Members Bound to the Company:** Since the Memorandum and Articles constitute a contract between the members and the company, the members are bound to the company by whatever is contained in these documents. Accordingly, the company is entitled to sue its members for enforcement of the articles and can restrain its

members through Court from violating any provisions contained therein.

In case of **Boreland's Trustee v. Steel Brothers and Co. Ltd**, [(1901) 1 Ch. 279], the Articles of the company provided that the shares of any member who became bankrupt would be sold to other persons at a price fixed by the directors. B, a shareholder became bankrupt and his trustee in bankruptcy claimed that he was not bound by the articles and could therefore, sell those shares at their true value. But it was held, that the trustee in bankruptcy was bound by the Articles as it constituted a binding contract between the members and the company.

Similarly in case of **Bradford Banking Company v. Briggs**, (1886) 12 A.C. 29, where the articles give the company a lien upon each share for debts due by shareholders to the company, and where a shareholder mortgages his shares and the mortgagee serves notice thereof upon the company, the mortgagee would have priority over the company, only if the shareholder had incurred a liability to the company after the notice of the mortgage was given to the company. If, on the other hand, the shareholder had incurred a liability before the notice of mortgage was given to the company, the company would have the priority.

2. **Company Bound to the Members:** Since the Memorandum and Articles constitute a contract between members and the company, the company is bound to its members by whatever is contained in these documents. Accordingly, the members are entitled to sue the company for enforcement of the Articles and can restrain the company through court from violating any provisions contained therein. Views differ on the questions as to whether and how far the memorandum and articles bind the company to the members. The views expressed in various judicial cases are given below:

- (a) "The company is bound to the extent that any member can sue it so as to prevent any breach of the article which is likely to affect his right as a member of the company". [**Hickman v. Kent Sheepbreeder's Association** (1885) 1 Ch. 88]

Thus, "An individual member can file a suit against the company to enforce his individual rights e.g. right to contest election for directorship of the company, right to get back his shares wrongfully forfeited, right to receive a share certificate, notice of general meetings etc." [**Pender v. Lushington** (1817) Ch. D. 70, **Nogaffa v. Madras Race Club**, AIR 1951 Mad. 83, **C.L. Joseph v. Los**, AIR 1965 (Ker.) 68]

- (b) "The member suing in cases sues not in the rights of a member but in his own right to protect from invasion of his own individual right as a member". [**Edwards v. Halliwell**, (1950) 2 All ER 1964 at p. 1067]
- (c) In case of **Johnson v. Lyttle Iren Agency**, (1877) 5 Ch. D. 687, a forfeiture of shares irregularly effected by a company was set aside at the instance of the aggrieved member as the company did not comply with the provisions of the Articles.
- (d) In case of **Wood v. Odessa Water Works**, 6 (1884) 42, Ch. D. 636, the articles empowered the company to declare a dividend to be paid to the shareholders

with the approval in the general meetings. A resolution was passed to pay the dividend by issue of debenture bonds and not in cash. At the instance of a member, the court grants an injunction restraining the director from acting on the resolution.

(e) Thus, the member can sue the company for the breach of the Articles in the following cases:

- (i) When the company does an *ultra vires* illegal act,
- (ii) For the enforcement of personal rights e.g. right to receive declared dividend,
- (iii) when majority plays fraud on minority, and
- (iv) for submitting the petition to Tribunal for its order for preventions of oppression and mismanagement under Sections 241 and 242.

3. **Between Members inter se:** Although there is no express agreement between the members of the company, yet articles regulate their rights inter se. Such rights can only be enforced by or against a member through the company or through the liquidator representing the company but no member has as between himself and another member any right beyond that which the contract with the company gives him [**Waltan v. Saffary (1897) A.C. 315**]. But the contrary view was taken in case of **Royfield v. Hands and others, (1852) 2. W.L.R. 851**. In this case, the articles provided that every member who intends to transfer his shares must inform the directors and directors must take the said shares equally between them at a fair value. The plaintiff informed the directors of his intention to transfer his shares. But the directors refused to take the shares and argued that the articles could not impose such obligation upon them in their capacity as directors. The court held that the directors were bound to take the shares since the articles imposed obligation upon them in their capacity as members and thus obligation was a personal one which could be enforced against them by other members directly without joining the company as a party.

It may also be noted that there is no privity of contract between the members, the articles constitute a contract between members only as regards matters arising out of the company relationship of members as members. They cannot regulate rights arising out of any other contracts in which other members have no interest. In case of **Khusi Ram v. Hanut Mal, (1949) 53, C.W.N. 305**, where a member had a commercial dispute of private nature with another member, an arbitration clause in the articles of the company was not allowed to be invoked.

4. **Between the Company and Outsider:** Since the memorandum and Articles do not constitute a contract between the company and outsider, an outsider is not entitled to sue the company for enforcement of the Articles even the articles provide certain rights to him. This is based on the general rule of law that a stranger to a contract can not sue.

The following case of **Eley v. Positive Government Life Assurance Co. Ltd., (1876) 1 Ex. D. 88** illustrates this point.

"The Articles of the company contained a provision that Eley would be the solicitor of the company for life and would not be removed from office except for

misconduct. Eley acted as solicitor to the company and also became a member of the company. The company, however, terminated his services. Thereupon, he sued the company of damages for breach of contract. Held, the Articles cannot be the basis of a contract between the company and an outsider. It would be noted here that he was trying to *Exercise his Right as an Employee and not as a Member. A Person can be a Member of the company and at the same time may be a creditor or employee of the company.* In the above case, he was trying to exercise his right as an employee of the company. There was no independent contract between the company and Eley apart from whatever was contained in the Articles. Therefore, his suit was dismissed.

Similarly in case of **Re Rotherham Alum & Co.**, (1883) 25 D. 103, where the articles provided for remuneration to be paid to the promoters, it was held that this clause did not give any right of action to promoters against the company.

It may also be noted that where articles are deemed to have formed a part of outsider's contract with the company, the outsider is entitled to maintain a suit on the basis of that contract. In case of **Re. New British Iron Co.**, (1898) 1 Ch. 324, where an individual entered into a contract with a company to serve as a director and the articles of the company required the director to have a share qualification and fixed his remuneration, it was held that director was entitled to recover his remuneration as fixed by the articles because the terms of articles were deemed to have formed a part of his contract with the company.

Though the articles and memorandum do not constitute a contract between the company and an outsider, still the outsider is entitled to assume that all the necessary formalities have been duly complied with in internal workings of the company. [**The Royal British Bank v. Turquand**]

#### 14.0 MEANING OF DOCTRINE OF CONSTRUCTIVE NOTICE

1. Since the Memorandum and Articles of Association on their registration with the Registrar become public documents and are available for public inspection in the Registrar's office on payment of prescribed fee, every person dealing with the company is presumed to have the knowledge of the contents of these documents and also to have understood them according to their proper meaning. [**Earnest v. Nicholls** (1857) 6 H.L.C. 401, **Griffith v. Poget**, (No. 2) (1877) 6 Ch. D. 517, **Oak Bank Oil v. Crum**, (1882) 8 A.C. 65]. This type of presumed knowledge of these documents is termed as 'Constructive Notice of Memorandum and Articles of Association.
2. Accordingly, if a person supplies goods to a company in which it cannot deal according to its objects clause, he will not be able to recover the price from the company. The supplier cannot in his defence take the plea that he did not have the knowledge of the contents of the memorandum of Association of the company. Thus, if a person enters into a contract which is *ultra vires* the company, he must do so at his peril.
3. The doctrine of constructive notice is not a positive one but a negative one like that of estoppel of which it forms part. It operates only against the person who has been

dealing with the company but not against the company itself. Consequently, he is prevented from alleging that he did not know that the constitution of the company rendered a particular act or particular delegation of authority *ultra vires*. Thus, **the doctrine of constructive notice protects the company and not the outsiders**. Thus, this doctrine is a 'Cloud' for the strangers.

#### **In case of Kotla Venakataswamy v C Rammurthi**

The articles of company require that all the documents and deeds of the company shall be signed by MD, the secretary and a working director of the company.

A mortgage deed was signed by the secretary and working director only.

It was held that the mortgage deed was invalid even though the plaintiff had acted in good faith and money was utilised for the benefit of the company.

### **14.0 PRINCIPLE OF OSTENSIBLE AUTHORITY**

A third party dealing with the company in good faith, assumes that the person who is dealing with him has the required authority to deal on behalf of the company. *For example* if a person is dealing with a director in a matter in which normally a director has power to act for the company, then that person can presume that latter has 'ostensible authority' or 'apparent authority on that matter on behalf of the company. Person dealing with the company is not under obligation to inquire that whether the person to whom which he is dealing really has the authority. In such cases, it is not material whether the person had actual knowledge of company's articles. Of course, the person concern should at least have 'ostensible authority' e.g. a purchase manager can be said to have ostensible authority to issue purchase orders, but he cannot have ostensible authority to sign cheques on behalf of the company.

#### **Notes:**

- (i) The director repaid their personal loan through the company's account by using company cheques. The lender knew from the cheques that the amount is from company account and not from his personal account. In this case the act of director are *ultra vires*. A director cannot be presumed to have ostensible authority to repay his personal loan from company account. Hence, lender is liable to repay the amount to the company.
- (ii) A director has no ostensible authority to institute a suit on behalf of the company. Such authority has to be specifically conferred by a resolution [**Indian Commerce v. Swadharma Swarajya Sangha** (1998)].
- (iii) Filing of suit cannot be done without specific authority [**BOC India Ltd v. Zinc Products** (1997)].
- (iv) Suit filed by the secretary under general power of attorney, later ratified by Board is valid [**Turner Marrison & Co. v. Hunger Ford Investment**, 42 Comp Cas 512 (SC) 85 ITR 607, AIR 1972 SC 1311].



## 15.0 DOCTRINE OF INDOOR MANAGEMENT

### MEANING OF DOCTRINE OF INDOOR MANAGEMENT

The doctrine of indoor management is an **exception to the doctrine of constructive notice**. This doctrine protects the outsiders against the company by entitling them to assume that the provision of the Articles of Association have been duly complied with by the company in its internal working. This doctrine is based on the principles of justice and public convenience. In case of ***Pacific Cost Mines Ltd. v. Arkuthnd***, (1971) A.C. 607, the Court held "An outsider is presumed to know the constitution of a company but not what may or may not have taken place within the doors that are closed to him." Therefore, if the contract is within the powers of the company, then company will be bound to the outsider and will not be allowed to escape liability by showing that there was some irregularity in following procedure. This is known as the Doctrine of Indoor Management or ***Rule in Royal British Bank v. Turquand***, (1856) 6 E & B 327. The facts of this case are as follows:

The directors of a company were authorised by the articles to borrow on bond such sums of money, as authorised from time to time, by a resolution of the company, in General Meeting. The directors borrowed money from Turquand without any resolution of the company and issued a bond to him. **Decision**, the Court held that Turquand could sue the company on the bond, as he was entitled to assume that the resolution of the company in General Meeting authorising the directors to borrow money on the basis of bond had been passed.

### CONDITIONS FOR AVAILABILITY OF THE BENEFIT OF DOCTRINE OF INDOOR MANAGEMENT

1. The person dealing with the company must have the knowledge of the Memorandum and Articles
2. The person dealing with the company must not have knowledge of irregularity.
3. The person dealing with the company must not be put upon an enquiry
4. There must be some procedural or internal irregularity.
5. There must not be any ultra vires act or illegality.

### EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT

The doctrine of indoor management is subject to the following limitations:

1. **Knowledge of Irregularity:** Where the person dealing with the company has knowledge of an internal irregularity, he cannot claim protection provided by this doctrine. The knowledge of irregularity may be actual or constructive. In the case of ***Howard v. Pokent Ivory Co.*** the directors were empowered to borrow money upto £1,000 and sanction of the shareholders was required for an amount in excess of this. The directors themselves lent £ 3500 to the company without the consent of the shareholders. It was held that the directors had the notice of the internal irregularity and therefore the company was liable to them only for £1,000.
2. **Suspicion of Irregularity:** Where the person dealing with the company is put upon



an enquiry, he cannot claim protection under this doctrine in the circumstances under which he would have discovered irregularity if he had made the proper enquiries. In case of ***Underwood v. Bank of Liverpool***, (1924) I.K.B. 775, the sole director paid a cheque drawn in company's name, into his own bank account. It was held that the bank was put upon inquiry and was not entitled to rely upon the ostensible authority of the director. Likewise, a person dealing with the company may be put upon enquiry by reason of the unusual magnitude of the transactions having regard to the position of the agent who is acting for the company. [***Houghton & Co. v. Nothard Howe & Wills***, [(1917) I.K.B. 147, 149]

3. **Forgery:** A person dealing with the company cannot claim protection under this doctrine where forgery is involved. A company can not be held liable for forgeries committed by its officers.

In case of ***Rubben v. Great Fingal Consolidated***, (1906) A.C. 439, the secretary of the company issued a share certificate in favour of Rubben by forging the signatures of two directors under the seal of the company. 'R' wanted to be registered as a member but the company refused to register him as a member. 'R' contended that since signatures were part of internal management and he had no means to ascertain the genuineness of the signatures, therefore he should be protected. The court held that the share certificate is not binding on the company since the **doctrine of indoor management applies to irregularities and not illegalities (i.e. forgery)**.

4. **No Knowledge of Articles:** Where the person dealing with the company has no knowledge of articles, he can not claim protection under this doctrine since this doctrine is based on the principle of estoppel and the person who did the act without consulting the Articles, can not be said to have relied upon the articles.

The company's articles contained a clause 'the directors may delegate any of their powers other than the power to borrow and make calls to committee consisting of such members of their body as they think fit. One 'T', an active director of the company entered into a contract with '*Rama Corporation*' under which he took a cheque from 'Rama Corp.' In fact, 'Rama Corp. had not inspected the defendant's articles, therefore he did not know of the existence of delegate authority.

It was held that defendant company was not bound by the agreement since the power was never delegated to 'T'.

In the opinion of Justice Slade, J. 'the knowledge of article is essential because the rule of 'Indoor management' is based upon the principle of estoppel. He observed, "A person who at the time of entering into a contract with a company, has the knowledge of the company's Articles of Association, cannot rely on those articles as conferring ostensible of apparent authority on the agent of the company with whom he dealt"

5. **Acts Beyond Apparent Authority:** Where an officer of the company does something, which would not ordinarily be within his powers, the person dealing with him must make proper inquiries and satisfy himself as to the officer's authority. If he fails to make proper inquiry in spite of suspicious circumstances, he cannot claim

any protection under the doctrine of indoor management.

In case of **Anand Bihari Lal v. Dinshaw & Co.**, AIR (1942), the accountant of the company transferred some property of the company to the plaintiff. The transfer was held by the Court to be void, because the power to transfer property could not be considered within the apparent authority of the accountant. The plaintiff were put upon an enquiry before entering into the transaction as they should have insisted on seeing the power of attorney executed in favour of the accountant. Even a delegation clause in the Articles is not enough to validate the transaction unless the accountant was in fact authorised.

Similarly in case of **Kredit Bank Case v. Scchenkers**, (1927) K.B. 826, where a branch manager of a bank drew and endorsed bills on behalf of his company without any authority, it was held that drawing of bills was not within the ordinary ambit of power of this branch manager and company was not bound unless such authority was in fact delegated to him.

### VERY SHORT ANSWER TYPE QUESTIONS

1. What is 'Memorandum of Association'?
2. What is 'Name Clause'?
3. (a) What is 'Registered office clause'?  
(b) Is it essential to mention the name of the city of the state in which registered office is likely to be situated?
4. What is 'Objects clause'?
5. What is liability clause? Name the company in which this clause is not required.
6. (a) What is capital clause?  
(b) Name the company in which case the capital clause is not required.  
(c) Is it essential to mention the division of authorised capital into different classes of shares and rights of various clauses of shareholders?
7. What is meant by 'Doctrine of Ultra Vires'?
8. What is 'Articles of Association'?
9. Is it necessary for every company to have its own articles?
10. What is 'Doctrine of constructive notice'?
11. What is 'Doctrine of Indoor Management'?
12. Name the doctrine which protects company.
13. Name the doctrine which protects outsiders.
14. Name the exception to the doctrine of constructive notice.
15. Enumerate the exceptions to the doctrine of constructive notice.
16. Can articles be altered to deprive a company of its powers to amend articles?

### SHORT ANSWER TYPE QUESTIONS

1. State the purpose of Memorandum of Association.
2. State the form in which the Memorandum of Association must be prepared.
3. State the provisions relating to printing and signature of Memorandum.
4. State the contents of Memorandum.
5. State the legal requirements as to the name clause.
6. State the legal requirements as to the registered office clause.
7. (a) State the legal requirements as to the objects clause.  
(b) Also state the importance of object clause.
8. State the legal requirements as to the liability clause.
9. State the legal requirements as to the capital clause.
11. Comment on the following:
  - (a) The memorandum is a charter of the company.
  - (b) The memorandum of a company defines as well as confines its objects.
  - (c) A company's object clause is of fundamental importance not only to members but also to non-members.
  - (d) Act *ultra vires* the company can be made binding upon the company by a unanimous vote of all the members of the company.
  - (e) The doctrine of *ultra vires* is illusory protection to the shareholders and pitfall for third parties.
  - (f) Alteration of Memorandum invariably involves passing of a special resolution.
  - (g) Each company must have capital clause in its Memorandum.
  - (h) A firm can never be a member of a company.
  - (i) The authorised capital must be stated in Articles of Association
  - (k) A firm can not be a signatory to Memorandum of Association.
12. State the form in which Articles of a company must be prepared.
13. State the provision relating to printing and signature of Article.
14. State any ten contents of Articles.
15. State the specific regulation required in the Articles of:
  - (a) an unlimited company,
  - (b) company limited by guarantee but not having share capital,
  - (c) company limited by guarantee and having share capital,
  - (d) private company having share capital, and
  - (e) private company having no share capital.
16. Comment on the following:
  - (a) The Articles are subordinate to and are controlled by the Memorandum of Association.

- (b) Articles constitute a contract between the member *inter se* and between the company and the members *qua* members.
- (c) Every person dealing with the company is deemed to have notice of the contents of its memorandum.
- (d) Doctrine of Indoor Management is an exception to the doctrine of constructive notice.
- (e) Power to alter the Articles conferred by the Companies Act is very wide yet it is subject to a large number of limitations.
- (f) The doctrine of indoor management in silver lining to strangers dealing with the company.
- (g) A company having its own Articles can adopt Table F.

### LONG ANSWER TYPE QUESTIONS

1. Discuss the meaning, importance and contents of Memorandum of Association.
2. Why is it necessary to have registered office?
3. (a) What is 'Doctrine of Ultra Vires'?
- (b) Explain the validity of acts *ultra vires* (i) the Company (ii) Directors (iii) Articles
- (c) Explain the effects of *ultra vires* transaction.
- (d) Describe the liability of a company and its agents for *ultra vires* acts.
4. 'The doctrine of *ultra vires* is an illusory protection to the shareholders and pitfall to outsiders'. Comment.
5. Explain the importance of Registered Office Clause and Objects Clause.
6. Distinguish between Memorandum and Articles of Association.
7. Discuss the binding effects of memorandum and Articles of Association.
8. (a) Explain the doctrine of constructive notice.
- (b) Explain the doctrine of indoor management and its exceptions.
9. Outline the *Turquand Rule* or *Rule in Royal British Bank v. Turquand*. Are there any exceptions to this rule? If yes, discuss them also.
10. What is the legal effect of the Articles between—
  - (a) Members and the company,
  - (b) Members *inter se*, and
  - (c) Company and outsiders.
11. Explain the procedure for the alteration of Articles of Association. Discuss the limits on the powers of a company to alter its Articles.



# Shares and Share Capital

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## 1.0 MEANING OF A SHARE [SEC. 2(84)]

1. A 'Share' is smallest unit into which the capital of the company is divided.
2. Section 2(84) of the Companies Act, 2013 defines a share as "a share in the share capital of a company, and includes stock except where a distinction between stock and share is expressed or implied".

For example, where a company has a share capital of Rs 1,00,000 divided into 10,000 units of Rs 10 each, then each unit of Rs 10 is called a share of Rs 10 each and a person who has taken 10 shares of that company is said to have share in the share capital of the company to the extent of Rs 100.

3. A share represents such proportion of the interest of the shareholders as the amount paid up thereon bears to the total capital payable to the company.
4. A share may be partly paid up or fully paid up.
5. A share is a measure of the interest in the company's assets to which a person holding a share is entitled.

## 2.0 NATURE OF A SHARE

1. A Share is not a sum of money but is an interest measured by a sum of money and made up of various rights contained in the contract [Borland Trustees v. Steel Bros. & Co Ltd.].
2. The shares [or debentures] or other interest of any member in a company are the movable properties, transferable in the manner provided by the articles of the company. [Section 44]

### Notes:

- (i) A shareholder has not only contractual rights against the company but also certain other rights which accrue to him according to the provisions of the Companies Act.
- (ii) The shareholders even in a group are not, in the eyes of law, part owners of the undertaking. The undertaking is somewhat different from the totality of the shareholders.

## 3.0 NUMBERING OF SHARES [SECTION 45]

Each share (Except the shares held with a depository) in a company having a share capital must be distinguished by its appropriate number.

#### 4.0 KINDS OF SHARE CAPITAL [SECTION 43]

The share capital of a company limited by shares shall be of two kinds only namely:

- (a) Equity share capital—
  - (i) with voting rights, or
  - (ii) with differential rights as to dividend, voting, or otherwise in accordance with such rules and subject to such conditions as may be prescribed.

**Example:** In 2008 Tata Motors introduced equity shares with differential voting rights (popularly called DVRs) in its rights issue. In the issue, every 10 'A' equity shares carried only one voting right but would get 5% points more dividend than that declared on each of the ordinary shares. Since 'A' equity share did not carry the similar voting rights, it was being traded at discount to other common shares having full voting. Other companies which have issued equity shares with differential voting rights (popularly called DVRs) are Future Retail, Jain Irrigation among others

- (b) Preference Share Capital.

#### 5.0 MEANING OF AN EQUITY SHARE [EXPLANATION (I) TO SEC 43]

1. An equity share is a share which is not a preference share. In other words, it is a share which does not carry two preferential rights (viz., right to receive dividend and right to receive repayment of capital) attached to a preference share.
2. The capital raised through equity shares is called equity share capital.
3. The persons who contribute money through equity shares are called equity shareholders.

#### MAIN FEATURES OF EQUITY SHARES

1. Payment of equity dividend is made after the payment of preference dividend.
2. Repayment of equity share capital is made after the repayment of preference share capital in the event of winding up of the company.
3. The equity shareholders generally enjoy voting rights. They have right to elect directors and to participate in the management.

**Note:** As per Sec 43, the company can issue equity shares with differential voting rights.

4. The rate of equity dividend is not fixed and may vary from year to year depending upon the profits available and the decision of directors (at board meeting) and members (at annual general meeting).
5. The equity share capital is generally not redeemable during the life of the company unless the company decides to buy back its shares.
6. Equity shareholders enjoy various rights as members

## 6.0 MEANING OF A PREFERENCE SHARE [EXPLANATION (II) TO SEC 43]

A preference share is one which carries the following two preferential rights:

1. a right to receive dividend at a stipulated rate or of a fixed amount before any dividend is paid on equity shares; and
2. a right to receive repayment of capital on winding up of the company, before the capital of equity shareholders is returned.

## 7.0 KINDS OF PREFERENCE SHARES

In addition to the aforesaid two preferential rights, a preference share may carry some other rights. On the basis of additional rights, preference shares can be classified into seven types as under:

1. **Participating Preference Share** is that share which, in addition to two basic preferential rights, also carries one or more of the following rights as per the articles of association:
  - (i) a right to participate in the surplus profits left after paying dividend to equity shareholders; and
  - (ii) a right to participate in the surplus assets left after the repayment of capital to equity shareholders on the winding up of the company.

**Note:** The right to participate in the surplus profits does not automatically entitle the preference shareholders to participate in the surplus assets on the winding up of the company. [Re. *Isle of Thanet Electric Supply Co.*, (1949) 2 All. E.R. 1060]

2. **Non-participating Preference Share** is the share which is not a participating share. Unless stated otherwise, a preference share is always deemed to be a non-participating preference share.
3. **Redeemable Preference Share** is the share which is redeemable in accordance with the provisions of Section 55. Paying back of capital is called the redemption. Now, a company limited by shares may issue preference shares which are redeemable within a period of 20 years from the date of their issue.
4. **Irredeemable Preference Share** is the share which is not redeemable during the life time of the company. Now, no company limited by shares can issue any irredeemable preference share [Section 55 (1)] .
5. **Cumulative Preference Share** is the share on which arrears of dividend accumulate. Unless stated otherwise in Articles or Terms of Issue, a preference share is always deemed to be a cumulative share. They carry the right to cumulative dividends if the company fails to pay the dividend in a particular year. The accumulated arrears of dividends shall be paid, if any dividend is declared in subsequent years, before any dividend is paid to the equity shareholders. If the company goes into liquidation, no arrears of dividends are payable unless either the Articles contain an express provision to this effect or such dividends have been declared. Of course the arrears of undeclared dividends shall be payable, even if the Articles are silent, out of any surplus left, after returning in full the preference and equity share capital.

6. **Non-cumulative Preference Share** is the share on which, arrears of dividends do not accumulate as per the express provision in the Articles of Association. If no dividend is paid in any particular year, it lapses.
7. **Convertible Preference Share** is the share which confers on its holder a right of conversion into equity share.
8. **Non-convertible Preference Share** is the share which does not confer on its holder a right of conversion into equity share. Unless stated otherwise, a preference share is always deemed to be a non-convertible share.
9. **Cumulative Convertible Preference Shares (CCP)** These shares were introduced in 1985. The objects of the issue of such shares should be for setting up new projects, expansion or diversification of existing projects, capital expenditure for modernisation and working capital requirements. The amount of issue of CCP shares will be to the extent the company would be offering equity shares to the public for subscription. These shares are deemed to be equity issue for the purpose of calculating debt-equity ratio. The entire issue would be convertible into equity shares between the end of 3 years and 5 years. The rate of dividend payable on CCP would be 100 per cent. The face value of these shares will ordinarily be Rs 100 each, and the holders are entitled to receive arrears of dividend, if any, even after conversion.

**Important Note:** Unless stated otherwise, a preference share is always deemed to be: (a) a cumulative share, (b) a non-participating share, (c) a non-convertible share

## 8.0 DISTINCTION BETWEEN AN EQUITY SHARE AND PREFERENCE SHARE

An Equity Share and Preference Share can be distinguished as follows:—

Basis of Distinction	An Equity Share	A Preference Share
1. <b>Preferential right as to the payment of dividend</b>	Payment of equity dividend is made <b>after</b> the payment of preference dividend.	Payment of preference dividend is made <b>before</b> the payment of equity dividend.
2. <b>Preferential right as to the repayment of capital</b>	Repayment of Equity share capital is made <b>after</b> the repayment of preference share capital.	Repayment of preference share capital is made <b>before</b> the repayment of equity share capital.
3. <b>Fluctuations in the rate of dividend</b>	The rate of equity dividend <b>may vary</b> from year to year depending upon the decision of directors and members.	The rate of preference dividend is <b>fixed</b> .
4. <b>Arrears of dividend</b>	In case of an equity share, arrears of dividend <b>cannot accumulate</b> in any case.	In case of a preference share, arrears of dividend may <b>accumulate</b> .
5. <b>Convertibility</b>	It <b>cannot</b> be convertible.	It <b>may be</b> convertible.



<b>6. Voting Rights</b>	Equity shareholders generally <b>enjoy</b> voting rights.	Preference shareholders <b>do not have</b> any voting rights <b>except at their class meetings</b> .
<b>7. Redeemability</b>	It is <b>not redeemable</b> during the life time of the company <b>unless</b> the company decides to <b>buyback</b> the shares.	It is <b>redeemable</b> during the life time of the company.

## 9.0 STOCK

### MEANING OF STOCK

“Stock” is an aggregate of fully paid shares which have been legally consolidated. The consolidated amount is divisible into fractions of any amount, regardless of the nominal value of the shares that have been consolidated. It thus represents a part of the fully paid capital of the company.

### CONDITIONS FOR CONVERSION OF SHARE INTO STOCK [SEC. 61(1)(C)]

1. A company must be limited by shares.
2. Articles must authorise the conversion of share into stock.
3. Ordinary resolution must be passed in a general meeting,
4. Shares must be fully paid up.
5. The notice of conversion must be given to the Registrar .

**Note:** All the provisions which are applicable to shares only, shall cease to apply as to so much of share capital as is converted into stock.

### ADVANTAGE OF STOCK

The main advantage claimed for stock is that it is transferable in any denomination which is not merely limited to the nominal value of the shares converted into a stock. However, this advantage may be limited by making such regulation in the Articles as contained in the proviso to Regulation 37 of Table F. Proviso to Regulation 37 runs as under: “Provided the Board may from time to time fix the minimum amount of stock transferable so however that such minimum shall not exceed the nominal amount of the shares for which the stock arose.”

### DISTINCTION BETWEEN STOCK AND SHARE

The difference between a share and stock may be noted as follows:

Basis of Distinction	Share	Stock
<b>1. Meaning</b>	Share represents the smallest unit into which the capital of the company is divided.	Stock represents aggregate of fully paid up shares of a member merged into one fund.

<b>2. Fully paid or partly paid</b>	Shares may be fully paid up or partly paid up.	Stock must be fully paid up.
<b>3. Transfer in fraction</b>	Shares transferable only in its entirety.	Stock is transferable in fraction also.
<b>4. Direct Issue</b>	Shares can be directly issued.	Stock cannot be issued directly. Stock comes into existence as a result of conversion of fully paid up shares.
<b>5. Serial No.</b>	Shares are serially numbered.	Stock is not serially numbered.
<b>6. Article's Authorisation</b>	Not Required	Required

## 10.0 SHARE CAPITAL

### MEANING OF SHARE CAPITAL

Share Capital means the capital raised by the issue of shares. The amounts invested by the shareholders towards the face value of shares are collectively known as 'Share Capital' which is quite distinct from the capital put in by individual shareholders.

### CLASSIFICATION OF SHARE CAPITAL UNDER THE COMPANIES ACT

- 1. Authorised Capital:** An Authorised Capital refers to that capital which is authorised by the Memorandum of Association to be the maximum amount of share capital of the company. This is the maximum limit of the company which it is authorised to raise and beyond which the company cannot raise unless the capital clause in the Memorandum is changed.[Sec 2(8)]
- 2. Issued Capital:** An Issued Capital refers to the nominal value of that part of authorised capital, which the company issues from time to time for subscription [Sec 2(50)].
- 3. Subscribed Capital:** Subscribed Capital refers to the capital which has been subscribed by the members of a company [Sec 2(86)].
- 4. Called- up Capital:** "Called-up capital" means such part of the capital, which has been called for payment; [Sec 2(15)].
- 5. Paid-up Capital:** "Paid-up share capital" or "share capital paid-up" means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called [Sec 2(64)].

### ILLUSTRATION

Calculate (a) Authorised Capital (b) Issued Capital (c) Unissued Capital (d) Subscribed Capital, (e) Called-up capital, (f) Uncalled Capital (g) Paid-up Capital in each of the following alternative cases:

- Case (i)** X Ltd. was formed with a capital of ₹ 10,00,000 divided into shares of ₹ 10 each. X offered the entire shares and called up fully on application. The subscribers paid ₹ 10,00,000.
- Case (ii)** X Ltd. was formed with a capital of ₹ 10,00,000 divided into shares of ₹ 10 each. It offered 90% shares and called up fully on application. The subscribers paid ₹ 9,00,000.
- Case (iii)** X Ltd. was formed with a capital of ₹ 10,00,000 divided into shares of ₹ 10 each. It offered 90% shares and called up fully on application. The subscribers paid ₹ 8,10,000.
- Case (iv)** X Ltd. was formed with a capital of ₹ 10,00,000 divided into shares of ₹ 10 each. It offered 90% shares and called up 60% on application. The subscribers paid ₹ 4,86,000.

**Solution:**

### CALCULATION OF VARIOUS TYPES OF CAPITAL

Type of Capital	Case (i) (₹)	Case (ii) (₹)	Case (iii) (₹)	Case (iv) (₹)
A. Authorised Capital	10,00,000	10,00,000	10,00,000	10,00,000
B. Issued Capital	10,00,000	9,00,000	9,00,000	9,00,000
C. Unissued Capital [A – B]	NIL	1,00,000	1,00,000	1,00,000
D. Subscribed Capital	10,00,000	9,00,000	8,10,000	4,86,000
E. Called-up Capital	10,00,000	9,00,000	8,10,000	4,86,000
F. Uncalled Capital	NIL	NIL	NIL	3,24,000
G. Paid-up Capital	10,00,000	9,00,000	8,10,000	4,86,000

### DISTINCTION BETWEEN AUTHORISED CAPITAL AND ISSUED CAPITAL

Authorised Capital and Issued Capital can be distinguished as follows:

Basis of Distinction	Authorised Capital	Issued Capital
<b>1. Meaning</b>	It refers to that amount which is stated in the Memorandum of Association as the share capital of the company.	It refers to the nominal value of that part of authorised capital which has been (i) subscribed for by the signatories to the Memorandum of Association and (ii) allotted for cash or consideration other than cash.

<b>2. Consideration of future requirements</b>	Its amount is determined after considering <b>present and future requirements</b> .	Its amount is determined after considering the <b>present requirements</b> .
<b>3. Disclosure in Memorandum of Association</b>	Its amount is <b>required</b> to be disclosed in Memorandum of Association.	Its amount is <b>not required</b> to be disclosed in the Memorandum of Association.
<b>4. Is it the basis of Stamp Duty?</b>	Stamp Duty is payable on the basis of <b>authorised capital</b> .	It is <b>not the basis</b> for calculating <b>stamp duty</b> .
<b>5. Is it the basis of Company registration fees?</b>	Company registration fee is payable on the <b>basis</b> of authorised capital.	Issued capital is <b>not the basis</b> for registration fees.
<b>6. Does the change amount to an alteration of Memorandum?</b>	Any change in the amount of authorised capital <b>amounts</b> to an alteration of Memorandum of Association.	Any change in the amount of issued capital <b>does not amount</b> to an alteration of Memorandum of Association.
<b>7. Whether one can exceed other</b>	It <b>can exceed</b> issued capital.	It <b>cannot exceed</b> authorised capital.

### DISTINCTION BETWEEN RESERVE CAPITAL AND CAPITAL RESERVE

Reserve Capital should not be confused with Capital Reserve which is created out of profits. Reserve Capital and Capital Reserve can be distinguished as follows:

<b>Basis of Distinction</b>	<b>Reserve Capital</b>	<b>Capital Reserve</b>
<b>1. Meaning</b>	It refers to those portion of uncalled share capital which shall not be capable of being called up except in the event and for the purpose of the company being wound up. (Sec. 65)	It refers to those amounts which are not regarded as free for distribution by way of divided through Profit and Loss Account.
<b>2. Mandatory or Not</b>	It is <b>not mandatory</b> to create Reserve Capital.	It is <b>mandatory</b> to create Capital Reserve in case of profit on forfeited shares.
<b>3. Disclosure in Balance Sheet</b>	It is <b>not disclosed</b> in the company's Balance Sheet.	It is required to be <b>disclosed</b> as the 1st item under the head 'Reserves and Surplus' on the liabilities side of the Balance Sheet.
<b>4. Time when it can be used</b>	It can be used during <b>only at the time of winding up</b> .	It can be used <b>during the life of the company</b> .

<b>5. Realised vs. Unrealised</b>	It refers to the amount which has neither <b>been called up</b> nor <b>been received</b> .	It (excluding items like revaluation profit) refers to that amount which has already been <b>realised</b> .
<b>6. Can it be used to write off capital losses?</b>	It <b>cannot be used</b> to write off capital losses.	It <b>can be used</b> to write off capital losses.
<b>7. Can it be used to declare share bonus?</b>	It <b>cannot be used</b> to declare a share bonus.	It (excluding items like revaluation profit) <b>can be used</b> to declare a share bonus.

### VERY SHORT ANSWER TYPE QUESTIONS

1. What is meant by 'Share Capital'?
2. What is meant by 'Authorised Capital'?
3. What is meant by 'Issued Capital'?
4. What is meant by 'Subscribed Capital'?
5. What is meant by 'Unissued Capital'?
6. What is meant by 'Uncalled Capital'?
7. What is meant by 'Reserve Capital'?
8. What is meant by 'Share'?
9. What is meant by 'Stock'?
10. What is meant by 'Equity Share'?
11. What is meant by 'Preference Shares'?
12. What is meant by 'Cumulative Preference Shares'?
13. What is meant by 'Non-cumulative Preference Shares'?
14. What is meant by 'Participating Preference Shares'?
15. What is meant by 'Non-Participating Preference Shares'?
16. What is meant by 'Convertible Preference Shares'?
17. What is meant by 'Non-convertible Preference Shares'?
18. What is meant by 'Cumulative Convertible Preference Share'?

### SHORT ANSWER TYPE QUESTIONS

1. Distinguish between the following:
  - (a) Reserve Capital and Capital Reserve
  - (b) Authorised Capital and Issued Capital
  - (c) Share and Stock
  - (d) An Equity Share and a Preference Share

2. State the nature of a share.
3. State the advantage of stock.
4. State the kinds of shares.

### **LONG ANSWER TYPE QUESTIONS**

1. Describe the various kinds of preference shares.
2. Describe the various kinds of Share Capital.



# Revision One Day before Examination

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## 1.0 ESSENTIALS OF A CONTRACT

- 1.1. Voidable contract is enforceable by law at the option of one or more of the parties but not at the option of the other party and remains enforceable by law if the aggrieved party does not repudiate the contract.
- 1.2. Void contract is one which was valid when entered into but which subsequently becomes void due to impossibility of performance due to change of law or any other reason.
- 1.3. Void Agreement is an agreement not enforceable by law and collateral agreements do not become void.
- 1.4. Illegal Agreement is an agreement the object or consideration of which is unlawful. Collateral agreements also become void.

## 2.0 OFFER AND ACCEPTANCE

- 2.1. A bid at an auction is an offer.
- 2.2. A notice that the goods stated in the notice will be sold by tender is mere statement of intention and not an offer to sell.
- 2.3. Display of goods with price tags in BIG BAZAR is an invitation to offer.
- 2.4. A prospectus issued for subscription of shares is an invitation to offer.
- 2.5. An advertisement inviting tender to supply specific quantity of certain goods during a specific period is an invitation to offer.
- 2.6. Cross offers do not amount to acceptance of one's offer by the other.
- 2.7. A counter offer amounts to rejection of original offer.
- 2.8. Standing offer is same as tender.
- 2.9. An offer made to a definite person or particular group of person can be accepted by that person/ group to whom the offer has been made.
- 2.10. The specific terms and conditions must be reasonable and must be brought to the knowledge of the offeree before the contract is concluded and not afterwards.
- 2.11. Death or insanity of the proposer revokes the proposal if the fact of death or insanity comes to the knowledge of the acceptor before he makes his acceptance.
- 2.12. The offer must not contain a term the non-compliance of which would amount to acceptance.
- 2.13. Acceptance must be communicated in the prescribed manner by the offeree himself

or an authorised person to the offerer within prescribed time before the lapse or withdrawal of offer.

### **3.0 CAPACITY OF PARTIES**

- 3.1. A person who is usually of unsound mind but occasionally of sound mind can make a valid contract when he is of sound mind.
- 3.2. An agreement with a minor cannot be ratified even after he attains majority.
- 3.3. A minor can not become a principle.
- 3.4. A claim for the payment of necessities supplied can be made against the minor's property.

### **4.0 CONSIDERATION**

- 4.1. Consideration must be given at the desire of the promisor.
- 4.2. Consideration may move from any person.
- 4.3. Consideration need not be adequate.
- 4.4. Consideration must be something other than the promisor's existing obligation.
- 4.5. A stranger to contract can not sue.
- 4.6. A stranger to consideration can sue.
- 4.7. Completed Gifts and Agency need no consideration.
- 4.8. A written promise to pay time barred debt is a valid contract.

### **5.0 FREE CONSENT**

- 5.1. An agreement without any consent is void-ab-initio.
- 5.2. A threat to commit suicide amounts to coercion.
- 5.3. An agreement with consent caused by coercion/under influence/fraud/misrepresentation/mistake is voidable at the option of aggrieved party.
- 5.4. A threat to file a suit (whether civil or criminal) does not amount to coercion unless the suit is on false charge.
- 5.5. Coercion involves physical pressure but undue influence involves moral pressure.
- 5.6. Fraud involves false representation made wilfully but Misrepresentation involves false representation made innocently.
- 5.7. The aggrieved party can claim damages under fraud and not under misrepresentation.
- 5.8. Silence amounts to fraud where parties stand in fiduciary relationship like parent-child and where the silence itself is equivalent to speech.
- 5.9. The agreement is void if both the parties are under mistake as to essential fact.
- 5.10. The contract is not voidable if both the parties are under a mistake as to Indian Law.
- 5.11. The contract is void if both the parties are under a mistake as to Foreign Law.
- 5.12. The agreement is voidable if one of the parties is under mistake as to the identity of the person contracted with.



**6.0 AGREEMENTS OPPOSED TO PUBLIC POLICY**

- 6.1. Agreement in Restraint of Parental Rights is An Agreement Opposed to Public Policy.
- 6.2. Agreement in Restraint of any lawful trade, profession or business to that extent is An Agreement Opposed to Public Policy.
- 6.3. Agreement in Restraint of Legal Proceeding is An Agreement Opposed to Public Policy.
- 6.4. Agreement in Restraint of Marriage of a Minor is not An Agreement Opposed to Public Policy.

**7.0 VOID AGREEMENTS AND CONTINGENT CONTRACTS**

- 7.1. Prize competition in games of skill if prize money does not exceed Rs. 1,000 is not wagering agreement.
- 7.2. Wagering agreement and transaction collateral to wagering agreement are illegal in the States of Maharastra and Gujrat.
- 7.3. An agreement to contribute to a plate or prize of the value of above Rs. 500 to be awarded to the winner of a horse race is not a wagering agreement.
- 7.4. Contracts of Insurance are not wagering agreements.
- 7.5. Contingent Contract is Valid.
- 7.6. Uncertain Agreement is not Valid.
- 7.7. Wagering Agreement is not Valid.
- 7.8. Contingent Agreement based on Impossible Event is not Valid.
- 7.9. Agreement to do an Impossible Act is not Valid.

**8.0 PERFORMANCE OF A CONTRACT**

- 8.1. Where the promisor offers to deliver the goods or services but the promisee refuses to accept the delivery, promisor is discharged from his liability.
- 8.2. Where the promisor offers to pay the amount but the promisee refuses to accept the same, the promisor is not discharged from his liability to pay the amount.
- 8.3. A contract must be performed by a promisor or promisor's agent, legal representatives or third party.
- 8.4. A valid tender (attempted performance) must be unconditional and for whole obligation at proper time, proper place and to proper person.
- 8.5. Promisee, Legal Representative of Promisee, Third party and Joint Promisor may demand performance.
- 8.6. Payment by a debtor can be appropriated by creditor as to any lawful debt due even if it is a time barred debt where debtor does not intimate anything.
- 8.7. Payment by a debtor is always appropriated in a chronological order.
- 8.8. Payment by a debtor cannot be appropriated by creditor to disputed debt.

## **9.0 DISCHARGE OF A CONTRACT**

- 9.1. Substitution of a new contract for the original contract the same or different parties on the same or different terms is 'Novation'.
- 9.2. Cancellation of the contract by any party or all the parties to a contract is 'Rescission'.
- 9.3. Change in the terms of a contract with mutual consent of same parties and not different parties is 'Alteration'.
- 9.4. Acceptance by the promisee of a lesser fulfilment of the promise made is called 'Remission'.
- 9.5. Intentional Relinquishment of a right under the contract is 'Waiver'.
- 9.6. Right to recover a debt lapses after 3 years as per Law of Limitation Act.
- 9.7. Where both the promisor and promisee knew about the initial impossibility, such agreement is void-ab-initio.
- 9.8. Where both the promisor and promisee did not know about the initial impossibility, such agreement is void.
- 9.9. Commercial Impossibility/Difficulty of performance is not a valid excuse for non-performance of a contract.

## **10.0 REMEDIES FOR BREACH OF A CONTRACT**

- 10.1. In case of anticipatory breach, the aggrieved party can either rescind the contract immediately or treat the contract as operative and wait till due date of performance.
- 10.2. In case of anticipatory breach, if the aggrieved party rescinds the contract immediately without waiting until the due date for performance, the amount of ordinary damages will be = Market Price on date of breach minus the Contract Price.
- 10.3. In case of anticipatory breach, if the aggrieved party treats the contract as operative and wait till the due date for performance, the amount of ordinary damages will be = Market Price on due date of performance minus the Contract Price.
- 10.4. Special Damages can be recovered, if the special circumstances which would result in a special loss in case of breach of a contract are communicated to the promisor.
- 10.5. In case of wrongful dishonour of a cheque of any trader, Exemplary Damages are larger if the amount of cheque is smaller.

## **11.0 QUASI-CONTRACTS**

- 11.1. A Quasi-contract is an obligation imposed by law upon a person for the benefit of another even in the absence of a contract.
- 11.2. The claim of Quantum Meruit arises in case of void agreement or contract that becomes void.
- 11.3. Right to recover the price of necessities supplied arises under Quasi-Contracts.
- 11.4. Right to recover from a person to whom money is paid or thing is delivered by mistake or under coercion arises under Quasi-Contracts.

**12.0 THE SALE OF GOODS ACT, 1930**

- 12.1. The Sale of Goods Act, 1930 deals with goods but not with other movable property or immovable property.
- 12.2. The term 'Goods' means every kind of movable property and includes Stock and Shares, Growing Crops, Grass & things agreed to be severed under the Contract of Sale but excludes actionable claims and money (but not old rare coins).
- 12.3. A Contract of Sale of Goods includes both a Sale & an Agreement to Sell.
- 12.4. The consideration for the contract of sale can be partly in money and partly in goods since the Act does not prohibit as such..
- 12.5. Essential elements of a contract of sale include Seller, Buyer, Goods, Transfer of Ownership, Price and essential elements of a valid contract.
- 12.6. The Sale of Goods Act does not apply to the Hire Purchase Agreements and Contracts for Skill & Labour.
- 12.7. There can be sale or agreement to sell in respect of existing goods but there can only be an agreement to sell in respect of future goods and contingent goods.
- 12.8. The contracting parties are not discharged on non – acquisition or non – production of future goods but are discharged on non- acquisition of contingent goods.
- 12.9. If goods are destroyed, the contract of sale or an agreement to sell specific goods becomes void but contract of sale or an agreement to sell unascertained goods does not become void.
- 12.10. Where the price is not determined in any manner, the buyer must pay the seller the reasonable price of goods.
- 12.11. Stipulation as to time of payment is not deemed to be an essence of a contract of sale unless otherwise agreed.
- 12.12. Stipulation can be a condition even if it is called a warranty in the contract of sale.
- 12.13. A stipulation the breach of which gives the aggrieved party a right to terminate the contract is called a condition.
- 12.14. The breach of condition is treated as breach of warranty where the contract is not severed and the buyer has accepted the goods or part thereof.
- 12.15. Conditions and Warranties may be implied or express.
- 12.16. In a contract of sale by description and by sample, the goods must correspond with the sample as well as description.
- 12.17. In a contract of sale of goods, there is no implied condition or warranty as to the quality of the goods or their fitness for any particular purpose.
- 12.18. A seller is not bound to disclose those defects of his goods to the buyer before sale which the buyer could have discovered if the buyer would have examined the goods.
- 12.19. The Rule of Caveat Emptor does not apply where the buyer has disclosed the purpose for which the goods are required and relied upon the seller's skills or judgement.

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- 12.20. Condition as to Merchantable Quality means goods must be free from any latent defects and does not apply to defects which the buyer could have discovered if the buyer would have examined the goods.
- 12.21. Passing of property means transfer of ownership and not the physical possession.
- 12.22. Ownership can be transferred only in case of specific or ascertained goods and not in case of unascertained goods / future goods / goods sent on approval.
- 12.23. In case of a contract for sale of specific goods not in deliverable state, the property in goods passes when the goods are put into a deliverable state and the buyer has notice thereof.
- 12.24. When goods are sent on approval, the property in goods passes if the customer to whom the goods were sent on approval also sends such goods on approval to some third party because it amounts to adoption of transaction.
- 12.25. In case of a contract for sale of unascertained goods, the property in goods passes when the goods are ascertained and unconditionally appropriated by the seller / buyer with the consent of the other.
- 12.26. The person whosoever be the owner at the time of occurrence of loss has to bear the loss even if delivery has not been made and price has not been paid.
- 12.27. Where the seller has reserved the right of disposal of goods the property in goods passes when the conditions imposed by the seller are fulfilled.
- 12.28. The seller is deemed to have reserved the right of disposal of goods in case of goods deliverable to the orders of seller or his agent or drawing of Bill of Exchange (B/E) for the price of goods and sending B/E with document of title.
- 12.29. Risk follows ownership.
- 12.30. No seller of goods can transfer better title to the buyer of the goods than he himself possesses.
- 12.31. A seller in possession of goods under a voidable contract can pass a good title to a bonafied buyer before the contract is rescinded.
- 12.32. A seller in possession of goods in the capacity of a bailee cannot pass a good title to a bonafied buyer.
- 12.33. A joint owner in sole possession of goods with the consent of all other co-owners can pass a good title to a bonafied buyer.
- 12.34. Where there is no contract as to the place of delivery of existing goods, the goods are to be delivered at the place at which goods are at the time of sale/ agreement to sale.
- 12.35. Delivery means voluntary transfer of possession from one person to another.
- 12.36. Delivery of the key of a warehouse where the goods were lying amounts to symbolic delivery.
- 12.37. Where there is no contract as to the time of delivery, the goods are to be delivered within reasonable time.
- 12.38. Unless otherwise agreed, there must be simultaneous payment of price and delivery of goods.

- 12.39. Unless otherwise agreed, the buyer must apply for delivery.
- 12.40. Unless otherwise agreed, the expenses of putting the goods into a deliverable state shall be borne by the seller.
- 12.41. Unless otherwise agreed, the buyer is not bound to accept delivery by installments.
- 12.42. Delivery of part of goods with an intension of giving the delivery of the whole amounts to the delivery of the whole of the goods.
- 12.43. Where the seller delivers a quantity of goods larger than contracted for, the buyer may accept/reject the whole or accept the contracted and reject the excess.
- 12.44. In case of short or excess delivery if the buyer rejects the whole quantity, the contract is not treated as cancelled. The seller still has the right to tender again the quantity of goods as per contract and the buyer is bound to accept the same.
- 12.45. Delivery of the goods to carrier (whether named by the buyer or not) for the purpose of transmission to the buyer, or delivery of the goods to wharfinger custody, is prime facie deemed to be a delivery of goods to the buyer.
- 12.46. Right of lien can be exercised where the goods have been sold without any stipulation to credit
- 12.47. Right of Lien can not be exercised where part delivery is intended as delivery of the whole.
- 12.48. Right of lien can be exercised where the goods have been sold on credit, but the term of credit has expired
- 12.49. Right of lien can be exercised where the buyer becomes insolvent.
- 12.50. Right of lien can be exercised if seller possesses the goods as agent or bailee for buyer.
- 12.51. Right of lien can be exercised if seller has obtained a decree for the price of the goods.
- 12.52. Right of stoppage in transit is an extension of Right of Lien.
- 12.53. Right of stoppage in transit can be exercised if the seller has parted with the possession of goods and goods are in the course of transit and the buyer has become insolvent.
- 12.54. Goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent in that behalf takes delivery of them from such carrier or other bailee.
- 12.55. Right of stoppage in transit can be exercised if the carrier holds the goods in the capacity of an independent person and not in the capacity of an agent for the seller or buyer.
- 12.56. An unpaid seller is bound to resale the goods.
- 12.57. The unpaid seller must give a notice of resale to the buyer irrespective of the nature of goods.
- 12.58. Where the seller has expressly reserved the right of resale, the unpaid seller must give any notice of the resale to the buyer.

- 12.59. Where a notice of resale has been given to the buyer and there is loss on resale, the unpaid seller can recover it from the buyer.
- 12.60. If notice of resale is not given, the new buyer who buys in resale from Unpaid Seller will get a good title irrespective of the fact whether the notice of resale has been given to the original buyer or not.
- 12.61. An auction sale can be subject to a reserve price.
- 12.62. The relationship between the owner of the goods and the auctioneer is that of the principal and agent.
- 12.63. In an auction sale a bid once given can be withdrawn before the fall of hammer.
- 12.64. An auctioneer can refuse to accept even the highest bid.
- 12.65. In an auction sale, bidder can enter into an agreement to keep the bid low by eliminating competition amongst them.
- 12.66. A seller can reserve a right to bid at an auction.
- 12.67. Where the right to bid at an auction is expressly reserved by the seller, the seller or anyone person on his behalf may bid the auction.

### **13.0 THE INDIAN PARTNERSHIP ACT, 1932**

- 13.1. There must be at least two competent persons to constitute partnership.
- 13.2. There must be an agreement to constitute partnership.
- 13.3. There must be a business to constitute partnership.
- 13.4. There must be mutual agency to constitute partnership.
- 13.5. There must be sharing of profits to constitute partnership.
- 13.6. The members of a joint Hindu family carrying on family business are called Coparcener.
- 13.7. There is no maximum limit on number of members of a Joint Hindu family carrying on family banking business.
- 13.8. Two or more persons who own some property jointly are called co-owners.
- 13.9. The joint owners of some property sharing profits or gross returns arising from the property do not become partners.
- 13.10. It is compulsory to have a partnership agreement but it is not compulsory to have a partnership deed or to get the firm registered.
- 13.11. The partnership deed must be signed by all the partners.
- 13.12. The terms laid down in the partnership deed may be varied by the consent of all partners.
- 13.13. An unregistered firm cannot file a suit against a third party if the value of suit exceeds ₹ 100 but a third party can file a suit against an unregistered firm or its partners.
- 13.14. If a minor on attaining majority, elects to become a partner, he becomes only personally liable to third parties for those acts of the firm since he was admitted to the benefits of partnership.
- 13.15. Partnership at will can be dissolved by any partner giving notice in writing to all other

partners but partnership for a fixed period can be dissolved only with the consent of all the partners.

- 13.16. A minor can be admitted to the benefits of partnership with the consent of all the partners.
- 13.17. The contract between the partners can provide that a partner shall not carry on any business other than that of the firm while he is a partner.
- 13.18. Any difference arising as to ordinary matter connected with the business must be decided with the consent of majority of the partners.
- 13.19. A change in the nature of the business can be made with the consent of all the partners.
- 13.20. The duties of the partners u/s 9 and 10 can never be changed even by an agreement amongst the partners.
- 13.21. The duties of the partners u/s 12 and 13 can be changed by an agreement amongst the partners.
- 13.22. The authority conferred on a partner by section 19 of the Indian Partnership Act is called his implied authority.
- 13.23. Implied authority of a partner does not empower him to enter into a partnership on behalf of the firm.
- 13.24. Implied authority of a partner does not empower him to submit a dispute relating to the business of the firm to arbitration.
- 13.25. Implied authority of a partner does not empower him to acquire/transfer any immovable property on behalf of the firm.
- 13.26. Implied authority can be restricted or extended by mutual agreement.
- 13.27. In case of an emergency, in order to prevent losses to the firm, a partner may exceed his implied or express authority.

#### **14.0 MEANING, NATURE AND TYPES OF COMPANY**

- 14.1. "Body Corporate" or "Corporation" includes a company incorporated outside India, but does not include a co-operative society registered under any law relating to co-operative societies. [Sec 2(11)]
- 14.2. The term 'Company' does not include a company incorporated outside India.
- 14.3. (a) The company is an artificial legal person created by law but not a fictitious person.  
(b) The company has nationality but has no citizenship because a citizen of a country is a personal right peculiar to human beings only.
- 14.4. The company has a separate legal entity of its own which is entirely distinct from that of its members. Effects of a separate legal entity are:
  - (a) The company may enter into contracts with its members and vice versa. Thus, a member can be a debtor, a creditor, a director, and an employee of the company at the same time.

- (b) Its members can not be held liable for the acts of the company even if he holds virtually the entire share capital.
  - (c) Its members cannot claim ownership right in company's assets during its lifetime or even on its winding up and can not have any insurable interest in the company's properties since they are not owners.
  - (d) Its creditors' remedy for the recovery of their debts lie only against the company and not against its members or directors.
- 14.5. With reference to a company, the term 'Perpetual Succession' means the continued existence of the company which is not affected by the death, insolvency or unsoundness of mind of its members or transfer of shares by its members. A company being a creation of law continues to exist for an indefinite period till it is wound up by the process of law.
- 14.6. The shares of a public company are freely transferable in the manner provided in the Articles [Sec 44].
- 14.7. (a) In case of a company limited by shares, the liability of a member is limited upto the amount remaining unpaid (if any) on the shares held by a member.
- (b) In case of a company limited by guarantee, the liability of a member is limited upto the amount guaranteed by a member.
- (c) In case of company limited by guarantee and having share capital, the liability of a member is limited upto the aggregate of amount unpaid on shares held by him and amount guaranteed by him.
- 14.8. In case a company does not have a common seal, the authorisation shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.
- 14.9 (a) Lifting the corporate veil means ' Ignoring separate legal entity of the company and looking at the real persons behind and treat the company and its members as same person when the company starts using the corporate veil for improper conduct, or to protect fraud or to justify wrongs etc.
- (b) Corporate Veil is Lifted under the following Statutory Provisions:
- (i) When the no. of members falls below the statutory minimum [Section 3A]
  - (ii) Misrepresentation in Prospectus [Section 35]
  - (iii) To investigate ownership of a company [Section 216]
  - (iv) To investigate into the affairs of related companies [Section. 219]
  - (v) When business is carried on to defraud the creditors [Section 339]
- (c) Corporate Veil can be Lifted under Under Judicial Interpretations:
- (i) For determination of the character of the company
  - (ii) For prevention of fraud or improper conduct
  - (iii) For the protection of revenue
  - (iv) When company is formed to act as an agent of its members
  - (V) When company is formed to avoid the welfare laws



- (d) If the company carries on business for more than 6 months with no of members reduced below the statutory minimum requirement (i.e. 2 in case of a Pvt. Co and 7 in case of public Co.) all the persons who were members of the company and were aware of this fact shall be personally liable for debts contracted after those 6 months.[ Sec 3A].Thus, Members of a limited company may have unlimited liability as per Sec 3A.

#### 14.10 Five Points of difference between a Partnership and a Company

Basis of Distinction	Partnership	Company
<b>1. Separate Legal Entity</b>	No	Yes
<b>2. Nature of Liability</b>	Unlimited.	Limited in case of a Limited Company
<b>3. Perpetual Existence</b>	does not enjoy	enjoys
<b>4. Minimum No. of Members</b>	2	<ul style="list-style-type: none"> <li>• A public Co. – 7.</li> <li>• A Pvt. Co. – 2</li> <li>• One Person Company – 1</li> </ul>
<b>5. Maximum No. of Members</b>	Banking business: 10 Non-banking business: 20.	<ul style="list-style-type: none"> <li>• Public Co. – no limit.</li> <li>• Pvt. – 200</li> </ul>
<b>6. Mutual Agency</b>	Exists	Does not exist
<b>7. Property of Organisation</b>	Joint property of all its partners.	Belongs to company and not to its members
<b>8. Remedy of Creditors</b>	against the partners jointly and severally.	only against the company and not against its members.
<b>9. Dissolution</b>	can be by mutual agreement.	can only be by law.

#### 14.11 Five Points of difference between a Company and LLP.

Basis of Distinction	Company	LLP
<b>Regulated by</b>	'The Companies Act, 2013'	'The Limited Liability Partnership Act, 2008'
<b>Motive of Formation</b>	Profit or Service motive.	only for Profit motive.
<b>Charter Document</b>	M e m o r a n d u m o f Association	LLP Agreement

<b>Number of Members</b>	<p>Private Company: Minimum 2 members &amp; maximum 200 members. One person Company 1 member.</p> <p>Public Company: Minimum 7 members but there is no limit on maximum number of members.</p>	Minimum 2 but there is no limit on maximum number of partners.
<b>Filing of Annual Statement of Solvency</b>	not required.	required
<b>Provision for Whistle Blowing</b>	Does not exist	Exists

- 14.12 Both the Company limited by share and Company limited by guarantee are required to state in the Memorandum that the members' liability is limited.
- 14.13 Members of Company limited by share may be called upon to discharge their liability either during the company's life time or during its winding up whereas In case of company limited by guarantee having no share capital, the liability of its members, can be enforced only by the liquidator since such liability can be enforced only after the commencement of winding up of the company and not during the life time of the company.
- 14.14 (a) An unlimited company must have its own Memorandum and Articles of Association.
- (b) The Articles of an unlimited company must state the number of members (at least 100) with which the company is to be registered.
- (c) The Articles of an unlimited company having a share capital must also state the amount of share capital with which the company is to be registered.
- 14.15 A Private Company means a company which by its articles—
- (a) restricts the right to transfer its shares, if any,
- (b) limits the number of its members to 200(except in case of One Person Company),
- Note: For the purposes of limit of 200, present employees who are members and ex-employees who were members while in that employment and have continued to be members after the employment ceased, are excluded and the joint shareholders are counted as a single member.
- (c) prohibits any invitation to the public to subscribe for any securities of the company.

**14.16 Five Points of difference between a Public Company and a Private Company.**

<b>Basis of Distinction</b>	<b>Public company</b>	<b>Private company</b>
<b>1. Use of the word 'Private'</b>	not required	required
<b>2. Minimum no. of members</b>	7.	2.
<b>3. Maximum no. of members</b>	no limit	200 (except in case of One Person Company).
<b>4. Minimum No. of Directors</b>	3.	2
<b>5. Transferability of shares</b>	not restricted	restricted
<b>6. Invitation to the public to subscribe Securities</b>	can invite	cannot invite
<b>7. Articles of association</b>	can either frame its own or adopt Table 'F'	has to compulsorily frame its own articles
<b>8. Special privileges</b>	Does not enjoy	enjoys

**14.17 Privileges available only to an independent private company (i.e. a private company which is not a subsidiary of a public company)**

- (a) Private limited company is free to issue any kind of shares if the articles of association or the memorandum of association of such private company provides so [ Sec 43 & 47].
- (b) Private Companies accepting deposits from members upto 100% of paid-up share capital & free-reserves need not to comply with conditions mentioned in section 73(2)(a) to (e).
- (c) Private company can frame own rules for General Meetings.
- (d) Private company having a paid up share capital of less than Rs. 100 Crore is not included in Max Audit Limit
- (e) An individual for directorships in private companies can stand in for directorship without serving the notice of 14 days and a deposit of ₹1 lakh [ Sec 160].
- (f) Appointment of Directors of a Private limited company need not to be voted individually.[ 162].
- (g) Private Companies are exempted from filing MGT-14 with the ROC on various provisions under section 179(3) and Rule 8 of the amended Companies (Meetings of Board & its powers) Rules, 2014.
- (h) Restrictions on powers of Board u/s 180 do not apply to a Private company.
- (i) An Interested Director of a private limited company can participate in the board meeting after disclosing interest {Sec 184(2)}

- (j) In case of private companies Shareholder's Approval is not required for Appointment or the Remuneration of MD/WTD u/s 196(4) & (5) even if the conditions for the appointment are not as per the requirements of Schedule V of the Act.

14.18 (a) "One Person Company" means a company which has only one person as a member.[Sec 2(62)]

- (b) The Memorandum of OPC is required to indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.[Proviso to Sec 3 (1)]
- (c) Only a natural person who is an Indian citizen and resident in India –
  - (i) shall be eligible to incorporate a One Person Company;
  - (ii) shall be a nominee for the sole member of a One Person Company.

**Note:** "Resident in India" means a person who has stayed in India for at least 182 days during the immediately preceding one calendar year.

14.19 (a) 'Association not for Profit' the Central Government may by license allow a person or an association of persons to be registered as a limited liability company without using the words 'limited' or 'private limited' as part of its name.

- (b) The Central Government will grant the license only if it is satisfied that a person or an association of persons proposed to be registered as a limited liability company:
  - (i) has in its objects the promotion of commerce, art, science, religion, charity or any other useful object;
  - (ii) intends to apply its profits, if any, or other income in promoting its objects; and
  - (iii) prohibits the payment of dividend to its members.

(c) A firm may be a member of the company registered u/s 8.[Sec 8(3)]

14.20 (a) As per Section 2(85) "Small Company" means a private company –

- (i) paid-up share capital of which does not exceed ₹ 50 lakh or prescribed higher amount which shall not be more than ₹ 5 crore ; or
- (ii) turnover of which as per its last profit and loss account does not exceed ₹ 2 crore or prescribed higher amount which shall not be more than ₹ 20 crore:

(b) Following can not be Small Company:

- (i) a holding company or a subsidiary company;
- (ii) a company registered u/s 8; or
- (iii) a company or body corporate governed by any Special Act;

25. (a) As per Section 2(45), a Government Company means "any company in which

at least 51% of the paid-up share capital is held

(i) by the Central Government or

(ii) by any State Government or Governments or

(iii) partly by the Central Government and partly by one or more State Governments

**and includes** a company which is a subsidiary of a government company as thus defined

(b) A Government Company registered under this Act is a non-statutory company and is not an agent of the government.

(c) A Government Company can be a Private Company.

14.21. (a) As per section 2(42) "Foreign Company" means any company or body corporate incorporated outside India which –

(i) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(ii) conducts any business activity in India in any other manner.

(b) A Foreign Company is required to file the following documents with the Registrar of companies within 30 days from the date of establishment of business in India like Memorandum and Articles, address of the registered or principal office, list of directors and secretary

14.22 As per Section 2(46) of the Companies Act, 2013, holding company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

14.23 As per Section 2(87) Subsidiary Company or Subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

**Note:** The composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company can appoint or remove all or a majority of the directors.

14.24 A Subsidiary Company either by itself or through its nominees can not hold any shares in its holding company unless it holds such shares as the legal representative or as a trustee or before it became a subsidiary company of the holding company. [Sec 19]

14.25 According Section 581A of the Companies Act, 1956, a Producer Company is a body corporate having objects or activities specified in Section 581B of the Companies Act, 1956, and which is registered as such under the provisions of the Act. The membership of producer companies is open to such people who themselves are the primary producers, which is an activity by which some agricultural produce is produced by such primary producers.

- 14.26 (a) A company can become a partner in a firm only if its Memorandum of Association specifically allows it to do so. Since it is a separate legal entity in the eyes of law, it has contractual capacity to enter into any valid contract.
- (b) A limited liability company can have unlimited liability as a partner in a firm since it is the liability of the members of a limited company which is limited and not that of the company itself.
- 14.27 (a) As per Sec 464, No association or partnership consisting of more than 100 persons shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force.
- (b) Sec 464 does not apply to Single Joint Hindu Family carrying on any business even for earning profits and with any number of members, Stock Exchange and Non-Profit Earning Association.
- (c) Where two or more Joint Hindu Families enter into partnership, then all adult members (whether Male or Female) are to be counted to determine the limit of 100 as per Sec 464. That means minor members of such families shall be excluded.
- (d) Every member of an Illegal Association shall be personally liable for all the liabilities incurred in carrying on the business and shall also be punishable with fine not exceeding ₹ 1,00,000.
- (e) Once the association contravened the provision of Section 464, it remains illegal even if there is subsequent reduction in the number of its members. In other words, the illegality of an Illegal Association can not be cured by subsequent reduction in the number of its members. [Madanlal v. Janki Parshad]
- (f) Contracts made before the registration can not be validated and issued upon by subsequent registration. [Gujarat Trading Co. v. Tricumji]
- (g) No suit either for administration or partition of assets of an illegal association can be filed by any member of Illegal Association. [Mewa Ram v. Ram Gopal] An Illegal association can not be wound up under the provisions of the Companies Act.
- (h) An Illegal association can not be sued by its members and outsiders .
- 14.28 As per section 2(51) "Key Managerial Personnel", in relation to a company, means –
- (i) the Chief Executive Officer or the Managing Director or the Manager;
  - (ii) the Company Secretary;
  - (iii) the Whole-time Director;
  - (iv) the Chief Financial Officer; and
  - (v) such other officer as may be prescribed.
- 14.29 (a) "Relative", with reference to any person, means any one who is related to another, if –

- (i) they are members of a Hindu Undivided Family;
- (ii) they are husband and wife; or
- (iii) one person is related to the other in such manner as may be prescribed.
- (b) the following are not relatives:
  - (i) Step-Daughter and her husband
  - (ii) Brother's Wife
  - (iii) Sister's husband
  - (iv) Children of Son, Daughter, Brother & Sister

14.30 Public Financial Institution" means—

- (a) the Life Insurance Corporation of India,
- (b) the Infrastructure Development Finance Company Limited (IDFC),
- (c) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal Act, 2002);
- (d) institutions notified by the Central Government u/s 4A(2) of the Companies Act, 1956 so repealed under section 465 of this Act;
- (e) such other institution as may be notified by the Central Government in consultation with the RBI: The Central Government by notification in the Official Gazette is empowered to specify any other institution as Public Financial Institution if:
  - (i) It is constituted under any Central/State Act or
  - (ii) At least 51% of its paid up capital is controlled or held by the Central/State Government(s) or partly by the Central Government and partly by one or more State Governments.

## **15.0 INCORPORATION OF A COMPANY**

15.1. Promotion" is the process of conceiving an idea and developing it into a concrete proposition or project and taking steps to implement it through the formation of a Company.

15.2 As per Sec 2 (69) the term "Promoter" means a person –

- (a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in Sec 92; or
- (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- (c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act. But a person who is acting merely in a professional capacity shall not be deemed as a promoter.

15.3. Persons who buy property with a view to selling it later at profit to a company to be formed by them are regarded as promoters. (Glucstein v. Barner)

15.4. The promoter's legal position is that he is neither an agent nor a trustee of the company he promotes because there is no company in existence.

- 15.5 The legal position of a promoter is that he stands in a fiduciary position (relationship of trust and confidence) in relation to the company he promotes. The fiduciary relation of a promoter really begins when the company is formed. . (Erlanger v. New Sombrero Phosphate Co.)
- 15.6. The fiduciary obligation of promoter, means an obligation of promoter to disclose fully all material facts of contracts, profit made or to be made and his personal interest in any transaction/contract with the company. In fiduciary capacity a promoter has duty:
- (a) 'Not to make any secret profit'.
  - (b) To make full and fair disclosure of his personal interest in every transaction with the company.
  - (c) To give the benefit of Negotiations to the company
  - (d) To ensure that prospectus issued at their instance contains all material facts and particulars and does not contain any untrue statement
- 15.7. Liability of promoters include (a) liability for not including prescribed matters and reports as per sec 26,(b) Criminal and Civil Liability for Mis-statements in a Prospectus [Sec 34& 35],(c) Personally Liability for Pre-incorporation Contracts
- 15.8. (a) Promoters can not claim remuneration and reimbursement of expenses incurred by them in promotion—
- (i) as a matter of right
  - (ii) even if they have already entered into a contract with the prospective Directors
  - (iii) even if the articles provide for it. Provision in articles merely gives the directors an authority to make such payment but does not give the promoters a right to claim remuneration or to sue the company for the same.
- (b) Promoters can claim remuneration and reimbursement of expenses incurred by them in promotion if the company after incorporation makes a contract with promoters to that effect.
- 15.9. Preliminary contracts are those contracts which are entered into by the promoters for and on behalf of the proposed company before its incorporation.
- 15.10. (a) The company is not bound by the preliminary contracts even if (a) the company has taken the benefit of the work on its behalf under the contract (b) the contract stipulates that the company, after incorporation shall be bound by it.
- (b) The company cannot enforce the Preliminary Contracts.
- Exception:** As per Sec. 15(h) and 19(e) of the Specific Relief Act, 1963, Preliminary Contracts can be enforced by or against the company if:
- (i) Such contracts are for the purposes of the company.
  - (ii) Such contracts are warranted by terms of incorporation (i.e. the contract must fall within any of the clauses contained in object clause)
  - (iii) Such contracts are accepted by the company after its incorporation.
  - (iv) The acceptance of such contracts is communicated by the company to the



other party to the contract.

However, the above provisions are not applicable for:

- (i) Contract to take shares
- (ii) Contract to render personal services.

- (c) The company cannot rectify the preliminary contracts since the company was not in existence when the preliminary contracts were made. A valid ratification of a transaction requires the existence of a Principal at the time of entering into a transaction. [Kelner v. Baxter]
- (d) The company can not adopt preliminary contracts either by passing special resolution or by making adoption of such contracts as one of the objects of the company in its Memorandum of Association. [North Sydney Investment Co. V. Higgins]
- (e) The promoters are personally liable for the preliminary contracts.

15.11. Steps involved in the formation of a company are:

Step 1: Obtain Digital Signature Certificate (DSC)

Step 2: Obtain the Name Approval

Step 3: Get e-MoA and e-AoA prepared

Step 4: Fill Form SPICe INC-32

Step 5: Apply for Company's PAN and TAN

15.12. Documents & Information required to be filed with SPICE

- 1. Memorandum and Articles of Association of the company duly signed by each subscriber to the Memorandum and duly witnessed by at least one witness. [Section 7(1)(a) & Rule 13]
- 2. Declaration from the Professional [Section 7(1)(b) & Rule 14]
- 3. Affidavit from each of the Subscribers to the Memorandum and each of the First Directors [Section 7(1)(c) & Rule 15]
- 4. Address for correspondence till its registered office is established [Section 7(1)(d)]
- 5. Particulars of each of the Subscribers [Section 7(1)(e) & Rule 16]
- 6. Particulars of each of the First Directors along with their consent to act as Directors [Section 7(1)(f) & Rule 17]

15.13. As per Sec 7(3), on and from the date mentioned in the Certificate of Incorporation issued, the Registrar shall allot to the company a unique 21 Digits(alpha-numeric) Corporate Identity Number (CIN), which shall be a distinct identity for the company and which shall also be included in the certificate.

15.14. From the date of incorporation

- 1. Body Corporate: The original subscribers to the memorandum as well as the other persons who may, from time to time, become members of the company, shall constitute a body corporate by the name contained in the Memorandum of Association.
- 2. The company shall have power:

- (i) to exercise all the Functions
  - (ii) to acquire, hold and dispose of property
  - (iii) to Contract
  - (iv) to sue others and be sued by others.
3. The company shall have perpetual succession
- 15.15. (a) Certificate of incorporation given by the Registrar of Companies in respect of any association shall be conclusive evidence that—
- (i) all the requirements of Companies Act have been complied with in respect of its registration as well as matters precedent and incidental thereto,
  - (ii) the association is a company authorized to be registered and duly registered under the Act.
- (b) The term 'conclusive evidence' means that no inquiry shall be allowed to be made regarding the correctness or incorrectness of any particulars contained in the certificate of incorporation.
- In other words, once issued, the certificate of incorporation cannot be challenged in any Court or Tribunal on any grounds whatsoever.
- 15.16 The validity of a certificate of incorporation can not be disputed on any ground whatsoever. The certificate of incorporation shall remain valid and corporate status shall remain unaffected even in the following cases :
- (a) Where one person has signed on behalf of all the subscribers.
  - (b) Where all the signatories to memorandum are minors
  - (c) Where all the signatures on the memorandum are forged
  - (d) Where the memorandum was altered after signing by subscribers, but before its registration
  - (e) Where illegal objects are incorporated in the object clause.
- 15.17 Certificate of incorporation is not the conclusive proof with respect to the legality of the objects of the company, mentioned in the objects clause of the Memorandum of Association. As such, if a company has been registered whose objects are illegal, the incorporation does not validate the illegal objects. In such a case the only remedy available is to wind up the company. [Performing Right Society Ltd. v. London Theatre of Varieties (1992)].

## **16.0 MEMORANDUM & ARTICLES OF ASSOCIATION**

- 16.1 Memorandum of Association is the constitution of the company which lays down the fundamental conditions upon which alone the company is allowed to be formed. It defines as well as confines the powers of the company.
- 16.2 The memorandum must be signed by each of the subscribers to the Memorandum in the presence of at least one witness who must attest the signature and add his address, description and occupation (if any).
- 16.3 Memorandum of association of a company must state the following clauses:
- (a) Name Clause

- (b) Registered Office Clause
- (c) Objects Clause
- (d) Liability Clause
- (e) Capital Clause:
- (f) Nominee Clause in the case of a One Person Company(OPC)

**Note:** Capital clause and liability clause are not required in Memorandum of Association of unlimited company whether or not having share capital and capital clause is not required in case of companies having no share capital.

- 16.4. (a) The term 'ultra vires' means beyond one's power or authority.
- (b) Acts ultra vires The Companies Act/Memorandum shall be void and can not be ratified even by an unanimous resolution of all the shareholders. [Ashbury Railway Carriage & Iron Co. v. Riche]
  - (c) Acts ultra vires the Articles of Association/Powers of Directors but within the powers of the company shall not be altogether void and can be rectified and made valid by altering its Articles by a special resolution at its general meeting with retrospective effect.
  - (d) For acts which are ultravires the company/Memorandum, neither the company can sue others nor be sued by others.
  - (e) A members can bring injunction against the company to restrain it from doing ultravires acts
  - (g) The directors can be held personally liable for breach of warranty of authority
- 16.5. Articles are the internal rules and regulations which govern the internal management of the company and bind the company and members thereof.
- 16.6. The Articles of Association may contain any regulation for the attainment of objects stated in the Memorandum subject to the following restrictions:
- (a) The Articles must not include anything which is illegal or contrary to general law.
  - (b) The Articles must not include anything which is against public policy.
  - (c) The Articles must not include anything which is prohibited by the Companies Act.
- 16.7 The Articles of an unlimited company and a company limited by guarantee must specify the number of members(at least 100) with which the company proposes to be registered .
- 16.8 Articles of Private Company having share capital must contain the three statutory restrictions as per Sec 2(68).
- 16.9 The Articles must be signed by each of the subscribers to the Memorandum in the presence of at least one witness who must attest the signature and add his address, description and occupation (if any).
- 16.10 (a) Subject to the provisions of The Companies Act and Memorandum a company may alter its Articles by a special resolution at the general meeting of the company [Sec 14(1)]

- (b) Alteration of Article involving conversion of public company into private company requires special resolution and approval of Tribunal as per Second Proviso to Sec 14(1).
  - (c) A copy of the special resolution authorising Articles' alteration must be filed with the Registrar within 30 days of passing the resolution.
  - (d) A copy of the Tribunal's Order approving the alteration involving conversion of public company into private company, together with printed copy of the altered articles must be filed with the Registrar within 15 days of the date of receipt of the order of approval [Sec 14(2)]
- 16.11 (a) Alteration of articles must not be inconsistent with any of the provisions of Act or Memorandum of Association or with Tribunal's Order.
- (b) Alteration having the effect of increasing the liability of a member shall not be binding upon him unless the company is a club any other associations.
  - (c) Alteration may have a retrospective effect so long as it does not effect the things already done by the company and alteration is for the benefit of the company as a whole. [Allen v. Gold Feet of West Africa]
  - (d) The alteration must be bona fide for the benefit of the company as a whole.
  - (e) Alteration must not constitute a fraud on minority.
  - (f) Alteration must not cause a breach of contract with an outsider.
  - (g) The power to alter articles is a statutory power and it can not be taken away by any provision in the Memorandum or Articles. [Walker Vs. London Tramways Co. (1879)]
  - (h) where the company is a club, its member is bound by alteration increasing his liability even if he does not agree in writing
    - (i) where the company is not a club or other association, its member is not bound by alteration increasing his liability unless he agrees in writing
- 16.12 A public company limited by shares need not have its own articles since it can adopt table F as per Sec 5
- 16.13 (a) Since the Memorandum and Articles constitute a contract between the members and the company, (i) the members are bound to the company and the company is bound to its members.
- (b) Since the memorandum and articles do not constitute a contract between the company and outsider A outsider is not entitled to sue the company for enforcement to the article even the article provide certain right to him. [Eley V. Positive Govt. Life Assurance Co. Ltd (1876)]
- 16.14 Since the Memorandum and Articles of Association on their registration with the Registrar become public documents and are available for public inspection in the Registrar's office on payment of prescribed fee, every person dealing with the company is presumed to have the knowledge of the contents of these documents and also to have understood them according to their proper meaning. [Earnest v. Nicholls (1857) 6 H.L.C. 401, Griffith v. Poget, (No. 2) (1877) 6 Ch. D. 517, Oak

Bank Oil v. Crum, (1882) 8 A.C. 65]. This type of presumed knowledge of these documents is termed as 'Constructive Notice of Memorandum and Articles of Association.

- 16.15 The doctrine of indoor management is an exception to the doctrine of constructive notice. This doctrine protects the outsiders against the company by entitling them to assume that the provision of the Articles of Association have been duly complied with by the company in its internal working. This doctrine is based on the principles of justice and public convenience. [Royal British Bank v. Turquand, (1856) ]
- 16.16 Conditions for Availability of the benefit of Doctrine of Indoor Management
- (a) The person dealing with the company must have the knowledge of the Memorandum and Articles
  - (b) The person dealing with the company must not have knowledge of irregularity.
  - (c) The person dealing with the company must not be put upon an enquiry
  - (d) There must be some procedural or internal irregularity.
  - (e) There must not be any ultra vires act or illegality.
- 16.17 Exceptions to the Doctrine of Indoor Management does not apply in the following cases:
- (a) If A person dealing with the company has Knowledge of Irregularity.
  - (b) A person dealing with the company has Suspicion of Irregularity.
  - (c) Where Forgery is involved [Doctrine of indoor management applies to procedural irregularities and not illegalities (i.e. forgery). [Rubben v. Great Fingal Consolidated, (1906)]
  - (d) A person dealing with the company has No knowledge of Articles.
  - (e) Where Acts are beyond Apparent Authority of officer

## **17.0 SHARES AND SHARE CAPITAL**

- 17.1 (a) Section 2(84) of the Companies Act, 2013 defines a share as "a share in the share capital of a company, and includes stock except where a distinction between stock and share is expressed or implied".
- (b) The shares are the movable properties transferable in the manner provided by the articles of the company.
  - (c) A share is the smallest unit into which the capital of the company is divided.
  - (d) A share is not a sum of money but is an interest measured by a sum of money and made up of various rights contained in the contract.
  - (e) Stock is an aggregate of fully paid shares which have been legally consolidated which is transferable in fraction also.
- 17.2 (a) The company can issue equity shares with voting rights, or
- (b) The company can issue equity shares with differential rights as to voting, dividend etc.
- 17.3 An equity share is a share which is not a preference share. In other words, it is a

share which does not carry two preferential rights (viz., right to receive dividend and right to receive repayment of capital) attached to a preference share.

17.4 A preference share is one which carries the following two preferential rights:

- (a) a right to receive dividend at a stipulated rate or of a fixed amount before any dividend is paid on equity shares; and
- (b) a right to receive repayment of capital on winding up of the company, before the capital of equity shareholders is returned.

17.5 Participating Preference Share is that share which, in addition to two basic preferential rights, also carries one or more of the following rights as per the articles of association:

- (a) a right to participate in the surplus profits left after paying dividend to equity shareholders; and
- (b) a right to participate in the surplus assets left after the repayment of capital to equity shareholders on the winding up of the company.

17.6 Unless otherwise stated, a preference share is deemed to be cumulative, non-participating and non-convertible.

17.7 No company limited by shares shall issue any preference share which is redeemable after the expiry of a period of 20 years from the date of issue.

17.8 Authorised Capital: An Authorised Capital refers to that capital which is authorised by the Memorandum of Association to be the maximum amount of share capital of the company. This is the maximum limit of the company which it is authorised to raise and beyond which the company cannot raise unless the capital clause in the Memorandum is changed.[Sec 2(8)]

17.9 Issued Capital: An Issued Capital refers to the nominal value of that part of authorised capital, which the company issues from time to time for subscription [Sec 2(50)].

17.10 Subscribed Capital: Subscribed Capital refers to the capital which has been subscribed by the members of a company [Sec 2(86)].

17.11 Called- up Capital: "Called-up capital" means such part of the capital, which has been called for payment; [Sec 2(15)].

17.12 Paid-up Capital: "Paid-up share capital" or "share capital paid-up" means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called [Sec 2(64)].

17.13 (a) That portion of uncalled share capital which shall not be capable of being called up except in the event of winding up of the company is called Reserve Capital.

(b) An Unlimited company may provide for Reserve Capital on its conversion into a limited company as per Sec 65 by passing a Resolution to that effect.

(c) Reserve Capital can not be dealt with in any manner under a power in the

Memorandum of Association.

- (d) A company can not borrow on the security of its Reserve Capital
- (e) Reserve capital cannot be turned into uncalled capital without the approval of the Tribunal.
- (f) Reserve capital is not required to be disclosed in the balance sheet.

## **18.0 THE LIMITED LIABILITY PARTNERSHIP ACT, 2008**

18.1 Need for LLP: A need was felt for a new corporate form that could provide the benefits of limited liability of a company and the flexibility of a traditional partnership to its members in organizing their internal structure based on a mutual agreement. Hence, a concept of LLP was introduced which combines the elements of both 'a corporate structure' (i.e. limited liability) as well as 'a partnership firm structure' (i.e. flexibility). The LLP is a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, the liability of its partners will be limited.

18.2 Limited Liability Partnership means a partnership formed and registered under this Act. [Sec 2(1) (n)]

18.3 Features of LLP:

1. Body Corporate
2. Separate Legal Entity
3. Perpetual Succession
4. Limited Liability
5. Minimum No of Partners
6. No Maximum Limit on Partners
6. Business for Profit Only
7. LLP Agreement
8. An Artificial Person Created by Law

18.4 Advantages of LLP form are as follows:

1. Limited Liability
2. Flexibility
3. Separate Legal Entity
4. Perpetual Succession:
5. Easy to Form
6. Easy to Dissolve
7. Foreign National
8. Whistle Blowing

18.5 Essential Elements to form LLP

1. To decide about Partners and to appoint minimum two individuals as Designated Partners.
2. To have LLP Name: The LLP cannot have the same name with any other LLP,

Partnership Firm or Company.

3. To have a Registered Office to which all communications and notices may be addressed and where they shall be received.
4. To execute a LLP Agreement
5. To complete and file Incorporation Document along with the Compliance Statement
6. To file LLP Agreement

#### 18.6 Steps to Incorporate LLP

Step 1: Name Reservation

Step 2: Incorporate LLP

Step 3: File LLP Agreement

#### 18.7 Five Points of Difference between A Partnership Firm and LLP

<b>Basis of Distinction</b>	<b>Partnership Firm</b>	<b>LLP</b>
<b>1. Regulating Law</b>	<b>'The Indian Partnership Act, 1932'</b>	<b>'The Limited Liability Partnership Act, 2008'</b>
<b>2. Body Corporate</b>	not	It is
<b>3. Separate Legal Entity</b>	<b>no</b> separate legal entity.	<b>has</b> separate legal entity.
<b>4. Perpetual Succession</b>	<b>does not enjoy</b>	<b>enjoys</b>
<b>5. Liability of Partners</b>	<b>unlimited.</b>	<b>limited</b> , to the extent their contribution
<b>6. Registration</b>	<b>optional.</b>	<b>compulsory.</b>
<b>7. Creation</b>	<b>by agreement.</b>	<b>by Law.</b>
<b>8. Designated Partners</b>	<b>need not have</b>	at least 2
<b>9. Digital Signature</b>	<b>no requirement</b>	At least one Designated Partner <b>must have</b>
<b>10. Liability of Partners for Legal Compliance</b>	<b>All Partners</b> are liable	<b>Only Designated Partners</b> are liable
<b>11. Name of Entity</b>	<b>any name.</b>	Its Name to contain ' <b>Limited Liability Partnership</b> ' or ' <b>LLP</b> ' as suffix.
<b>12. Mutual Agency</b>	Partners are <b>agents of the firm and other partners.</b>	Partners act as <b>agents of LLP and not of other partners.</b>
<b>13. Admission of Minor</b>	<b>can be admitted</b> to the benefits	Minor <b>can not be admitted.</b>
<b>14. Can Foreign National become partner?</b>	<b>can not become</b>	<b>can become a Partner</b>



<b>15. Number of Members</b>	Minimum <b>2</b> and Maximum <b>10</b> for Banking business & <b>20</b> for non- Banking business.	<b>Minimum 2</b> but their is <b>no limit on maximum</b> number of partners.
<b>16. Whistle Blowing</b>	<b>No such provision</b>	<b>Provision has been made</b>
<b>17. Annual Filing with Registrar</b>	No Return	1. Annual Statement of Accounts 2. Statement of Solvency 3. Annual Return required to be filed with Registrar of LLP every year.

## 18.8 Five Points of Difference between A Partnership Firm and LLP

<b>Basis of Distinction</b>	<b>Company</b>	<b>LLP</b>
<b>Regulated by</b>	'The Companies Act, 2013'	'The Limited Liability Partnership Act, 2008'
<b>Motive of Formation</b>	Profit or Service motive.	only for Profit motive.
<b>Charter Document</b>	Memorandum of Association	LLP Agreement
<b>Number of Members</b>	Private Company: Minimum 2 members & maximum 200 members. One person Company 1 member.  Public Company: Minimum 7 members but their is no limit on maximum number of members.	Minimum 2 but their is no limit on maximum number of partners.
<b>Filing of Annual Statement of Solvency</b>	not required.	required
<b>Provision for Whistle Blowing</b>	Does not exist	Exists





# Correct-Incorrect Questions

## CORRECT INCORRECT QUESTIONS

### 1. State with reason whether the following statements are correct or incorrect:

1. An agreement entered into with a minor may be ratified on his attaining majority.
2. A promissory note duly executed in favour of minor is void.
3. A minor and a major can enter into an agreement of partnership.
4. An agreement with an alien friend is valid but an agreement with an alien enemy is void.
5. X promises to paint a picture for Y by a certain day, at a certain price. X dies before the day. The contract can be enforced either by X's representative or by Y.
6. X and Y had a contract. X broke it. Y had a right to file a case against X for damages. Y can assign this right to Z.
7. X,Y & Z jointly borrowed from 'L' ₹ 3000/- the liability of borrower is joint & several. L can bring a suit against any one or more of legal heirs of a debtor on his death.
8. 'Y' the son of 'X' has inherited assets of ₹ 10 lacs & liabilities of ₹ 12 lacs from his father after his death. 'Y' will be responsible to pay off all liabilities.
9. X agrees to sell 100 tons of some raw material to Y on 1st April 2018. X delivers the goods on 30th April, 2018. Y is bound to accept the goods.
10. X appointed Y to accompany him on a tour for three months from 1st July at a certain salary. Before the 1st July, X told Y that Y was no more required by him. Y cannot sue X.
11. X contracted to sell 200 kg of Sugar to Y at ₹ 30 per kg on a certain date. In anticipation X contracted to purchase from Z the same quantity at ₹ 16 per kg. Z does not deliver the sugar to X. X suffers the loss of ₹ 14 per kg. He can recover this loss from Z.
12. X was appointed as a managing director by a company. Later on it was found that appointment was invalid. X can not claim salary for the time he worked.
13. In case of breach of promise to marry the special damages are awarded on the basis of injury suffered by the person.
14. A contract of Insurance is a wagering agreement.
15. The principle that no one shall be allowed to enrich himself at the expense of another is known as Quantum Meruit.

16. A promises to give money or money's worth if an uncertain event happens or does not happen is Contingent Contract.
17. A contract to do or not to do something with reference to a collateral event happening or not happening is Wagering agreement.
18. X promises to sell his bike to Y for ₹ 1,40,000 if he feels like selling it after having a new bike. It is a contingent contract.
19. X agrees to make a furniture for Y for ₹ 2 lac on the term that payment will be made after the completion of the work. It is a contingent contract.
20. X had to pay property tax to the government. To save X's property from being seized by the government, X's friend Y paid the tax to the government in X's presence. Y can not recover the money from X.
21. X pays the arrears of rent of his nephew to his landlord just to avoid tension. X can recover this amount from his nephew.
22. F found a purse in a mall. He deposited the purse to the manager of the mall, so that the true owner can claim it back. However, no one claimed the purse. F wants the purse back. F cannot succeed.
23. An agreement to subscribe to or contribute a plate or prize of the value of ₹ 500 or above to be awarded to the winner of a horse race is unlawful.
24. X sells the goodwill of his retail store to Y for ₹ 10 lac and promises not to carry on the same business forever and anywhere in India. This agreement is valid.

## ANSWERS

1. **Incorrect.** As per Section 11, a minor is incompetent to contract. The law declares that an agreement entered into with a minor is void. As a minor's agreement is *void ab initio*, he cannot validate it by ratification on attaining his majority. Ratification in law is treated as equivalent to a validation of previous authority. Of course, such a person (minor) can enter into a fresh agreement, but the earlier amount received cannot be treated as consideration for the new agreement. (Relevant cases are **Mohiri Bibi vs. D.D. Ghosh and Nazir Ahmed vs. Jeevandas**).
2. **Incorrect:** As per the Indian Contract Act, 1872, minor is not competent to contract, but he can be a beneficiary. In this case, the minor is a beneficiary. Hence the Promissory Note is not void and the minor at his option can enforce it.
3. **Incorrect:** As per the Indian Contract Act, 1872, minor is not competent to contract and any agreement with him is void.
4. **Correct.**
5. **Incorrect.** The Contract **cannot be enforced** either by X's representative or by Y. To paint a picture is a personal contract and may be performed only personally. X personal contract cannot be performed by anybody other than the promisee. Hence, if X dies, the contract cannot be enforced.
6. **Incorrect.** Y cannot assign the right to sue to a third party because right to sue for damages is not a contractual right but a personal right given by law.

7. **Incorrect.** L can bring a suit against all legal heirs jointly.
8. **Incorrect.** 'Y' will be responsible to pay only to the extent of the assets he has inherited. (i.e. ₹ 10 lacs)
9. **Incorrect.** Y is not behind to accept the delivery because, in commercial deals, time is of essence.
10. **Incorrect.** Y can sue X on the basis of the anticipatory breach of contract.
11. **Incorrect.** X can not recover this loss from Z since. This is a special loss which X and Z had not contemplated in their contract.
12. **Incorrect.** He is entitled to remuneration for the services rendered on **quantum meruit basis**.
13. **Incorrect.** **Exemplary damages** are awarded on the basis of injury suffered by the person.
14. **Incorrect.** A contract of Insurance is a contingent contract.
15. **Incorrect.** It is known as "Quasi Contract": In certain situations, a person is obliged to compensate another although the basis of this obligation is *neither* a contract between the parties *nor* any tort on the part of the person who is bound to compensate. The basis of the obligation is that no one should have unjust benefit at the cost of the other. It is based on equity. These obligations relate to money and such other benefits, which the party under obligation has benefited from the other.
16. **Incorrect.** It is Wagering agreement.
17. **Incorrect.** It is Contingent Contract.
18. **Incorrect.** It is a void agreement because it is an uncertain agreement.
19. **Incorrect.** It is not a contingent contract because the uncertain event (completion of the work) is not collateral to the contract, but the main part of the consideration in the contract.
20. **Incorrect.** Y can recover the money from X as per Sec. 69 of the Indian Contract Act, 1872.
21. **Incorrect.** X can not recover this amount from his nephew since Sec. 69 applies only when such a payment is made in which the person is interested.
22. **Incorrect.** F can succeed since finder's right of possession is superior to all except the true owner.
23. **Incorrect.** According to the exception as per Section 30 of the Indian Contract Act, 1872, a subscription, or contribution or agreement to subscribe or contribute, made or entered into for or towards any plate, prize or sum of money, of the value or amount of ₹ 500 or upwards, to be awarded to the winner of any horse race, shall **not be deemed to be unlawful**.
24. **Incorrect.** As per Section 27 of the Indian Contract Act, 1872, an agreement in restraint of trade is void. However, a buyer can put such a condition on the seller of goodwill not to carry on the same business. However, the conditions must be reasonable regarding the duration and the place of the business.

**2. State with reasons whether the following statements are correct or incorrect:**

1. "An agreement with intention to create legal liability is not enforceable by law."
2. "Death or insanity of the proposer automatically revokes the proposal."
3. "Crossing of letters of offer in the post for the sale and purchase of the same articles constitute a valid agreement."
4. "A proposal may be revoked by the proposer before the posting of the letter of acceptance by the acceptor."
5. "If an offer is made in the form of a promise in return for any act, the performance of that act even without any communication thereof, is to be treated as an acceptance of the offer."
6. "Acceptance can be made even without the knowledge of the offer."
7. "An agreement with intention to create legal liability is not enforceable in law."
8. "If the offeree does not accept the offer according to the mode prescribed by the offerer, the offer does not lapse automatically."
9. "Where the mode of acceptance is prescribed in the proposal, it need not be accepted in that manner."
10. A minor can be a promisee in a contract.
11. A person who is usually of unsound mind but casually of sound mind can always enter into a valid contract.
12. A minor can be a partner in a firm.
13. "A person who is usually of unsound mind cannot enter into a contract even when he is of sound mind."
14. "A contract to take a loan by a boy of sixteen years of age from a money-lender of 50 years old, in a valid contract."
15. "A person who is usually of sound mind, but occasionally of unsound mind is unable to make the contract."
16. "Inadequacy of consideration does not affect the validity of a contract."
17. "A stranger to the consideration can enforce the contract."
18. "Inadequacy of the consideration cannot be taken into account by the Court in determining whether the consent was given freely."
19. "In discharge of the whole claim a party to the contract agrees to accept a lesser amount than due, from the other party is a valid contract in spite of inadequate consideration."
20. Consent obtained by fraud makes the agreement void.
21. "According to the doctrine of 'Privity of Contract'. a stranger to a contract, if he is beneficiary cannot enforce the contract."
22. "A promise to take either rice or smuggled opium for a consideration of rupees one thousand is wholly void"
23. "An agreement to discover treasure by magic is valid."
24. "A contract of insurance is a wagering agreement."

- 
25. An agreement the meaning of which is not certain or capable of being made certain is not void.
  26. "Transactions incidental to wagering agreements are not void."
  27. "Performance of the contract may be made only by the parties to the contract."
  28. "A promise under a contract can be performed by the promisor himself"
  29. "When the promisee does not accept the offer of performance, the promisor is not responsible for non-performance."
  30. "Payments made by a debtor are always appropriated in a chronological order."
  31. Commercial impossibility is not a valid excuse for the non-performance of a contract.
  32. "Commercial impossibility does not make the contract void."
  33. Cancellation of a contract by mutual consent of the parties is called waiver'.
  34. For default in the repayment of loan on the agreed date, interest can be increased retrospectively from the date of lending.
  35. "In Quasi-Contracts the promise to pay is always an implication of law and not of facts."
  36. Pledging of goods obtained on sale or return basis will complete the sale.
  37. Delivery of ascertained goods is essential for the completion of sale.
  38. Parties to a contract of sale can get the price of goods fixed by third parties.
  39. In an auction sale, a bid once given cannot be withdrawn.
  40. In a contract of sale by description and by sample, the bulk of the goods must correspond to either description or sample.
  41. In an agreement to sell the title of the goods passes to the buyer immediately.
  42. A seller need not disclose defects in the goods to the buyer before sale.
  43. [n an auction sale, bidders can enter into an agreement to keep the bid low by eliminating competition amongst them.
  44. In a sale, the property of the goods is transferred from seller to the buyer in case of generic goods.
  45. An unpaid seller who is in possession of goods sold, can exercise the right of lien even when the property has passed to the buyer.
  46. A seller can never bid at an auction sale.
  47. An unpaid seller can exercise the right of stoppage of goods in transit if the buyer becomes insolvent.
  48. The rights and liabilities arising in a contract of sale may be varied or avoided by a binding usage.
  49. Actionable claim is a subject matter of contract of sale.
  50. When goods are delivered at a distance place, the liability for deterioration necessarily incidental to the course of transit will fall on the seller.
  51. In a contract for the sale of unascertained goods, no property in the goods is transferred unless and until the goods are ascertained.

52. A railway receipt is not a document of title.
53. When goods are delivered to the buyer and he refuses to accept them he is not bound to return the goods to the seller.
54. Consideration in a contract of sale of goods can also be paid partly in money and partly in goods.
55. The right of lien by an unpaid seller can be exercised for the non-payment of price of goods and other charges.
56. In an auction sale goods to be auctioned can be put for sale in lots.
57. 'Right of Lien' and 'Right to Stoppage the goods in transit' may be exercised simultaneously by an unpaid seller.
58. After completion of the sale in an auction, the property in the goods and the risk of the loss caused in an accident to the auctioned property therein, is transfer to the bidder.
59. Where the goods are of perishable nature the unpaid seller cannot re-sell the goods without any notice to the buyer.
60. Exchange of goods for goods between the two parties amounts to sale under the sale of Goods Act, 1930.
61. Where the buyer elects to treat the breach of condition as one of warranty, he may repudiate the contract.
62. A partner can be admitted in a firm by the consent of the majority of partners.
63. A minor can be a partner in a firm.
64. The liability of a retired partner to third parties continues even after his retirement.
65. A partner of an unregistered firm can sue for the dissolution of a firm.
66. A partner is not an agent of other partners.
67. On becoming major, the liability of a minor admitted to the benefits of partnership and now becoming a partner becomes unlimited from the date of majority.
68. Partners can change the nature of the business of the firm by majority decision.
69. A person can be admitted to a partnership firm with the consent of majority of partner only.
70. A money lender getting a share in the profits of the firm for the sum lent is a partner in the firm.
71. Implied authority of a partner does not include entering into partnership on behalf of the firm.
72. Sharing of profits of a business is conclusive evidence of partnership.
73. A major and a minor can create a partnership.
74. An unregistered firm can file a suit for set off.
75. A partner whether active or dormant is entitled to have access to any of the books of the firm and take out a copy thereof.
76. A partner in a firm has a right to receive interest on advances given by him to the Firm @ 12% p.a.



77. An invalid expulsion of a partner does not give him a right to claim damages.
78. A partnership contract providing that no partner shall carry on any business other than that of the firm, while he is a partner, is void.
79. 'Sharing of Profits is conclusive evidence of partnership'.
80. 'A partner is not entitled to claim remuneration'.
81. A new partner may be introduced in the firm even by any existing partner of the firm.
82. The implied authority of a partner empowers him to acquire immovable property on behalf of the firm.
83. A transferee of a partner's interest in a firm accept a loan on behalf of the firm, for which the other partner was authorised to do so, invest it in the non partnership business, without the consent of all the partners. The transferee is empowered to accept the loan.
84. A third party cannot exercise any right against a non-registered firm.
85. Where two person jointly run a coach and share the profits derived from running such business constitute partnership business.
86. A partnership may be formed with two partnership firms as partners.
87. A partner who has purchased the goodwill of the firm on the dissolution of partnership firm has right to make use of the firm's name for earning profits.
88. All partners are not joint owners of the property of the firm, unless otherwise provided in the agreement.
89. The test of existence of partnership is the element of sharing of profits rather than mutual agency.
90. Permanent incapacity of partner is not a ground for dissolution of partnership firm.

### ANSWERS

- |               |               |               |               |               |
|---------------|---------------|---------------|---------------|---------------|
| 1. Incorrect  | 2. Incorrect  | 3. Incorrect  | 4. Correct    | 5. Correct    |
| 6. Incorrect  | 7. Incorrect  | 8. Correct    | 9. Incorrect  | 10. Correct   |
| 11. Incorrect | 12. Incorrect | 13. Incorrect | 14. Incorrect | 15. Incorrect |
| 16. Correct   | 17. Correct   | 18. Incorrect | 19. Correct   | 20. Incorrect |
| 21. Incorrect | 22. Incorrect | 23. Incorrect | 24. Incorrect | 25. Incorrect |
| 26. Correct   | 27. Incorrect | 28. Incorrect | 29. Correct   | 30. Incorrect |
| 31. Correct   | 32. Correct   | 33. Incorrect | 34. Incorrect | 35. Correct   |
| 36. Correct   | 37. Incorrect | 38. Correct   | 39. Incorrect | 40. Incorrect |
| 41. Incorrect | 42. Correct   | 43. Correct   | 44. Incorrect | 45. Correct   |
| 46. Incorrect | 47. Correct   | 48. Correct   | 49. Incorrect | 50. Incorrect |
| 51. Correct   | 52. Incorrect | 53. Correct   | 54. Correct   | 55. Incorrect |
| 56. Correct   | 57. Incorrect | 58. Correct   | 59. Incorrect | 60. Incorrect |
| 61. Incorrect | 62. Incorrect | 63. Incorrect | 64. Correct   | 65. Correct   |
| 66. Incorrect | 67. Incorrect | 68. Incorrect | 69. Incorrect | 70. Incorrect |
| 71. Correct   | 72. Incorrect | 73. Incorrect | 74. Incorrect | 75. Correct   |
| 76. Incorrect | 77. Correct   | 78. Incorrect | 79. Incorrect | 80. Correct   |
| 81. Incorrect | 82. Incorrect | 83. Incorrect | 84. Correct   | 85. Incorrect |
| 86. Incorrect | 87. Correct   | 88. Incorrect | 89. Incorrect | 90. Incorrect |

### QUESTION ON VALIDITY OF CONTACT

**State with reason whether there is any contract made in the following cases as per The Indian Contract Act, 1872:**

1. X accepts an invitation of Y to dinner but fails to attend.
2. A father promised to pay his son ₹1 lac on passing CA examination in first attempt. The son passed in the first attempt but father failed to pay.
3. Cash is withdrawn by customer of bank from ATM.
4. X takes a seat in a public Bus.
5. X puts ten Ten rupees coin in the slot of a water bottle vending machine at Airport.
6. X bids at a public auction.
7. X tells Y that Z has expressed her willingness to marry him (Y).
8. X offers to donate a specified sum to an orphanage who accepts this offer but does not donate.
9. Where there is a family settlement in writing a family member who is not a party to the settlement wishes to enforce his claim.
10. X agrees with Y to sell his black horse. Unknown to both the parties, the horse was dead at the time to agreement.
11. X promises Y to put life into the dead wife of Y for ₹ 10 lacs. Y accepted.
12. The agreement towards compounding of an offence to avoid prosecution.
13. A and B enter into a contract believing wrongly that a particular debt is not barred by law of limitation.
14. 'A' and 'B' are partners in a firm. They agree to defraud a Government department by submitting a tender in the individual name and not in the firm name.

### SOLUTION

1. There is no contract. It is a social agreement which is unenforceable by law as the parties never intended to create legal relationship.
2. There is no contract. It is a social agreement which is unenforceable by law as the parties never intended to create legal relationship.
3. There is Tacit contract which is inferred through the conduct of parties.
4. There is a valid contract since there is an implied acceptance (i.e. by taking seat) of an implied offer (i.e. by transport company to carry passengers).
5. There is a valid contract since by putting ten rupees coin X has accepted an implied offer by the owner of water bottle vending machine.
6. There is no contract unless an offer by the bidder is accepted by the auctioneer by some customary method such as fall of hammer.
7. There is no contract since the essential element of communication of offer by one party and its acceptance by the other party is missing.

8. There is no contract since the essential element of consideration is missing in Gratuitous Promise. Hence it cannot be enforced.
9. As per the judgement in Shuppu Vs Subramanian (Madras), a family settlement in writing may be enforced by a member of the family who was not a party to the settlement.
10. There is no contract. Such agreement is void since both the parties to an agreement are under mistake as to a matter of fact, which is essential to the agreement. [Sec. 20]
11. There is no contract. This agreement is void since the act is impossible at the time of making agreement.
12. There is valid contract.
13. There is valid contract because there is no mistake of fact but of law only.
14. There is no valid contract. It is a void agreement as it is a fraud on the Government department.

## **CORRECT INCORRECT QUESTIONS ON THE COMPANIES ACT, 2013**

**State with reason whether the following statements are Correct or Incorrect:**

1. Member of a limited company may nevertheless have unlimited liability.
2. A limited liability company can become a partner in a firm
3. A limited company can be formed without the word 'limited' as the last word of its name.
4. A promoter is trustee and agent of the company.
5. A promoter can demand remuneration if the articles provide for the payment thereof.
6. The validity of a certificate of incorporation can not be disputed on any ground whatsoever.
7. Act ultravires the company can be made binding upon the company by a unanimous vote of all the members of the company.
8. Alteration of Memorandum invariably involves passing of a special resolution.
9. Alteration of Memorandum does not require Articles' Authorisation.
10. Each company must have capital and liability clause in its Memorandum.
11. A firm can never be member of any company.
12. An unlimited company may be registered as a limited company.
13. Alteration of articles may have retrospective effect.
14. Articles can be altered to deprive a company of its powers to amend articles.
15. Outsider can sue the company for enforcement of articles which provide certain rights to him.
16. Doctrine of Indoor management protects the outsiders against the illegalities of the company.

17. A minor can become neither member nor transferee.
18. A company can not become a member of another company.
19. The shares of every company are freely transferable.
20. The shareholders are the joint owners of the company's property.
21. When two joint Hindu families form a partnership, then all the male members of both joint families will be counted for the purposes of determining the no of members.
22. A public limited company in which 200 couples hold shares jointly in the name of husband and wife, 50 present employees who hold shares and 50 ex employees to whom shares were allotted when they were employees can not be converted into private company.
23. The memorandum of association is an unalterable charter of a company.
24. In the event of conflict between the memorandum and the articles, it is the memorandum that will prevail.
25. A partnership firm may hold shares in a Company by holding shares in the individual names of the partners as joint holders.

## ANSWERS

1. **Incorrect:** As per Sec 3A, if the company carries on business for more than 6 months with no of members reduced below the statutory minimum requirement (i.e. 2 in case of a Pvt. Co and 7 in case of public Co.) all the persons who were members of the company and were aware of this fact shall be personally liable for debts contracted after those 6 months.
2. **Correct:** A company can become a partner in a firm since it is a separate legal entity. However, the liability of such limited company shall be unlimited like that of other partners. It may be noted that it is the liability of the members of a limited company which is limited and not that of the company itself. As per department of company affairs, a company can become a partner only if its memorandum of association specifically allows so.
3. **Correct:** As per Sec 8. The Central Govt. may by licence permit an association not for profit to be formed with limited liability without using the word 'limited' or 'private limited' as part of its name. The Central Govt. may grant such license if:
  - (i) the association about to be formed as a limited company aims at the promotion of commerce, art, science, religion, charity or any other useful object;
  - (ii) it intends to apply its profits, if any, for promoting its objects; and
  - (iii) it prohibits the payment of dividend to its members.
4. **Incorrect:** A promoter is neither trustee nor agent of the company but he stands in a fiduciary position towards the company. The fiduciary obligation of promoter, means an obligation of promoter to disclose fully all material facts of contracts, profit made or to be made and his personal interest in any transaction/contract with the company. In fiduciary capacity a promoter has duty—
  - (a) Not to make secret profit

- (b) To make full disclosure of material facts to company
  - (c) To give benefit of negotiation to the company.
  - (d) To ensure that prospectus issued at his instance contains no concealment and misstatement of material facts.
5. **Incorrect:** Provision in articles merely gives the directors an authority to make such payment but does not give the promoters a right to claim remuneration or to sue the company for the same.
  6. **Correct:** As per Sec 9 Certificate of incorporation given by the Registrar of Companies in respect of any association shall be conclusive evidence that—
    - (a) all the requirements of Companies Act have been complied with in respect of its registration as well as matters precedent and incidental thereto,
    - (b) the association is a company authorized to be registered and duly registered under the Act.

Meaning of 'conclusive evidence' The term 'conclusive evidence' means that no inquiry shall be allowed to be made regarding the correctness or incorrectness of any particulars contained in the certificate of incorporation.

Procedural Irregularities relating to registration, defects in prescribed particulars (including forged signature of subscribers) etc. shall not affect the corporate legal status of the company.
  7. **Incorrect:** Act ultravires the company shall be void and it can not be ratified even by an unanimous resolution of all the shareholders [Ashbury railway carriage & iron Co. V. Riche]
  8. **Incorrect:** As per Sec 61, alteration of share capital and as per Sec. 16 Rectification of Name of Co. requires passing of ordinary resolution.
  9. **Incorrect:** As per Sec 61, alteration of share capital requires articles' authorisation.
  10. **Incorrect:** Company having no share capital need not have capital clause and unlimited company need not have liability clause.
  11. **Incorrect:** A firm can become a member of a licensed company u/s 8 and ceases to be member on dissolution of him.
  12. **Correct:** Sec 18 permits so.
  13. **Correct:** Articles' alteration may have retrospective effect so long as it does not affect the things already done by the company and alteration is for the benefit of the company as a whole [Allen V. Gold Feet of West Africa]
  14. **Incorrect:** The power to alter A/A is a statutory power and it cannot be taken away by any provision in M/A or A/A. [Walker V. London Tramways Co.]
  15. **Incorrect:** Outsider can not sue merely on the basis of articles since M/A & A/A do not constitute a contract between a company and outsider. [Eley V. Positive Govt. life Assurance Ltd.]
  16. **Incorrect:** Doctrine of indoor management protects the outsiders against the procedural irregularities of the company and not illegalities. [Rubben V. Great Fingal Consolidated]

17. **Incorrect:** A minor can not be come a member because he does not have contractual capacity to enter any valid contract. But a minor can become transferee of a fully paid shares through guardian. [Miss Nandita jain V. BC & Co.]
18. **Incorrect:** A company can become member of another company if it is so authorised by its M/A since it is a separate legal entity. But a subsidiary company can not become a member of its holding company except in two cases as per Proviso to Sec 19 (1)
19. **Incorrect:** The shares of only public company are freely transferable and not of a private company as per Sec 2(68).
20. **Incorrect:** Company is the owner of its property. The shareholders are not the joint owners of the company's property. They do not even have an insurable interest in company's property. They can not get the company's property insured in their names. [Macaura V. Northern Assurance Co. Ltd. (1925)]
21. **Incorrect:** When two joint Hindu Families form a partnership, then all the adults (whether Male or Female) of both joint families will be counted for the proposes of determining the no. of members.
22. **Incorrect:** Such public co. can be converted into Pvt. Co. because its total members are limited to 200.

200 Couples [Joint shareholders are considered as single member) (200 × 1)	200
Present & Ex. Employees (not considered for limit of 200)	0
Total Members	200

23. **Incorrect:** The Memorandum of Association can be altered in cases, in the mode and to the extent for which express provision is made in the Act.
24. **Correct:** The Memorandum of Association is the charter of the company which defines and confines its objects. The Articles of Association are subordinate to the Memorandum of Association. Hence, in case of conflict between the two the provision of memorandum will be upheld.
25. **Correct:** Partners may become members of the Company.



# Practical Problems

## 1.0 MEANING AND ESSENTIALS OF CONTRACT

1.1 State with reason whether there is a valid contract in the following cases:

- (a) X invited Y for dinner and Y accepted the invitation.
- (b) X makes a promise to his wife Y to give her pocket money of ₹ 10,000 per month.
- (c) X appointed Y an agent, by an agreement which shall not be subject to legal jurisdiction in the law courts.

**Answer:**

- (a) No, because it was a social agreement and the parties never intended to create any legal relations. [Leading case: Balfour v. Balfour]
- (b) No, because it was a domestic agreement and the parties never intended to create any legal relations. [Leading case: Balfour v. Balfour]
- (c) No, because there was no intention to create legal relations. [Leading case: Rose & Frank Company v. Crompton Brothers]

## 2.0 OFFER AND ACCEPTANCE

2.1 State with reason whether the following constitute a valid offer to sell.

- (a) A notice stated that the goods included in the notice will be sold by tender.
- (b) An advertisement in a newspaper that a sale of office furniture by auction will be held at 2 P.M. On 9th August, 2018 at Pragati Maidan, Stall No. 420, New Delhi.
- (c) The display of articles with a price in a shop having “self service” system.

**Answer:**

- (a) The notice was a mere statement of intention and not an offer to sell. [Spencer v. Harding]
- (b) The advertisement was merely an invitation to offer and not an offer to sell. [Leading case: Harris v. Nickerson]
- (c) The display of articles with a price in a shop is **merely an invitation to offer and not an offer for sale.**

2.2 State with reason whether there is a valid contract in the following cases:

- (a) X sold his business to Y but this fact was not known to an old customer Z. Z placed an order for certain goods to X by name. Y supplied the goods to Z.

- (b) X offered to sell two plots of land to Y at a certain price. Y accepted the offer for one plot.
- (c) F offered by a letter to buy his nephew's horse for ₹ 1,00,000 saying "If I hear no more about him, I shall consider the horse mine." The nephew sent no reply at all but told B his auctioneer not to sell that particular horse as he intended to sell that horse to F.
- (d) X made an offer to buy shares of Y Ltd. on 10th Jan. but the allotment was made on 10th July.
- (e) X offered his cottage to Y for a cash price of ₹ 50,000. Y accepted the offer, sent ₹ 20,000 by cheque and a promissory note for the balance payable after three months.
- (f) X sends an offer to Y to sell his second-car for ₹ 1 lac with a condition that if Y does not reply within a week, he (X) shall treat the offer as accepted but Y communicates his acceptance after one week.
- (g) X proposed to sell his house to Y. Y sent his acceptance by post. Next day, Y sends a telegram withdrawing his acceptance. The telegram of revocation and letter of acceptance both reached together.
- (h) On 5th Jan., X offered to Y to sell him horse for ₹ 4,000 and that this offer will remain open till 3 PM, Jan 9. On 6th Jan., X sold the horse to Z, Y sent his acceptance to X before 3 PM on 9th Jan.
- (i) X offered to sell his car for ₹ 1,00,000 to Y. Y replies "I will pay ₹ 90,000 for it." X refuses to sell at this price. Y then attempts the original offer but X refuses to sell his car.

**Answer:**

- (a) No, because Z's offer was a specific offer to X and X alone could accept it. [Leading case: Boulton v. Jones]
- (b) No, because the acceptance was not valid as it was not for the whole of the offer. [Leading case: Bhawan v. Sadula]
- (c) No, because his nephew had not communicated acceptance to him. Mental acceptance is no acceptance. [Leading case: Felthotase v. Bindley]
- (d) No, because the acceptance was not given within a reasonable time. [Leading case: Ramsgate Victoria Hotel Co. v. Montefiore]
- (e) Yes, because X 's offer was duly accepted by Y.
- (f) No, because Acceptance to an offer cannot be implied merely from the silence of the offeree, even if it is expressly stated in the offer itself. Unless the offeree has by his previous conduct indicated that his silence amounts to acceptance, it cannot be taken as valid acceptance. So in the given problem, if Y remains silent, it does not amount to acceptance.

The acceptance must be made within the time limit prescribed by the offer. The acceptance of an offer after the time prescribed by the offeror has elapsed will not avail to turn the offer into a contract. **(Ramsgate Victoria Hotel (v) Montefiore).**



- (g) Section to which the given Problem relates: Sec. 4 & 5
- (i) If X opens the telegram (containing the revocation of acceptance) first and reads it, the revocation is valid and there is no contract.
  - (ii) If X opens the letter (containing the acceptance) first and reads it, the revocation is not valid as the contract has already been concluded.
- (h) No, because offer was revoked before its acceptance.
- (i) No, because Y's first reply is a counter offer and not an acceptance of X's offer and has put an end to the original offer. After having made the counter offer, Y cannot accept the original offer which has already come to an end. [Leading case: Nihal chand v. Amar Nath]

**2.3** X advertises in a newspaper that he would pay ₹ 1,00,000 to anyone who traces his missing son. Y traced that boy and claimed the amount of reward. State whether Y is entitled to receive the amount of reward if (a) he did not know about the reward before tracing the missing son, (b) if he knew about the reward before tracing the missing son?

**Answer:**

- (a) No, because there can be no valid acceptance without the knowledge of the offer. [Leading case: Lalman Shikla v. Gauri Dual]
- (b) Yes, because Y has accepted the general offer by tracing the missing son. [Leading case: Har Bhajan Lal v. Harcharan Lal]

**2.4** X delivered a coat to Y, a dry cleaner for dry cleaning and took the receipt. On the back of the receipt, certain conditions were printed in English language. One of the conditions printed on the back was "The liability of the dry cleaner Company shall be limited to the 50% of the cost of the goods." X never looked at the back of the receipt. X's coat was lost and X claimed the actual value of the coat. Discuss the legal position in each of the following alternative cases:

Case (a) If there was nothing on the face of the receipt to draw the attention to the conditions printed on the back side and X was a graduate in English.

Case (b) If on the face of the receipt, the words 'See Back' were printed in English but X did not read it.

**Answer:**

- (a) X was entitled to claim compensation for the loss of his coat because there was no indication on the face of the ticket to draw his attention to the special terms printed on the back of the ticket. If conditions are not properly communicated, the same would't be binding on the parties. [Handerson v. Stevenson]
- (b) X was entitled to claim only 50% of the cost of the coat because there was sufficient notice on the face of the ticket as to the existence of conditions.

**2.5** X and Mrs. X hired a room in a hotel for a week. When they entered the room, they found a notice on the wall disclaiming the owner's liability for damages, loss or theft of articles. Some of their items were stolen. Discuss the legal position.

**Answer:** The owner of the hotel was liable because the special terms (i.e. notice)

were communicated after the formation of the contract. [Leading case: Olley v. Marlborough Court Ltd.]

### **3.0 CAPACITY OF PARTIES**

**3.1** State with reasons whether the following statements are True or False:

- (a) A minor can become a partner in a partnership firm.
- (b) A minor can not act as an agent .
- (c) A minor can not become a member of a Company.
- (d) A minor can be declared insolvent.
- (e) A minor can not be apprentice.
- (f) A minor can be an employee .
- (g) A minor can be a guarantor.
- (h) A mortgage can be executed in favour of a minor who has advanced money.
- (i) A minor can be a promisor on a promissory note.
- (j) A minor can be a drawee on a bill of exchange.
- (k) A minor who sold goods is entitled to recover the price from the buyer.
- (l) X, a guardian, on behalf of Y, a minor can enter into a contract for the purchase of a movable property for the benefit of the minor.

**Answer:**

- (a) **False:** A minor cannot become a partner in a partnership firm. However, according to Section 30 of The Indian Partnership Act 1932, with the consent of all the partners for the time being be admitted to the benefits of partnership. In other words, he can share the profits without incurring any personal liability.
- (b) **False:** A minor can act as an agent and bind his principal by his acts without incurring any personal liability.
- (c) **False:** A minor can become a shareholder or member of a Company if (a) the shares are fully paid up and (b) the articles of association do not prohibit so.
- (d) **False:** A minor cannot be declared insolvent because he is not competent to contract.
- (e) **False:** A minor can be apprentice if he is of at least 14 years of age.
- (f) **False:** A minor can not be an employee because minor's promise to serve is not a consideration for employer's promise to pay salary.[Raj Rani vs. Prem Adib]
- (g) **False:** A minor can not be a guarantor.
- (h) **True:** A mortgage can be executed in favour of a minor who has advanced money since a minor can be a promisee.
- (i) **False:** A minor can be a promisee but not a promisor on a promissory note.
- (j) **False:** A minor can be a drawer but not a drawee on a bill of exchange.
- (k) **True:** A minor who sold goods is entitled to recover the price from the buyer since a minor can be a promisee.

(I) Yes, because this contract is for the benefit of minor. [Leading case: Subramanayan v. Subba Rao]

**\*3.2** D, a minor, borrowed a sum from M by executing a mortgage of his property in favour of M. Can M recover the sum advanced to D in the following cases ?

Case (a) If lending of money was not for the necessities

Case (b) If lending of money was for meeting the cost of education.

Case (c) If lending of money was for buying eleven fancy coats for minor's own use

Case (d) If D, a minor, borrowed by misrepresenting himself to be of 19 years

**Answer:**

Case (a) No, M can not recover the sum advanced to D since a minor is not competent to contract and hence minor's contract is void. [Leading case: Mohori Bibee v. Dharmodas Ghosh]

Case (b) This type of contract is called a Quasi-contract and the right of the supplier/lender is based on the principle of equity. As per Sec. 68 of the Indian Contract Act, 1872, a person who has supplied necessities or lent money for the necessities suited to his condition of life, is entitled to claim the price of necessities/money lent for the necessities from the property of the minor. The liability of minor is limited only to the extent of the minor's property. Thus, M will be entitled to recover the amount of loan given to D for meeting the cost of education from the property of the minor.

Case (c) No, M can not recover the sum advanced to D since a minor is not competent to contract and hence minor's contract is void. [Leading case: Mohori Bibee v. Dharmodas Ghosh]. Lending of money for buying eleven fancy coats for minor's own use can not be said to be for necessities since eleven coats at a time cannot be a necessity.

Case (d) According to Sections 30 and 33 of the Specific Relief Act, 1963, in case of a fraudulent misrepresentation of his age by the minor inducing the other party to enter into a contract, the court may award compensation to the other party. The Lahore High Court in Khan Gul v. Lakha Singh held that where the contract is set aside, the status quo ante should be restored and the court may direct the minor on equitable grounds to restore the money or property to the other party if the money or property could be traced.

**3.3** D, on attaining majority, gave a promissory note in the satisfaction of one executed by him for money borrowed when he was a minor. Is this promissory note valid?

**Answer:** No, because there was no consideration. An agreement with a minor cannot be ratified even after he attains majority. Ratification relates back to the date of the making of the agreement and therefore an agreement which was then void cannot be made valid by subsequent ratification.

## 4.0 CONSIDERATION

**\*4.1** State with reasons whether Y can recover the promised amount from X in each of the following cases:

- (a) X promised to donate ₹ 10,000 towards the repairs of a temple of Y. X did not pay.
- (b) X promised to donate ₹ 10,000 towards the repairs of a temple of Y. Y has incurred a liability on the faith of this promise. X did not pay.
- (c) X a Hindu husband executed a registered document in favour of Y his wife, whereby he promised to pay her ₹ 10,000 per month. Later, X did not pay.
- (d) X a Hindu husband executed a registered document in favour of Y his wife, whereby he promised to pay her ₹ 10,000 per month after disagreement and quarrels between them. Later, X did not pay.
- (e) X wrote to Y, "At the risk of your own life, you saved me from a serious motor accident. I promise to pay you ₹ 1,000". X did not pay.
- (f) X, a client promises to pay Y, his advocate ₹ 10,000 in addition to his fees if he succeeds. X succeeds but refuses to pay ₹ 10,000.
- (g) X owed to Y ₹ 2,00,000. The debt was barred by the Limitation Act. X signed a written promise to pay ₹ 2,000 to Y on account of this debt.
- (h) X gifted ₹ 1,00,000 to Y his neighbour's wife by executing a registered gift deed without any consideration. There is no near relation between X and Y.

**Answer:**

- (a) No, because the agreement was void in the absence of any consideration. [Leading case: Abdul Aziz v. Masum Ali]
- (b) Yes, the agreement was valid because it was supported by consideration in the form of a detriment to Y who had incurred liability on the faith of the promise made by X. [Leading case: Kedar Nath v. Gorie Mohammad]
- (c) Yes. The agreement was valid because agreement made on account of natural love and affection between X and Y is valid even without consideration vide Section 25(1).
- (d) No. The agreement was void because it was **not made** on account of natural love and affection between X and Y. [Leading case: Rajlakhya Devi v. Bhoothnath Mookherjee]
- (e) Yes. The agreement was valid because a promise to compensate for voluntary acts done in the past is valid even though without consideration vide Section 25(2).
- (f) No, because X's promise to pay the additional sum was without any consideration. The consideration must be something which the promisor is not already bound to do. Here, Y was bound to render the best of his services under the original contract. [Leading case: Ramchandra Chintaman v. Kalu Raju]
- (g) Yes. The agreement was valid because a duly signed written promise to Pay Time Barred Debt is valid even though without consideration vide Section 25(3)].
- (i) Yes. The gift is valid. A completed gift needs no consideration and need not be a result of natural love and affection or near relation vide Explanation I to Section 25.

- \*4.2** X, by a registered deed gifted certain property to Y, his daughter with a direction that she should pay ₹ 10,000 per month to Z, her uncle (father's brother). On the same day the daughter entered into an agreement with her uncle to pay ₹ 10,000 per month. Later she refused to pay on the ground that she did not receive any consideration from her uncle. Advise her.

**Answer:** The facts of the given problem are based on case of **Chinnaya v. Ramayya**. Her action is wrong because:

- (i) as per Sec. 2(d) a consideration need not necessarily move from the promisee, it may move from any other person who may be stranger to the contract. (i.e. X in the present case).
- (ii) The deed of gift and the promise made by Y to Z to pay the annuity were executed simultaneously and therefore they should be regarded as one transaction and further consideration did flow from X to Y and such consideration from third party is sufficient to enforce the promise of Y, the daughter, to pay an annuity to Z.

## 5.0 FREE CONSENT

- 5.1** X threatens to kill Z, Y's son if Y does not sell his house to W for ₹ 1,00,000. Y sells his house to W and receives the payments. Later on, Y wants to avoid the contract. Will he succeed?

**Answer:** Y can avoid the contract on the ground of coercion u/s 15 since Y's consent is not free as it has been obtained by threatening to commit an act forbidden by the Indian Penal Code. Y will have to return ₹ 1,00,000 which he has received from W u/s 72.

- 5.2** A Hindu widow of 13 years was forced to adopt a boy under threat that her husband's dead body would not be allowed to be removed if she does not adopt the boy. She adopted the boy. Is widow's consent free?

**Answer:** Widow's consent is not free as it has been obtained by coercion u/s 15 because preventing the dead body from being removed for cremation is an offence u/s 297 of the Indian Penal Code. [Ranganayakamma v. Alwar Setti]

- 5.3** X, an agent, refused to hand over the account books of the principal to the new agent appointed in his place unless the principal released him from all liabilities. The principal had to give a release deed as demanded. Is this release deed binding upon the principal?

**Answer:** The release deed is not binding upon the principal on the ground of coercion u/s 15 since Y's consent is not free as it has been obtained by unlawful detaining of the property (i.e., account books). [Leading case: Muthia v. Karuppan]

- 5.4** The Government of a State gave a threat of attachment against the property of Y for the recovery of a fine due from Y's son. Y paid the fine. Advise Y.

**Answer:** Y could recover the amount paid on the ground of coercion u/s 15 because Y's consent is not free as it has been obtained by threatening to detain a property unlawfully. [Leading case: Bansraj v. The Secretary of State]

- 5.5** X, by a threat to commit suicide induced Y, his wife, and Z, his, son to execute a release deed in favour of his brother in respect of certain property. Are Y and Z. bound by such release deed?

**Answer:** Y and Z are not bound by such release deed on the ground of coercion u/s 15 since the consent of Y and Z is not free as it has been obtained by threatening to commit an act which is deemed to be forbidden by the Indian Penal Code. [Leading case: Ammiraju v. Seshamma]

- 5.6** X, an illiterate old man of about 90 years, physically infirm and mentally in distress, executed a gift deed of his properties in favour of this nearest relative who was looking after his daily needs and managing his cultivation. Is X bound by this gift deed.

**Answer:** No, Y's consent is not free as it has been obtained by exercising undue influence u/s 16(2) because Y was in position to dominate the will of X. [Leading case: Sher Singh v. Prithi Singh]

- 5.7** X, a poor Hindu widow, was in great need of money to establish her right to maintenance. She took a loan of ₹ 1,500 bearing a rate of interest of 100% p.a. Is this transaction an unconscionable?

**Answer:** Yes, not only the rate of interest is too high but also the lender has used the circumstances of poor Hindu widow to obtain an unfair advantage. [Leading case: Rane Annapurni v. Swaminatha]

- \*5.8** 'X' applies to a banker for a loan at a time where there is stringency in the money market. The banker declines to make the loan except at an unusually high rate of interest. X accepts the loan on these terms. Whether the contract is induced by undue influence? Decide.

**Answer:** This is a transaction in the ordinary course of business, and the contract is not induced by undue influence. As between parties on an equal footing, the court will not hold a bargain to be unconscionable merely on the ground of high interest. Only where the lender is in a position to dominate the will of the borrower, the relief is granted on the ground of undue influence. But this is not the situation in this problem, and therefore, there is no undue influence as per Sec. 16.

- 5.9** X's son forged Y's name to a promissory note. Y, under threat of prosecuting X's son, obtains a bond from X, for the amount of the forged note. Is X bound by bond?

**Answer:** No, the consent of X is not free as Y was in position to dominate the will of X and Y used the circumstances to obtain an unfair advantage. If X sues on this bond, the court may set the bond aside.

- 5.10** On 1st January X correctly informs Y that the monthly sales of his business are ₹ 1,00,000. In May the contract of sale of business was signed. During this period the monthly sales decreased to ₹ 50,000. Now Y wants to rescind the contract. Decide giving reasons.

**Answer:** Y is entitled to avoid the contract **because as per Sec 17** X's failure to disclose the fall in monthly sales amounts to fraud. [With V O' Flanagan]

- 5.11** X had a defective cannon. In order to conceal the defect, he put a metal plug on it. Y bought this cannon without examining. When Y used it, it burst. Y refused to pay the balance.

**Answer:** As per Sec 17, Y cannot avoid the contract on the ground of "fraud". Y was liable to pay as he was not actually deceived by fraud because he would have bought it even if no deceptive plug was inserted. [Horsefull v. Thomas]

- \*5.12** X bought shares in a company on the faith of a prospectus which contained an untrue statement that one Z, a popular key person in the industry was a director of the company. Actually Z was not a director of the company. X had never heard of Z. Can X claim damages on grounds of fraud?

**Answer:** X cannot claim damages on the ground of "fraud" since the untrue statement in the prospectus as to Z being a director was not the one that induced X to purchase the shares. He was not actually deceived by fraud because he would have bought the shares even if the prospectus did not contain the untrue statement as to Z being a director as X had never heard of Z. The problem is based on the facts of the case **Smith vs Chadwick** (1884).

- \*5.13** X sells by auction to Y a horse which X knows to be unsound. The horse appears to be sound but X knows about the unsoundness of the horse. Is this contract valid:

- (a) If X says nothing about the unsoundness of the horse to Y.
- (b) If X says nothing about it to Y who is X's daughter who has just come of age.
- (c) If Y says to X "If you do not deny it, I shall assume that the horse is sound." X says nothing.

**Answer:**

- (a) This contract is valid since as per Sec 17 Mere silence as to the facts likely to affect the willingness of a person to enter into a contract is not fraud. Here, it is not the duty of the seller to disclose defects.
- (b) This contract is not valid since as per Sec 17 It becomes X's duty to tell Y about the unsoundness of the horse because a fiduciary relationship exists between X and his daughter Y. Here, X's silence is equivalent to speech and hence amounts to fraud.
- (c) This contract is not valid since as per Sec 17 X's silence is equivalent to speech and hence amounts to fraud.

- 5.14** X chartered a ship to Y which was described in the 'Charter party' and was represented to him as being not more than 2,800 tonnage register. It turned out that the registered tonnage was 3,045 tons. Y refused to accept the ship in fulfillment of the charter party. Is Y's action valid?

**Answer:** Y was entitled to avoid the Chartered party since as per Sec 18 X's statement as to tonnage is misrepresentation. [Leading case: The Oceanic Steam Navigation Co. v. Soonderdas Dhurmsy]

- 5.15** X, a vendor of a piece of land tells a Y, prospective purchaser that, in his opinion, "this land produces 2 tons of rice per acre." X believes the statement to be true although he has no sufficient ground for the belief. Y purchases X's land believing

X's statement. Later on, Y finds that the land produces only 1.5 tons of rice per acre. Now Y wants to rescind the contract. Decide giving reasons.

**Answer:** Y can not avoid the contract since as per Sec 17 since X's statement is merely an opinion and not a representation and hence cannot amount to fraud. The problem is based on the facts of the case *Bisset vs Wilkinson* (1927).

- 5.16** X, by way of misrepresentation leads Y erroneously to believe that 100 quintals of indigo are made annually at Peter's factory. Y examines the accounts of the factory and finds that only 50 quintals of indigo have been made. Afterwards, Y buys the factory. Y now wants to avoid the contract on the ground of "misrepresentation" Advise him giving the reason.

**Answer:** As per Sec 18, Y cannot avoid the contract on the ground of "misrepresentation" because Y after becoming aware of misrepresentation takes the benefit under the contract.

- \*5.17** X induced Y to buy his motorcycle saying that it was in a very good condition. After taking the motorcycle, Y complained that there were many defects in the motorcycle. X proposed to get it repaired and promised to pay 50% cost of repairs. After a few days, the motorcycle did not work at all. Now Y wants to rescind the contract. Decide giving reasons.

**Answer:** As per Sec 18, Y cannot avoid the contract on the ground of "misrepresentation" because Y after becoming aware of misrepresentation takes the benefit under the contract. Y's acceptance to the X's to bear 50% of the cost of repairs impliedly amounts to final acceptance of the sale. [**Long v. Lloyd, (1958)**].

- 5.18** P inquired about the price of rifles from H suggested that he might buy fifty rifles. On receiving the quotation, P telegraphed "Send three rifles". But because of the mistake of the telegraph authorities, the message transmitted was "Send the rifles". H despatched fifty rifles. P accepted three rifles and returned the remaining forty-seven rifles. Is this agreement valid?

**Answer:** This agreement is void as per Sec 20 since both the parties under a mistake as to the quantity of the subject matter. [Leading case: *Henked v. Pape*]

- 5.19** X entered into a contract for the hiring of a room for witnessing the coronation procession of Edward VII. Unknown to both the parties, the procession had already been cancelled. Is this contract valid?

**Answer:** This agreement is void as per Sec 20 since both the parties under a mistake as to the possibility of performance. [Leading case: *Griffith v. Brymer*]

- 5.20** X buys from Y a painting which both believe to be the work of an old master and for which X pays a high price. The painting turns out to be only a modern copy. Discuss the validity of the contract.

**Answer:** The contract is absolutely void as per Sec 20 since there is a bilateral mistake as to the substance or quality of the subject-matter.

- 5.21** X offers to sell a painting to Y which X knows is the copy of a well-known master piece. Y, thinking that the painting is the original one, decides to buy it at a very high price. Is this a valid contract?



**Answer:** This contract is valid since as per Explanation to Section 20 An erroneous opinion as to the value of the thing which forms the subject matter of the agreement is not treated as mistake relating to a matter of fact. Here, Y will have to blame himself for ignorance of the true value of the painting.

- 5.22** X sold oats to Y by sample and Y, thinking that they were old oats, purchased them. In fact, the oats were new. Is Y bound by the contract?

**Answer:** Y is bound by the contract because a contract is not voidable because of unilateral mistake (i.e. mistake by only one party to the agreement) u/s 22 as to the matter of fact. Here, Y will have no blame himself for ignorance or wrong judgment. [Leading case: Smith v. Hughes]

- \*5.23** One Blankarn, knowing that Blankarn & Co was a reputed customers of Lindsay & Co., placed an order with Lindsay & Co. by imitating the signature of Blankarn & Co. The goods were then sold to Cundy, an innocent buyer. A suit was filed by Lindsay & Co. against Cundy for recovery of goods. Discuss the legal position.

**Answer:** As per Sec 22, there was no contract between Lindsay & Co., and Cundy as Lindsay never intended to contract with Blankarn. Hence, Cundy didn't get a good title and hence he must return the goods or make payment for the same u/s 72. [Leading case: Cundy v. Lindsay & Co]

- \*5.24** A women by falsely misrepresenting her to be wife of a well-known Baron (a millionaire), obtained two pearl necklaces from a firm of jewellers on the pretext of showing them to her husband before buying. She pledged them with a broker, who in good faith paid her ₹ 10,00,000. A suit was filed by the jeweller against the broker. Discuss the legal position.

**Answer:** As per Sec 22, there was no contract between the jeweller and the woman as jeweller never intended to contract with her. Hence, Broker did not get a good title and hence he must return the goods u/s 72. [Leading case: Lake v. Simmons]

- \*5.25** 'S' knew that on account of his criticism of the plays in the past, he would not be allowed entry to the performance of a play at the theatre. The managing director of the theatre gave instructions that no ticket should be sold to S. S, however, obtained a ticket through one of his friends. On being refused admission to the theatre, he sued for damages for breach of contract. Discuss the legal position.

**Answer:** As per Sec 22, there was no contract between the theatre company and 'S' as the theatre company never intended to contract with 'S'. Hence, 'S' is not entitled to claim any damages. [Leading case: Said v. Butt]

- \*5.26** 'X', an old illiterate man, was induced to sign a Bill of Exchange by means of a false representation that it was a mere guarantee. Discuss the legal position.

**Answer:** X is not liable for the Bill of Exchange since X never intended to sign a Bill of Exchange. [Leading case: Foster v. Mackinnon].

## **6.0 LEGALITY OF OBJECT**

- \*6.1** State with reason whether the following agreements are valid or void:

(i) X granted a loan to Y a guardian of a minor to enable him to celebrate the minor's marriage.

- (ii) X promises to drop prosecution which he has instituted against Y for robbery and Y promises to restore the value of the things taken.
- (iii) X's estate is sold for arrears of revenue under the provisions of an Act of the Legislature, by which a defaulter is prohibited from purchasing the estate. Y, upon the understanding with X, becomes the purchaser and agrees to convey the estate to X for the price which has paid.
- (iv) X borrowed ₹ 1,00,000 from Y and agreed not to raise any objection as to the limitation and that Y may recover the amount even after the expiry of limitation period.
- (v) X, being agent for a landed proprietor, agrees for money, without the knowledge of his principal, to obtain for Y a lease of land belonging to his principal.
- (vi) X borrowed ₹ 1,00,000 from Y, X executed a bond promising to work for Y without pay for 2 years and in case of default agreed to pay interest at 1 per month and the principal amount at once. Is this agreement valid?
- (vii) X promised to pay ₹ 10,000 to Y when he agreed to publish a libel (i.e. defamatory article against someone).
- (viii) X let a flat on hire to Y, a prostitute, knowing that it would be used for immoral purposes.
- (ix) 'X' advanced ₹ 1,00,000 to 'Y' a married woman to enable her to obtain a divorce from her husband. She also promised to marry him after divorce.
- (x) X promises to pay ₹ 1,00,000 to Y in order to induce him to retire so as to provide room for X's appointment to the public office held by Y.
- (xi) X, a father having two minor sons agreed to transfer their guardianship in favour of Mrs. Y and also agreed not to revoke the transfer. Subsequently, he filed a suit for the recovery of the boys and declaration that he was the rightful guardian.
- (xii) X borrowed ₹ 1,00,000 from Y on the promise that he would not, without the Y's written permission leave his job, borrow money, dispose of his property or change his residence.
- (xiii) X promises to supervise on behalf of Y, a licensed manufacture of some permissible chemicals and contraband items. For X's supervision Y promises him a salary of ₹ 5,000 per month.
- (xiv) X an industrialist has been fighting a long drawn litigation with Y another industrialist. To support his legal campaign X enlists the services of Z a legal expert stating that an amount of ₹ 10 lakhs would be paid, if Z does not take up the brief of Y. Z agrees, but at the end of the litigation X refuses to pay.
- (xv) X, agreed to pay ₹ 10,000 to Y to enable him to file a suit for the recovery of his property and Y promised to give him 3/4th share in the property, if recovered.

**Answer:**

- (i) The agreement is void as per Sec 23 because its object (i.e minor's marriage in contravention of the Child Marriage Restraint Act) is unlawful u/s 23. X can not recover his loan from Y. [Leading case: C. Srinivas v. K. Raja Ram Mohan Rao]

- (ii) The agreement is void as per Sec 23 because its object is unlawful u/s 23. [Leading case: William v. Bayley]
- (iii) The agreement is void as per Sec 23 because its object is to defeat the provisions of the law by which a defaulter is prohibited from purchasing the estate. This agreement results in an indirect purchase by the defaulter.
- (iv) The agreement is void as per Sec 23 because its object is to defeat the provisions of the law. Hence, Y is not entitled to recover the amount from X. [Rama Murthi v. Goppayya]
- (v) The agreement is void as per Sec 23 because its object is to defraud the principal by concealment by X.
- (vi) The agreement is void as per Sec 23 because its object is unlawful as it involves an injury to another person. Hence, Y is not entitled to recover the amount from X. [Leading case: Ram Saroop v. Bansi Mandar]
- (vii) The agreement is void as per Sec 23 because its object is unlawful as it involves an injury to another person. Y could not recover the amount. [Leading case: Clay v. Yates]
- (viii) The agreement is void as per Sec 23 because its object is immoral. [Leading case: Pearce v. Brooks]
- (ix) The agreement is void as per Sec 23 because its object is immoral. Hence, X is not entitled to recover the amount from Y. [Leading case: Baivijli v. Hamda Nagar]
- (x) The agreement is void as per Sec 23 because it is opposed to public policy as it is for the sale of public office. Hence, Y is not entitled to recover the amount from X. [Leading case: Yenkataramanaya v. J.M. Laho]
- (xi) The agreement is void as per Sec 23 because it is opposed to public policy as it is in restraint of parental rights. Hence, X had the right to revoke his authority and get back the children. [Leading case: Giddu Narayanish v. Mrs. Annie Basant]
- (xii) The agreement is void as per Sec 23 because it is opposed to public policy as it is in restraint of personal liberty of X. Hence, Y is not entitled to recover the amount from X. [Harwood v. Miller's Timber and Trading Co.]
- (xiii) The agreement is void as per Sec 24 because the legal promise cannot be separated from the illegal promise and hence it is not enforceable by law.
- (xiv) The agreement is void as per Sec 24 because it is an illegal agreement and cannot be enforced by law. Hence, Mr. Z cannot recover the amount.
- (xv) The agreement is void because it is champertous. Champerty is an agreement whereby one party agrees to assist another in recovering property and in turn is to share in the proceeds of the action. [Nuthahi Venkataswami v. Katta Nagi]

## **7.0 VOID AGREEMENTS AND CONTINGENT CONTRACTS**

**7.1** State with reason whether the following agreements are valid or void:

- (i) X promised to marry Y only and none else, and to pay ₹ 2,000 in default. X married Z and Y sued X for recovery of ₹ 2,000.

- (ii) An agreement between two co-widows that if one of them remarried, she should forfeit her right to her share in the deceased husband's property.
- (iii) Nikah Nama (i.e. a marriage agreement in Muslims) which authorises wife to divorce herself and to claim maintenance from the husband on his marrying a second wife.

**Answer:**

- (i) The agreement is void as per Sec 26 because it is in restraint of marriage. Hence, Y could not recover anything. [Lowe v. Peers]
- (ii) The agreement was not void as per Sec 26 because no restraint was imposed upon either of the two widows from remarrying. [Roa Rani v. Gulab Rani]
- (iii) The agreement was not void as per Sec 26 because no restraint was imposed upon husband from marrying a second wife. [Badu v. Badarannessa]

**\*7.2** State with reason whether the following agreements are valid or void:

- (i) A clause in a contract provided that no action should be brought upon it in case of breach.
- (ii) An agreement between two or more persons to refer to arbitration any dispute which has already arisen or may arise in future.
- (iii) Where two courts have jurisdiction to try a suit, an agreement between the parties that the suit should be filed in one of those courts alone and not in the other.
- (iv) An agreement not to go in appeal to a higher court against the judgement of a lower court.
- (v) A clause in a life insurance policy was that "no suit to recover under the policy shall be brought after one year from the date of death of assured." X died and his legal representatives filed a suit to recover the assured sum after two and half years.
- (vi) An agreement between X and Y not to institute legal proceedings against each other without consent.

**Answer:**

- (i) Such a clause is void as per Sec 28 because it is in restraint of legal proceedings as it restricts both the parties from enforcing their legal rights.
- (ii) The agreement is not void as per Sec 28 because it is not in restraint of legal proceedings.
- (iii) The agreement is not void as per Sec 28 because it is not in restraint of legal proceedings. [C. Milton & Co. v. Ojha Automobile Co.]
- (iv) The agreement is not void as per Sec 28 because it is not in restraint of legal proceedings.
- (v) The clause in policy is void because it curtailed the prescribed period of limitation (which is 3 years) according to Law of Limitation Act. Hence, This suit is maintainable.
- (vi) The agreement is void as per Sec 28 because it is in restraint of legal proceedings.

**\*7.3** State with reason whether the following agreements are valid or void:

- (i) X agreed to pay Y ₹ 5,00,000 if Y closes his business in that locality. Y accordingly did so but X refused to pay.
- (ii) X sells the goodwill of his shop to Y for ₹ 10,00,000 by an agreement which provided that X shall not carry on the similar business anywhere in India for the next 10 years.
- (iii) X sells the goodwill of his shop to Y for ₹ 10,00,000 by an agreement which provided that X shall not carry on the similar business in the same locality for the next 3 years.
- (iv) X sells the goodwill of his shop to Y for ₹ 10,00,000 by an agreement which provided that X shall not carry on any business in the same locality for the next 2 years.
- (v) An agreement among the partners that no partner shall not carry on any business other than that of the firm while he is a partner.
- (vi) An agreement with an outgoing partner that he will not carry on any business similar to that of the firm in the same locality for the next 3 years.
- (vii) An agreement among the partners upon the dissolution of the firm that some or all of them will not carry on a business similar to that of the firm in the same locality for the next 3 years.
- (viii) An agreement by a partner with the buyer of goodwill of the firm that he will not carry on any business similar to that of the firm in the same locality for the next 3 years.

**Answer:**

- (i) The agreement is void as per Sec 27 because it is in restraint of trade. Hence, Y cannot recover anything from X. [Leading case: Madhub Chander v. Raj Coomar]
- (ii) The agreement is void as per Sec 27 because it is in restraint of trade as the restrictions in regard to time and vicinity are unreasonable.
- (iii) The agreement is valid as per Sec 27 because it is not in restraint of trade as the restrictions in regard to time and vicinity seem to be reasonable.
- (iv) The agreement is void as per Sec 27 because it is in restraint of trade as the restriction in regard to carry on any business are unreasonable. Restriction must relate to a similar business.
- (v) The agreement is valid as per Sec 11(2) of The Indian Partnership Act, 1932.
- (vi) The agreement is valid as per Sec 36(2) of The Indian Partnership Act, 1932 as the restrictions in regard to time and vicinity seem to be reasonable.
- (vii) The agreement is valid as per Sec 54 of The Indian Partnership Act, 1932 as the restrictions in regard to time and vicinity seem to be reasonable.
- (viii) The agreement is valid as per Sec 55(3) of The Indian Partnership Act, 1932 as the restrictions in regard to time and vicinity seem to be reasonable.

**7.4** State with reason whether the following agreements are valid or void:

- (i) An agreement among four ginning factories to fix uniform rate for ginning cotton and to divide the profits in a certain proportion.
- (ii) An agreement among some ice manufacturing companies not to sell ice below a minimum price and to divide the profits in a certain proportion.
- (iii) An agreement between X, a dealer and Y, a manufacturer that X will deal in the products of Y only.
- (iv) An agreement between X, a dealer and Y, a manufacturer that Y will sell the whole produce to X only and not to any other person.
- (v) An agreement by a buyer of goods for Delhi market, not to sell them in Kolkata.
- (vi) X, a seller of imitation jewellery in England sold his business to Y and agreed not to deal for two years (a) in imitation jewellery in England, (b) in real jewellery in certain foreign countries.

**Answer:**

- (i) The agreement is not void as per Sec 27 because it is not in restraint of trade. [Haribhai v. Sharafali]
- (ii) The agreement is not void as per Sec 27 because it is not in restraint of trade as the agreement is to regulate the business and not to restrain it. [S.B. Fraser & Co. v. Bombay Ice Mfg. Co.]
- (iii) The agreement is valid if their terms are reasonable.
- (iv) The agreement is valid if their terms are reasonable. [Subha Naidu v. Haj Badsha Sahib]
- (v) The agreement is valid.
- (vi) The first promise was held lawful, the second promise was held as void because the restraint was unreasonable having regard to the nature of business.

**7.5** X employed Y. The terms of service agreement are-

- (a) The employee has to serve the organisation for 5 years.
- (b) The employee shall not accept any other similar engagement during the term of agreement.
- (c) The employee shall not accept similar engagement after the termination of services.
- (d) The employee shall not compete with his employer after the termination of services.

State the legal position of the terms of service agreement.

**Answer:** First two terms (a) and (b) are not in restraint of trade and hence valid. Last two terms (c) and (d), are restraint of trade and hence void.

**7.6** 'X' agreed to become an assistant for 3 years to 'Y' who was a Doctor practising at Delhi. It was also agreed that during the term of agreement 'X' will not practise on his own account in Delhi. At the end of one year, 'X' left the assistantship of 'Y' and began to practise on his own account. Decide whether 'X' could be restrained from doing so.

**Answer:** As per Sec. 27 an agreement in restraint of trade/business/profession is void. But an agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else directly or indirectly to promote any business in direct competition with that of his employer is not in restraint of trade. In such a situation the agreement is valid. Therefore, X can be restrained by an injunction from practicing on his own account in Delhi.

- 7.7** Miss X, a film actress agreed to work exclusively for a period of two years, for a film production company. However, during the said period she enters into a contract to work for another film producer. Advise.

**Answer:** Restraints on Miss X is valid since an agreement of service under which an employee agrees to serve a certain employer for a certain duration, and that the employee will not serve anybody else during such period is a valid agreement. Hence, Miss X may be restrained from working for another producer since, in case of breach of a negative term of a contract, the defaulting party is generally restrained from doing what she promised not to do. [Charlesworth v Mac Donald].

- \*7.8** State with reason whether the following agreements are valid or void:

- (i) An employee agreed not to carry on the similar business during 5 years after the termination of service.
- (ii) An employee who possesses certain trade secrets, agreed not to carry on the similar business during 5 years after the termination of service.

**Answer:**

- (i) The agreement is void as per Sec 27 because it is in restraint of trade as this agreement is to avoid competition. [Brahmaputra Tea Co. v. E. Scarth]
- (ii) The agreement is not void as per Sec 27 because it is not in restraint of trade as the restraint is intended only to protect an employer against an employee making use of trade secrets learned by him in the course of his employment. [Forster & Sons Ltd. v. Suggett]

- 7.9** X promised to pay Y for his services at his (X) sole discretion found to be fair and reasonable. However, Y dissatisfied with the payment made by X and wanted to sue him.

**Answer:** The agreement is void as per Sec 29 because the performance of a promise is contingent upon the mere will and pleasure of the promisor. Hence, Y's suit will not be valid. As per section 29 of the Indian Contract Act, 1872 – agreements, the meaning of which is not certain, or capable of being made certain, are void”.

- \*7.10** A Cricket match is to be held between India and Pakistan. X agrees to pay ₹ 10 lakhs to Y if India wins the match and agrees to deposit the money with Z a third person of confidence for this purpose. X borrows ₹ 10 lakhs from W.

Answer the following:

- (i) If India wins the match, can Y (a winner) recover?
- (ii) If India wins the match, can X (a loser) recover from Z?
- (iii) Can W recover from X if Borrowing agreement is entered into (a) Delhi (b) Bombay (c) Ahmedabad?

**Answer:**

- (i) The agreement between X and Y is a wagering agreement because the performance of an agreement depends upon the happening or non-happening of a future uncertain event and each party stands to win or lose. If India wins the match, Y (a winner) cannot recover the amount. Thus, a winner cannot recover the amount but a loser can if the amount has not been paid to the winner.
- (ii) Even if India wins the match, X (a loser) can recover from Z if the amount has not been paid to Y. [Bridger v. Savage]
- (iii) The agreement between X and W which is a collateral to wagering agreement, is valid in India except in the States of Maharashtra and Gujarat. Thus,
  - (a) W can recover the money from X if the agreement between X and W is entered into in Delhi
  - (b) W cannot recover the money from X if the agreement between X and W is entered into in Bombay or Ahmedabad.

**7.11** State whether the following are wagering agreements or not:

- (i) an agreement to enter into a wrestling event in which winner was to be rewarded by the entire sale proceeds of tickets.
- (ii) Prize competition in games of skill where the prize money is ₹ 1,000.
- (iii) An agreement to contribute to a plate or prize of the value of ₹ 500 to be awarded to the winner of a horse race.
- (iv) Contracts of insurance.

**Answer:**

- (i) It is not a wagering agreement. [Babasaheb v. Rajaram]
- (ii) It is not a wagering agreement because according to the Prize Competition Act, 1955, prize competition in games of skill are not wagers provided the prize money does not exceed ₹ 1,000.
- (iii) An agreement to contribute to a plate or prize of the value of ₹ 500 or above to be awarded to the winner of a horse race is not a wagering agreement u/s Sec 30.
- (iv) Contracts of insurance are contingent contracts but not wagering agreements.

**7.12** X agrees to pay B ₹ 50,000 if Y marries Z within 1 year. State the legal position :

- (a) If Y marries Z within 1 year.
- (b) If Y marries Z after 1 year.
- (c) If Y marries W within 6 months of agreement.
- (d) If Y marries W within 6 months of agreement. Subsequently, W dies and Y marries Z within 6 months of marriage W.

**Answer:**

- (a) Y can recover ₹ 50,000 from X since as per Sec 32 the contract can be enforced by law when the event has happened (i.e. the marriage of Y to Z).



- (b) Y cannot recover anything from X since as per Sec 35 the contract becomes void on the expiry of 1 year.
- (c) Y cannot recover anything from X since as per Sec 34 & 35 the contract becomes void as the event (i.e. the marriage of B to C) has become impossible.
- (d) Y can recover ₹ 50,000 from X since as per Sec 32 the contract can be enforced by law when the event has happened (i.e. the marriage of Y to Z).

## 8.0 PERFORMANCE OF A CONTRACT

- 8.1** X received certain goods from Y and promised to pay ₹ 60,000. Later on, X expressed his inability to make payment. Z, who is known to X, pays ₹, 40,000 to Y on behalf of X. However, X was not aware of the payment. Now Y is intending to sue X for the amount of 60,000. Can Y do so? Advise.

**Answer:** As per section 41 of the Indian Contract Act, 1872, when a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor. That is, performance by a stranger, accepted by the promisee, produces the result of discharging the promisor, although the latter has neither authorised nor ratified the act of the third party. Therefore Y can sue X only for ₹ 20,000.

- \*8.2** X, Y and Z jointly borrowed ₹ 60,000 from L. Decide in the light of The Indian Contract Act, 1872:
- (i) whether L can compel only Y to pay the entire loan of ₹ 60,000,
  - (ii) If X,Y and Z died,whether L can compel only the Legal representatives of Y to pay the loan of ₹ 60,000,
  - (iii) If the whole amount was repaid to L by Y. How much Y can recover from X and Z?
  - (iv) If the whole amount was repaid to L by Y. Z became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts. How much Y can recover from X and Z?
  - (v) If the whole amount was repaid to L by Y. Z became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts and X died and his son W inherited the assets of ₹ 17,000. How much Y can recover from X and Z?
  - (vi) If L releases X from his liability and sues Y and Z for payment. whether Y and Z are also released from their liability to L and X is released from his liability to Y and Z for contribution.

**Answer:** Section to which the given problem relates: Section 42 to 44

**Decision:**

- (i) Yes. L can compel only Y to pay ₹ 60,000 since as per Sec. 43 in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise.
- (ii) No. L can compel the Legal representatives of X,Y and Z **jointly and not severally** to pay the loan of ₹ 60,000, since as per Sec. 45 unless a contrary intention appears from the contract, the right to claim performance rests, as

between him and them, with them during their joint lives, and, after the death of any of them, with the representative of such deceased person jointly, with the survivor or survivors and after the death of the last survivor, with the representatives of all jointly.

- (iii) Y can recover the contribution of ₹ 20,000 each from X and Z since as per Sec. 43 in the absence of express agreement to the contrary, the promisors, may compel every joint promisor to contribute equally to the performance of the promise (unless a contrary intention appears from the contract).
- (iv) Y can recover the contribution of ₹ 28,000 (i.e. ₹60,000 × 1/3) + (16,000 × 1/2) from X and ₹ 4,000 (i.e. ₹ 60,000 × 1/3 × 1/5) from Z since as per Sec. 43 in the absence of express agreement to the contrary, if any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.
- (v) Y can recover the contribution of ₹ 17,000 from X and ₹ 4,300 [i.e. (₹60,000 × 1/3) + (3,000 × 1/2)] × 1/5 from Z since as per Sec. 43 in the absence of express agreement to the contrary, if any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

**Note:** A legal representative is liable only to the extent of property of the deceased received by him as per Sec. 42.

- (vi) If L releases X from his liability and sues Y and Z for payment **neither** Y and Z are released from their liability to L **nor** X is released from his liability to Y and Z for contribution since as per Sec. 44 a release of one of such joint promisors by the promisee, does not discharge the other joint promisors neither does it free the joint promisor so released from responsibility to the other joint promisors.

**8.3** 'X', 'Y' and 'Z' are partners in a firm. They jointly promise to pay ₹ 6,00,000 to 'L'. Z became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts. X is compelled to pay the whole amount to L. Examining the provisions of the Indian Contract Act, 1872, decide the extent to which X can recover the amount from Y.

**Answer:** As per Sec. 42 of the Act "When two or more persons have made a joint promise then unless a contrary intention appears from the contract, all such persons, during their joint lives, and after the death of any one of them, his representative jointly with the survivor or survivors and after the death of the last survivor, representatives of all jointly must fulfill the promise".

As per Sec. 43 in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise and the promisors, may compel every joint promisor to contribute equally to the performance of the promise (unless a contrary intention appears from the contract). If any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

As per Sec. 44 of the Act, release of one of the joint promisors, neither discharges other joint promisors nor does the released joint promisor stand released to other joint promisor or promisors.

Here, X is entitled to recover:

- (a) From Z's assets: ₹ 40,000 (i.e. ₹6,00,000 × 1/3 × 1/5)
- (b) From Y: ₹ 2,80,000 (i.e. ₹6,00,000 × 1/3) + (1,60,000 × 1/2) being one half share of total loss of ₹1,60,000/- due to Z's insolvency).

- 8.4** W promises X, Y and Z jointly to repay a sum of ₹ 9,000. Who can demand the performance of the promise (a) If X dies (b) If Y dies (c) If Z dies (d) If X, Y and Z die?

**Answer:** Section to which the given problem relates: Section 45.

**Decision:**

Case (a) Legal representatives of X **jointly** with Y and Z

Case (b) Legal representative of Y **jointly** with X and Z

Case (c) Legal representatives of Z **jointly** with X and Y

Case (d) Legal representatives of X, Y and Z **jointly**

- 8.5** X owes Y three sums. one for ₹ 2,000 which is barred by limitation, second for ₹ 3,000 which is not barred, and third for ₹ 4,000 which is not barred. X sends ₹ 1,000 to Y. Can Y appropriate ₹ 1,000 towards ₹ 2,000 (a) if X gives no direction in this regard (b) if X asks Y to appropriate ₹ 1,000 towards the third debt of ₹ 4,000?

**Answer:** (a) Y can appropriate ₹ 1,000 towards ₹ 2,000. (b) Y cannot appropriate ₹ 1,000 towards ₹ 2,000. He must appropriate ₹ 1,000 towards ₹ 4,000 only because the creditor is bound to follow the instruction of debtor regarding application of the payment

## **9.0 DISCHARGE OF A CONTRACT**

- 9.1** X owes Y ₹ 1,000 and Z owes X ₹ 1,000. Can Y recover ₹ 1,000 from Z. (a) if no agreement has been entered into between X, Y and Z (b) if Y accepts Z as his debtor in pursuance of an agreement entered into between X and Z?

**Answer:** (a) No, because there is privity of contract between Y and Z. (b) Yes, because. X, the promisor has transferred his liability by novation (i.e. by tripartite agreement between promisor, promisee and transferee)u/s 62.

- 9.2** State with reason whether the following agreements/contracts are valid or void:

- (i) X undertakes to put life into the dead wife of Y.
- (ii) X of Delhi agreed to sell 10 tons of a particular chemical stored in his godown to Y of Lahore @ ₹ 8,000 per ton. Unknown to both the parties, the entire chemical in the godown was destroyed by fire at the time of agreement.
- (iii) X of Delhi agreed to sell 10 tons of a particular chemical stored in his godown to Y of Lahore @ ₹ 8,000 per ton. X knew that the entire chemical in the godown was destroyed by fire at the time of agreement.
- (iv) X of Delhi agreed to sell 10 tons of a particular chemical stored in his godown

to Y of Lahore @ ₹ 8,000 per ton. The entire chemical in the godown was destroyed by fire immediately after the formation of agreement.

- (v) X of Delhi agreed to sell 10 tons of a particular chemical stored in his godown to Y of Lahore @ ₹ 8,000 per ton. A war is declared between India and Pakistan immediately after the formation of agreement.
- (vi) X of Delhi agreed to sell 10 tons of a particular chemical stored in his godown to Y of Lahore @ ₹ 8,000 per ton. After the formation of agreement, the Government issued a notification and banned the export of this chemical.
- (vii) X hired a room from Y for viewing the coronation process of King Edward VII. The procession was cancelled because of King's illness.

**Answer:**

- (i) This agreement is void ab-initio as per Sec 56 (Para 1).
- (ii) This agreement is void ab-initio on the ground of mutual mistake as per Sec 56 (Para 1).
- (iii) The contract is void as per Sec 56 (Para 1) but X, the promisor, must compensate Y, the promisee for any loss which such promisee sustains through the non-performance of the promise.
- (iv) The contract has become void on the ground of supervening possibility as per Sec 56 (Para 2) as the act has become impossible. Hence, the contract is discharged.
- (v) The contract has become void on the ground of supervening possibility as per Sec 56 (Para 2) as the act has become unlawful. Hence, the contract is discharged.
- (vi) The contract has become void on the ground of supervening possibility as per Sec 56 (Para 2) as the act has become unlawful. Hence, the contract is discharged.
- (vii) The contract has become void on the ground of supervening possibility as per Sec 56 (Para 2) as the act has become unlawful. Hence, the contract is discharged. X was not liable to pay the room rent because the procession which formed the basis of the contract did not occur. (Krell v. Henry)

**\*9.3** State with reason whether the following contracts are discharged or not:

- (i) X agreed to supply coal within a specified time. He failed to supply in time because of government's restriction on the transport of coal from collieries.
- (ii) X agreed to sell 10 tons of a particular chemical to be manufactured in his factory to Y @ ₹ 8,000 per ton. After the formation of agreement, there was a sharp increase of 40% in the rates of the materials and wages. As a result the production cost increased to ₹ 10,000 per ton. Since, it was no longer profitable to supply at the agreed rate, X did not supply.
- (iii) X of Delhi agreed to sell 10 tons of a particular chemical to be manufactured by Z to Y of Lahore @ ₹ 8,000 per ton. X could not supply since Z did not manufacture those goods.

- (iv) X agreed to sell 10 tons of a particular chemical to be manufactured in his factory to Y @ ₹ 8,000 per ton. X could not supply since the chemical could not be manufactured because of strike by the workers.

**Answer:**

- (i) The contract is not discharged on the ground of difficulty of performance. Here, X will not be discharged because the coal was available in the open market from where X could have obtained it.
- (ii) The contract is not discharged on the ground of commercial impossibility.
- (iii) The contract is not discharged because of default of third party.
- (iv) The contract is not discharged on the ground of strikes, lockouts and civil disturbances unless otherwise agreed by the parties to the contract. (**Budget V Bennington; Jacobs V Credit Lyonnais**).

- 9.4** X entered into an agreement with Y to deliver him X 10,000 bags to be manufactured in his factory. The bags could not be manufactured because of strike by the workers and X failed to supply the said bags to Y. Decide whether X can be exempted from liability under the provisions of the Indian Contract Act, 1872.

**Answer:** As per Sec. 56 (Para 2) of the Indian Contract Act, 1872 when the performance of a contract becomes impossible or unlawful subsequent to its formation, the contract becomes void, this is termed as 'supervening impossibility' (i.e. impossibility which does not exist at the time of making the contract, but which arises subsequently).

But impossibility of performance is, as a rule, not an excuse from performance. It means that when a person has promised to do something, he must perform his promise unless the performance becomes absolutely impossible. Whether a promise becomes absolutely impossible depends upon the facts of each case.

The performance does not become absolutely impossible on account of strikes, lockout and civil disturbances and the contract in such a case is not discharged unless otherwise agreed by the parties to the contract (**Budget V Bennington; Jacobs V Credit Lyonnais**).

In this case X could not deliver the bags as promised because of strike by the workers. This difficulty in performance cannot be considered as impossible of performance attracting Section 56 (Para 2) and hence **X is liable to Y for non-performance of contract**.

## 10.0 REMEDIES FOR BREACH OF CONTRACT

- \*10.1 On 20th September X agreed to sell to Y of 10 tons of a particular chemical to be manufactured in his factory @ ₹ 8,000 per ton to be delivered on 20th October. Calculate the amount of damages which could be recovered by Y from X in each of alternative cases:

**Case(a):** The chemical could not be manufactured because of strike by the workers and X failed to supply the said chemical to Y on 20th October when the price of that chemical was ₹ 12,000 per ton.

**Case (b):** On 19th October, the entire chemical in the factory was destroyed by fire without the fault of either party and X failed to supply the said chemical to Y on 20th October.

**Case (c):** On 1st October, X informed Y that he was not going to supply the goods since the price of that chemical rose to ₹ 10,000 per ton on 1st October. The price of that chemical further rose to ₹ 12,000 per ton on 20th October. Y decided to rescind the contract on 1st October.

**Case (d):** On 1st October, X informed Y that he was not going to supply the goods since the price of that chemical rose to ₹ 10,000 per ton on 1st October. The price of that chemical further rose to ₹ 12,000 per ton on 20th October. Y decided not to rescind the contract on 1st October and to wait till 20th October.

**Case (e):** On 1st October, X informed Y that he was not going to supply the goods since the price of that chemical rose to ₹ 10,000 per ton on 1st October. The price of that chemical further rose to ₹ 12,000 per ton on 20th October. Y decided not to rescind the contract on 1st October and to wait till 20th October. On 19th October, the entire chemical in the factory was destroyed by fire without the fault of either party.

**Answer:**

**Case (a):** Section to which the given problem relates: Section Sec 56, para 2

Impossibility of performance is, as a rule, not an excuse from performance. A contract is not discharged by the supervening impossibility on the grounds of strikes, lockouts and civil disturbances unless otherwise agreed by the parties to the contract. (**Budget V Bennington; Jacobs V Credit Lyonnais**).

This difficulty in performance cannot be considered as supervening impossibility attracting Section 56 (Para 2) and hence X is liable to Y for non-performance of contract and Y can claim damages of ₹ 40,000@ ₹ 4,000 per ton [i.e. ₹ 12,000 – ₹ 8,000].

**Case (b):** Section to which the given problem relates: Section Sec 56, para 2

As per Sec. 56 (Para 2) of the Indian Contract Act, 1872 when the performance of a contract becomes impossible subsequent to its formation, the contract becomes void. Hence, this contract is discharged by the supervening impossibility since the subject matter of the contract was destroyed after the formation of the contract without any fault of either party.

Hence, X is not liable to Y for non-performance of contract and Y can not claim any damages.

**Case (c),(d) & (e):** Section to which the given problem relates: Section 39

The stated problem is a case of 'Anticipatory breach of Contract' as per Sec. 39 of the Indian Contract Act, 1872.

The case law applicable here is **Frost vs. Knight**.

The answer to the problem is that

**Case (c):** Y can claim damages of ₹ 20,000@ ₹ 2000 per ton [i.e. ₹ 10,000 – ₹ 8,000].

**Case (d):** Y can claim damages of ₹ 40,000 @ ₹ 4000 per ton [i.e. ₹ 12,000 – ₹ 8,000].

**Case (e):** Y had lost his right to sue X for damage since the contract had become void on the ground of supervening impossibility. [Sec 56, para 2]. As per Sec. 56 (Para 2) of the Indian Contract Act, 1872 when the performance of a contract becomes impossible or unlawful subsequent to its formation, the contract becomes void, this is termed as 'supervening impossibility' (i.e. impossibility which does not exist at the time of making the contract, but which arises subsequently).

- \*10.2 'X' entered into a contract with 'Y' to supply him 1,000 water bottles @ ₹ 10.00 per water bottle, to be delivered at a specified time. Thereafter, 'X' contracts with 'Z' for the purchase of 1,000 water bottles @ ₹ 9 per water bottle. 'Z' failed to perform his contract in due course and market price of each water bottle on that day was ₹ 10.50 per water bottle. Consequently, 'X' could not procure any water bottle and 'Y' rescinded the contract. What would be the amount of damages which 'X' could claim from 'Z'?

(a) if 'Z' had not informed about the 'Y's contract'?

(b) if 'Z' had informed about the 'Y's contract'?

**Answer:** Section to which the given problem relates: Section 73.

**Decision and Reason:**

- (a) If 'X' had not informed 'Z' of 'Y's contract, then X is entitled to recover **only the ordinary damages** which are equal to the difference between the contract price (₹ 9) and the market price (₹ 10.50) on the day of default. In other words, the amount of damages would be ₹ 1,500 (i.e. 1000 water bottles x ₹ 1.50).
- (b) If 'X' had intimated to 'Z' that he was purchasing water bottles from him for the purpose of performing his contract with 'Y', then X is entitled to recover **the special damages being** the amount of profit 'X' which would have made by the performance of his contract with 'Y' which is equal to the difference between the procuring price of water bottles and contracted selling price to 'Y' since the special circumstances under which the contract was actually made were communicated by X to 'Z'. Therefore, 'X' is entitled to claim from 'Z' ₹ 1000 at (i.e. 1000 water bottles x ₹ 1)'. **[Leading case: Hadley v. Baxendale]**

- \*10.3 X contracts with Y to make and deliver certain machinery to them by 30.6.2018 for ₹ 23 lakhs. Due to labour strike, X. could not manufacture and deliver the machinery to Y. Later, Y procured the machinery from another manufacturer for ₹ 25.50 lakhs. Y was also prevented from performing a contract which it had made with Z at the time of their contract with X. and was compelled to pay compensation for breach of contract. Advise Y the amount of compensation which it can claim from X, as per provisions of the Indian Contract Act, 1872.

**Answer:** Section 73 of the Indian Contract Act, 1872 provides for consequences of breach of contract. According to it, when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which

naturally arose in the usual course of things from such breach or which the parties knew when they made the contract, to be likely to result from the breach of it. Such compensation is not given for any remote and indirect loss or damage sustained by reason of the breach. It is further provided in the explanation to the section that in estimating the loss or damage from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account.

Applying the above principle of law to the given case, X is obliged to compensate for the loss of ₹ 2.50 lakhs (i.e. ₹ 25.50 minus ₹ 23 = ₹ 2.50 lakhs) which had naturally arisen due to default in performing the contract by the specified date.

Regarding the amount of compensation which Y was compelled to pay to Z, it depends upon the fact whether X, knew about the contract of for supply of the contracted machinery to Z on the specified date. If so, X is also obliged to reimburse the compensation which Y had to pay to Z for breach of contract. Otherwise X is not liable.

- 10.4 X bought a horse with a warranty that it was free from any disease. The horse was suffering from a disease at the time of sale. As a result, not only that horse died but infected other horses also. Discuss the legal position.

**Answer: As per** Sec 73 X is entitled to claim not only the loss occasioned by the death of the horse bought but the entire loss which occurred as a result of the breach of warranty.

**[Leading case:** Smith v. Green]

- 10.5 X lends ₹ 10,000 to Y without interest for one month with a stipulation that in case of default, interest shall be payable. State the legal position if rate of interest is (a) 2% p.m. (b) 3% p.m.

**Answer:**

(a) As per Sec 74, X is entitled to recover from X as per stipulation because the stipulation is not in the nature of a penalty.

(b) As per Sec 74 ,X is entitled to recover from Y such compensation as the court considers reasonable because the stipulation is in the nature of a penalty.

- 10.6 A clause in a contract which provides for forfeiture of security deposit in the event of failure to perform. State the legal position.

**Answer:** As per Sec 74 ,the court may award reasonable compensation only because the stipulation is in the nature of a penalty.

- 10.7 W agreed to sing at L's theatre only during the contract period. During the contract period, W made contract with Z to sing at another theatre and refused to perform the contract with L. State the legal position.

**Answer:** W could be restrained by injunction from singing for Z. [Lumely v. Wagner]

- 10.8 X, a singer, contracts with Y, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months and engages to pay her ₹ 10,000 for each night's performance. On the sixth night, X wilfully absents herself from the theatre, and Y, in consequence, rescinds the contract.



**Answer:** As per Sec 75, Y is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract because a person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract.

## 11.0 QUASI-CONTRACTS

**\*11.1** Can X recover anything from Y in the following cases?

- (a) X supplied rice and wheat worth ₹ 20,000 and a mobile phone worth ₹ 85,000 to the wife and children of Y, a lunatic. Y had assets worth ₹ 1,00,000.
- (b) X holds agricultural land in Delhi on a lease granted by Y, the owner. The land revenue payable by Y to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue law, the consequence of such sale will be termination of X's lease. X, in order to prevent the sale and the consequent termination of his own lease, pays the Government, the sum due from Y.
- (c) X saved Y's house from fire. Y enjoyed the benefit of X's act.
- (d) X picked up a diamond from the floor of Y's shop and handed it over to Y to keep it till owner is found, Y did his best to find out the owner but true owner could not be found. After sometime, X offered Y the lawful charges incurred by Y for finding out the true owner and asked him to return the diamond to him. Y refused to do so.
- (e) X owes Z and pays to Y, a twin brother of Z by mistake.

**Answer:**

- (a) X can recover ₹ 20,000 from Y's assets as per Sec 68 because X supplied necessities but he cannot recover ₹ 85,000 because an expensive mobile phone can not fall under the category of necessities.
- (b) X is entitled to get the reimbursement from Y as per Sec 69 since he has made the payment of lawful dues of Y in which X had an interest.
- (c) Y cannot claim compensation from X as per Sec 70 unless the circumstances show that he did not intend the act gratuitously.
- (d) Y must return the diamond to X as per Sec 71 because X was entitled to retain it against the whole world except the true owner.
- (e) Y must repay the money to X as per Sec 72 because money was paid by mistake. Z cannot recover from Y because there is no privity of contract between Z and Y.

**\*11.2** Can X recover anything from Y in the following cases?

- (a) X is engaged by Y to write a book to be published in 12 volumes for ₹ 5,00,000 payable on the completion of the whole work. Y abandoned the publication after completion and delivery of six volumes.
- (b) X is engaged by Y to write a book to be published in 12 volumes for ₹ 5,00,000 payable on the completion of the whole work. X died after completion and delivery of six volumes.

- (c) X is employed as a managing director in a company. After he rendered service for some time, it is found that the Board of Directors was not competent to appoint him as such.
- (d) X agreed to construct a house for Y for ₹ 1,00,000 but after having done three-fourth of the work, he abandons the contract. Y, afterwards, completed the house.
- (e) X, a singer, contracts with Y, the manager of a theatre, to sing at the latter's theatre for two evenings every week during the next two months. Y agrees to pay ₹ 5,000 for each evening's performance. On the 7th evening, S willfully absents herself from the theatre. Y, in consequence, rescinds the contract and claims compensation for the loss suffered by him through the non-fulfilment of the contract by X.
- (f) X entered into a contract with the Indian Railways for the construction of a Bridge and received an advance of ₹ 10 lakhs for the same. He did not complete the work within time and the Railways terminated the Contract. This contract was found to be void from its inception for not being in conformity with the Constitution of India. The Indian Railways want to recover the advance given to the contractor.

**Answer:**

- (a) X is entitled to claim compensation for the work already done on quantum meruit basis. [**Leading case:** Planche v. Colburn]
- (b) X's legal representatives are not entitled to claim compensation for the work already done by X because the contract to write a book in 12 volumes is an indivisible contract.
- (c) X can recover compensation for the work done by him on quantum meruit basis. [Leading case: Craven Ellis v. Canons Ltd.]
- (d) X cannot recover anything from Y because the contract is indivisible. [Leading case: Sumpeter v. Hedges]
- (e) X can recover compensation for the six evenings she had sung on quantum meruit basis. Y may rescind the contract but must pay 'X'.
- (f) When an agreement is discovered to be void, any person who has done some work under a contract, is entitled to compensation for the work done on the basis of quantum meruit. Indian Railways cannot recover the advance.

## **12.0 THE SALE OF GOODS ACT, 1930**

**12.1** State whether each of the following transactions is a contract of sale under the Sale of Goods Act, 1930:

- (a) X is the owner of some goods but he is not aware of this fact. Y pretends to be the owner of these goods and sells them to X.
- (b) X agreed to exchange with Y 100 kg of rice (valued at ₹ 100 per kg) for 200 kg of wheat (valued at ₹ 50 per kg) and pay the difference in cash.
- (c) X engaged an artist to paint a portrait, canvas and other materials were to be

supplied by X to painter.

- (d) Supply of food by a hotel company to its resident customers, where no rebate is allowed if food is not taken by the customers.
- (e) X sold a car to Y, on the payment of ₹ 6,000 per month for 36 months at the end of which the ownership of the car will be transferred to Y. It was agreed that X can recover the car if Y makes a fault.

**Answer:**

- (a) No, because there are not two distinct parties--buyer and seller. A person cannot buy his own goods.] [Leading case: Bell v. Lever Bros Ltd.]
- (b) Yes, because there is nothing in law to prevent the consideration from being partly in money and partly in goods.] [Leading case: Sheldon v. Cox]
- (c) No, because it is a contract for work and labour and not contract of sale. In this case rendering of service and exercise of skill is the essence of contract and the delivery of the goods is merely ancillary to the contract. [Leading case: Robinson v. Graves]
- (d) No, because supply of food is essentially in the nature of service and not a transaction of sale because there is an indivisible contract of multiple services. [Leading case: Associated Hotels of India v. Excise and Taxation Officer]
- (e) Yes, because X did not have any option to return, but was under compulsion to buy. Hence, it is not a hire purchase agreement.] [Leading case: Lee v. Butler]

- 12.2** X purchased from Y tins of condensed milk bearing the label 'N BRAND.' It is proved that there was an infringement of trademark. X had to remove the labels and sold the tin at a loss. Decide.

**Answer:** As per Sec 14(a), X was entitled to sue Y for breach of implied condition that Y had the right to sell. [Niblett Ltd. v. Confectioner's Materials Co.]

- 12.3** The buyer bought after seeing certain goods which were described by the seller as "dating from seventeenth century" but he found them of eighteenth century. Decide.

**Answer:** As per Sec 15, the buyer was entitled to reject the goods because goods did not correspond with the description given by the seller. [Nicholson and Venn v. Smith Marriot]

- \*12.4** X bought from Y certain quantity of worsted coating equal to sample. The coating was equal to sample but due to a latent defect, the cloth was found to be unfit for making coats. Decide.

**Answer:** As per Sec 17, the buyer was entitled to reject the goods because the defect contained in the sample was not apparent on reasonable examination of the sample. [Drummond & Sons v. Van Ingen]

- \*12.5** X bought from Y foreign refined rapeseed oil which was warranted to be equal to sample. The oil supplied was equal to the sample. The sample was actually a mixture of rapeseed oil and hemp oil. Decide.

**Answer:** As per Sec 15, the buyer was entitled to reject the goods because the goods supplied did not correspond with the description. [Nichol v. Godts]

- 12.6** X purchased a hot water bottle from Y, retail chemist. X asked Y if it would stand boiling water. The Chemist told him that the bottle was meant to hold hot water. The bottle burst when water was poured into it and injured his wife. Decide.

**Answer:** As per Sec 16(1), the chemist is liable to refund the price and pay damages because bottle was unfit for the purpose for which it was purchased. [Priest v. Last]

- 12.7** X asked a car dealer to suggest him car suitable for touring purposes. The dealer suggested a 'Buggati Car.' Accordingly, X purchased it but found it unsuitable for touring purpose. X rejected the car and claimed the refund of price. Decide.

**Answer:** As per Sec 16(1), the buyer who relied upon his skill and judgement is entitled to reject the goods and have refund of the price paid. The seller is liable for breach of condition as to fitness. [Baldry v. Marshall]

- \*12.8** X bought a refrigerator without asking the dealer whether it is fit to make ice. Refrigerator failed to make ice. X rejected the Refrigerator and claimed the refund of price. Decide.

**Answer:** As per Sec 16(1), the buyer is entitled to reject the goods and have refund of the price paid because refrigerator was unfit for the purpose for which it was meant for and the buyer was not required to disclose this particular purpose. The seller is liable for breach of condition as to fitness.

- 12.9** X bought a set of false teeth from Y a Dentist. But the set was not fit for X's mouth. X rejected the set of teeth and claimed the refund of price. Decide.

**Answer:** As per Sec 16(1), the buyer is entitled to reject the goods and have refund of the price paid because the only purpose for which he wanted the set of teeth was not fulfilled.[Dr. Baretto v. T.R. Pruce]

- \*12.10** X bought tweed coat and found unfit for her abnormally sensitive skin. X rejected the tweed coat and claimed the refund of price. Decide.

**Answer:** As per Proviso to Sec 16(1), the buyer is not entitled to reject the goods and have refund of the price paid because the cloth was fit for anyone with a normal skin and she did not inform the seller about her abnormally sensitive skin.[Griffiths v. Peter Conway Ltd.]

- 12.11** X bought from a dealer a bottle of wine. While opening its cork in the normal manner, the bottle broke off and injured X's hands. Decide.

**Answer:** As per Sec 16(2), the buyer was entitled to claim damages because the bottle was not of merchantable quality. [Morelli v. Fitch & Gibbons]

- \*12.12** X purchased glue from Y. The glue was packed in barrels and every facility was given to X for its examination but X did not examine the contents. X wants to reject the goods by saying that they are not merchantable.

**Answer:** As per Proviso to Sec 16(2), the buyer could not reject the goods by saying that they are not merchantable because opportunity of examining the goods was given to X but he did not examine. [Thornett & Fehs v. Beers & Sons]

- 12.13** X bought milk from Y's dairy. The milk contained typhoid terms. X's wife consumed milk, became infected and died. Decide.

**Answer:** Y was liable for damages because the milk was not fit for human consumption [Frost v. Aylesbury Dairy Co. Ltd.].

- 12.14** Pigs were sold subject to all faults and the seller knew that the pigs were suffering from swine-fever but he did not inform the buyer about this defect. Decide.

**Answer:** The seller was not liable for damages because there was no implied warranty. [Ward v. Hobbs]

- 12.15** X agreed to sell to Y a parcel of 700 bags of groundnuts lying in his godown. Unknown to X 109 bags had been stolen at the time of contract. X tendered delivery of 591 bags. Y declined to accept. State the legal Position.

**Answer:** The contract of sale has become void and thus, Y cannot be compelled to accept 591 bags. There was a contract for sale of an indivisible lot of specific goods and some goods are destroyed at the time when the contract was made without the knowledge of the seller. [Leading case: Barrow Lane & Ballard Ltd. v. Phillips & Co.]

- 12.16** In a painting exhibition, a famous painting was offered for sale. A thief replaced the painting with a 'duplicate' one. When the buyer came to know of the reality, he refused to pay for the painting. What is the remedy available to the buyer? Give reasons in support of your answer.

**Answer:** The buyer cannot rescind the contract. The rule of caveat emptor will apply.

- 12.17** X was shopping in a self-service super market. He picked up a bottle exploded in his hand and injured him. Can X claim damages for the injury?

**Answer:** No, there is no contract of sale.

- 12.18** X agreed to purchase 100 bales of cotton from Y from his large stock and sent his men to take delivery of the goods. They could pack only 70 bales. Then there was an accidental fire and the entire stock was destroyed including the 70 bales that were packed. Who will bear the loss and to what extent? Explain.

**Answer:** X will bear the loss of 70 bales. [Rugg vs. Minett].

- \*12.19** J the owner of a fiat car wants to sell his car. For this purpose he hands over the car to P, a mercantile agent for sale at a price not less than ₹ 50,000. The agent sells the car for ₹ 40,000 to A, who buys the car in good faith and without notice of any fraud. P misappropriated the money also. J sues A to recover the car. Decide giving reasons whether J would succeed.

**Answer:** As per Sec 27, J cannot recover the car from A who has good title to it as he buys in good faith and without notice of defective title of the mercantile agent.

- 12.20** P, a manufacturer of watches delivers certain watches to Q upon the condition that the watches would remain P's property until sold or paid for. Q is a famous dealer dealing watches all over India. Q fraudulently pledges the watches with a money lender and obtains ₹ 10,000. P on coming to know of the deal between Q and the moneylender, challenges the "pledge" and wants the watches back, on the ground that Q had no authority to pledge the watches. Decide Whether P's contentions is valid and would, therefore, get the watches back?

**Answer:** As per Sec 27, the pledge is valid and therefore, P cannot get the watches

back. A pledge by a mercantile agent is valid if it is made in good faith and without any knowledge of the defective title of the pledger.

- \*12.21** Goods are delivered by A to B on 'sale or return' basis. They are further delivered by B to C and then by C to D on similar terms. The goods are stolen while in the custody of D. Who is to bear the loss of goods and why?

**Answer:** As per Sec 24, B by delivering goods has accepted the goods and therefore, is liable to A but B may recover the loss from C. D cannot be held liable as he never became the owner of goods.

- \*12.22** Certain goods were sold by sample by A to B, who in turn sold them by sample to C. The goods were not according to the sample. Therefore, C rejected the goods and gave notice to B. B sued A. Advise B.

**Answer:** As per Sec 24, **B can not sue A since** B by delivering goods has accepted the goods.

- \*12.23** X of Delhi orders Y of Madras, to deliver certain goods to him at Delhi. While the goods are lying at the Delhi Railway Station, the station master informs that the goods are held at the station at X's risk. But X has become insolvent. Has Y any right over the goods as an unpaid seller?

**Answer:** As per Sec 49, Y has no right on the goods as the station master acknowledged holding goods on behalf of the buyer, the right of lien comes to an end.

- \*12.24** X of Bombay enters into an agreement with Y of New Delhi to supply five motor-cycles to be delivered to the later at New Delhi. X sends these motor-cycles through Transport Ltd., a leading transporter. The motor-cycle reach New Delhi on time but Y delays to take the delivery. Transporter informs Y that the motor cycles are lying at their godown at Y's risk. Before taking the delivery of these motor-cycles, Y becomes insolvent. X wants to exercise his right of stoppage of goods in transit, under the Sale of Goods Act. Advise.

**Answer:** As per Sec 51(3), X cannot exercise the right of stoppage in transit as the transporter acknowledges holding goods on behalf of Y.

- \*12.25** R sells and consigns certain goods to P for cash and sends the Railway receipt to him. R, being still the unpaid seller, P becomes insolvent and while the goods are in a transit, passes the Railway receipt to N who does not know that P is insolvent. R being an unpaid seller wants to exercise his right of stoppage of goods in transit. Advise

(i) Whether R can do so?

(ii) Would your answer be different if N was aware P's insolvency, before the assignment of the Railway receipt in favour of N?

**Answer:**

(i) As per Proviso to Sec 53(1), R cannot stop the goods in transit because the transfer was by way of sale and N took the railway receipt in good faith and for valuable consideration and hence, N got a good title.

(ii) As per Proviso to Sec 53(1), R can stop the goods in transit because N has not

acted in good faith and hence, N did not get a good title.

**\*12.26** At an auction sale, C made the highest bid for an article of P. State the legal position in each of the following alternative cases:

Case (a) If C withdrew the bid before the fall of the hammer though he knew that one of the condition of the sale was 'bid once made cannot be withdrawn'.

Case (b) If P refused to accept the highest bid. The sale was not notified subject to a reserve price.

Case (c) If P appointed two persons A and B, to bid on his behalf. The sale was notified subject to a right to bid.

Case (d) If C was allowed to take it away on (i) giving a cheque for the price (ii) signing an agreement that ownership should not pass to him until the cheque was cleared. The cheque was dishonoured but in the meantime C sold the article to Z.

Case (e) If the sale was notified subject to a reserve price and the auctioneer by mistake accepted the C's highest bid (which was lower than the reserve price) by striking the hammer. Later, auctioneer refused to deliver the goods.

**Answer:**

Case (a): C's bid was an offer to buy and he was entitled to withdraw his bid before the sale is completed as per express provision of Section 64(2) [*Payne v. Cave*]. Such a condition in an auction sale was inoperative because it was against the provisions of the law. [*Champa Lal v. Jaigopal*]

Case (b): C's bid was an offer to buy which may or may not be accepted by the auctioneer. Hence, P could refuse to accept the highest bid. [*Fenwick v. Macdonald*]

Case (c): It amounts to fraud and sale is voidable at the option of the buyer because the seller could appoint only one person to bid on his behalf. [Section 64(3) and Section 64(6)]. Here, intention of the seller was not to protect his interest but to raise the price. [*Thornett v. Haines*]

Case (d): Z had a good title because the property passed to C on the fall of the hammer [*Dennant v. Skinner*]. The ownership of specific goods in a deliverable state passes on the completion of contract of sale.

Case (e): The sale was not valid and C was not entitled to goods. It was held that the auctioneer could not effectively accept such a bid (which was lower than reserve price) because he could not make a contract so as to bind his principal to accept less than the reserve price. [*Manas v. Fortesque*]

### 13.0 THE INDIAN PARTNERSHIP ACT, 1932

**13.1** Three brothers, X (age 19 years), Y (age 18 years) and Z (age 17 years), decide to form a partnership with a provision that Z will share the profit only. Can they do so?

**Answer:** No, because all the persons entering into partnership agreement must be competent to contract. Z is not competent to contract because he is a minor. Hence, a partnership cannot be formed with a minor as a partner but as per Sec 30 after the formation of partnership a minor can be admitted to the benefit of a firm with

the consent of all other partners. [Leading case: Shivaram v. Gauri Shankar]

- 13.2** X, Y and Z agreed to share the profits of a business carried on by all or any of them acting for all. The management and control was entrusted in X with power to restrict the rights of Y and Z. Is there a valid partnership?

**Answer:** Yes, because all the essential elements of partnership exists under the partnership agreement.] [Leading case: K.D. Kamath Co v. Commission of Income Tax (1972) 82, ITR 680 (SC)]

- 13.3** X and Y agreed to share the profits of a business carried on by all or any of them acting for all. Later on, Z lent ₹ 1,00,000 to the firm on the condition that he will take 25% share in profits. Can Z be regarded as a partner?

**Answer:** No, because sharing of profit, which is a prima facie evidence, exists, but the mutual agency relationship among X, Y and Z, which is a conclusive evidence, does not exist. [Leading case: Mollow March cPc Co. v. The Court of Wards]

- \*13.4** X, a contractor, appointed Y, one of his servants to manage his business of loading and unloading railway wagons. Y was to receive 50%, of the profits of the business and also to bear the losses, if any. Is Y a partner of X?

**Answer:** No, because sharing of profit which is a prima facie evidence, exists but the mutual agency relationship among X and Y, which is a conclusive evidence, does not exist. Here, Y is an agent of X but X is not an agent of Y. [Leading case: Munshi Abdul Latif v. Gopeshwar Chatteraj]

- 13.5** X, Y and Z were equal partners in a firm. X died. It was agreed that the widow of X would receive the same equal share of profits of business as annuity. Is the widow of X a partner?

**Answer:** No, because sharing of profit, which is a prima facie evidence, exists but the mutual agency relationship among X, Y and widow of X which is a conclusive evidence, does not exist. [Leading case: I.T. Commissioner v. Kesharmal Keshardeo]

- 13.6** Can X and Y be regarded as partners in the following cases?

- (a) X and Y who jointly own a house, let it out on rent of ₹ 10,000 p.a. and share the rental income equally.
- (b) X and Y who jointly own a house, converted that house into a hotel after investing ₹ 1,00,000 each. X manages the hotel and meets all expenses and retains half of gross earnings and hands over the other half to Y.
- (c) X and Y who jointly own a house, converted that house into a hotel after investing ₹ 1,00,000 each. It was agreed that X would manage the hotel on his own behalf and on behalf of Y and the net earnings would be divided equally.
- (d) X, a publisher agrees to publish at his own expense, a book written by Y and to pay Y half of the net profits.
- (e) X admits Y as a partner. Y does not bring any capital. He is not liable for any loss and is to receive ₹ 1,000 p.m. as salary in lieu of profits and have all the powers of a partner.



**Answer:**

- (a) No, because X and Y are merely co-owners who are sharing the gross returns arising from a joint property.] [Leading case: Govind Nair v. Maga]
- (b) No, because X and Y are merely co-owners who are sharing the gross returns arising from a joint property. [Leading case: Govind Nair v. Maga]
- (c) Yes, because All the essential elements of partnership exist.
- (d) No, because Sharing of profit, which is a prima facie evidence, exists but mutual agency among X and Y, which is a conclusive evidence does not exist.
- (e) Yes, because All the essential elements of partnership are present. Bringing of capital and sharing of losses are not essential elements to constitute a partnership.

**\*13.7** X, Y and Z are partners in an unregistered firm. Is the suit maintainable in the following cases?

- (a) X filed a suit against the firm for the recovery of his share of profit.
- (b) X filed a suit against Y who has stolen the property of the firm.
- (c) the firm filed a suit against W , a customer for the recovery of the amount due from W.
- (d) the firm filed a suit against W , a customer for the recovery of the amount due from W. and immediately after filing the suit, the firm got itself registered.
- (e) the firm filed a suit to restrain the third party from misusing the Patent right of firm.
- (f) W , filed a suit against the firm for the recovery of ₹ 1,00,000 due from the firm. W also owed ₹ 6,000 to the firm. The firm claimed a set off of ₹ 6,000.
- (g) X filed a suit for the dissolution of the firm,
- (h) X filed a suit for the accounts of a dissolved firm,
- (i) X filed a suit for claiming share of the assets of a dissolved firm.

**Answer:**

- (a) No, because as per Sec 69(1), a partner of an unregistered firm cannot file a suit against the firm or any partner of the firm to enforce any right arising from contract.
- (b) Yes, because Section 69(1) prohibits the institution of civil suit and not the criminal suit.
- (c) No, because as per Sec 69(2), an unregistered firm cannot file a suit against a third party to enforce any right arising from contract. Here, the firm is not registered at the time of institution of the suit.
- (d) No, because as per Sec 69(2), an unregistered firm cannot file a suit against a third party to enforce any right arising from contract. Here, the firm is not registered at the time of institution of the suit. The subsequent registration cannot cure the initial defect. [*Puran Mal v. Central Bank of India*]
- (e) Yes, because as per Sec 69(4), Right to enforce a right arising otherwise than out of a contract is not affected by non-registration of a firm.

- (f) Yes, because right of a third party to file a suit against the unregistered firm or partners thereof is not affected by non-registration of a firm. An unregistered firm cannot claim a set off exceeding ₹ 100 in value as per Sec 69(3).
- (g) Yes, because as per Sec 69(3)(a), Right of a partner to sue for the dissolution of the firm is not affected by non-registration of a firm.
- (h) Yes, because as per Sec 69(3)(a), Right of a partner to sue for the accounts of a dissolved firm is not affected by non-registration of a firm.
- (i) Yes, because as per Sec 69(3)(a), Right of a partner to sue for claiming share of the assets of a dissolved firm is not affected by non-registration of a firm.

**13.8** X and Y purchased a taxi and they were plying it in partnership. The firm was not registered. After 1 year, X sold the taxi without Y's consent and did not pay anything to Y. Y filed a suit against X to recover his share in the sale proceeds. X defended the suit on the ground that the firm was not registered.

**Answer:** The suit was maintainable because it was for the realisation of the assets of a dissolved firm. [Basant Lal v. Chiranjit Lal]. As per Sec 69(3)(a), Right of a partner to sue for claiming share of the assets of a dissolved firm is not affected by non-registration of a firm.

**\*13.9** P, X, Y and Z are partners in a registered firm. X died and P retired. The firm filed a suit against W in the name and on behalf of firm without notifying to the Registrar of firms about the changes in the constitution of the firm. Is the suit maintainable?

**Answer:** Yes, because both the requirements of Section 69(2) have been complied with (i) the suit must be instituted by or on behalf of the firm which had been registered; (ii) the persons suing must have been shown as partners in the Registrar of Firms. Persons suing means all the partners at the date of instituting the suit. [Leading case: Durga Das v. Preete Shah]

**\*13.10** X, Y and Z are partners in a registered firm. X died and D was admitted as a partner. The firm filed a suit against W, in the name and on behalf of firm without notifying to the Registrar of Firms about the changes in the constitution of the firm. Is the suit maintainable?

**Answer:** No, because first requirement of Section 69(2) that the suit must be instituted by or on behalf of the firm which had been registered, had been complied with, whereas the second requirement of Section 69(2) that all the partners at the date of instituting the suit have been shown in the Registrar of Firms, had not been complied with. [Leading case: VS. Behal v. Kapur & Co.]

**13.11** X and Y are in partnership. X was appointed to buy goods for the firm. Is X accountable to firm for profit he makes in the following cases?

- (a) X without the knowledge of Y, supplied his own goods to the firm at market price and made a huge gain.
- (b) X without the knowledge of Y, obtains for his own sole benefit a lease of the building in which the partnership business is carried on.
- (c) X without the knowledge of Y, received commission from Z, a supplier of goods to the firm.

- (d) It is found out that X is engaged with Z in the supplying goods to the customers of firm.

**Answer:**

- (a) Yes, because subject to contract between the partners, if a partner derives any profit for himself from any transaction of the firm, he must account for the profit and pay it to the firm (Section 16(a)). [Leading case: Bentley v. Craven]
- (b) Yes, because subject to contract between the partners, where a partner derives any profit for himself from the use of the property of the firm, he must account for the profit and pay it to the firm u/s 16(a). [Leading case: Featherstonhaugh v. Fenwick]
- (c) Yes, because subject to contract between the partners, if a partner derives any profit for himself from any transaction of the firm, he must account for the profit and pay it to the firm (Section 16(a)).
- (d) Yes, because subject to contract between the partners, if a partner carries on competing business, he must account for and pay to the firm all profits made by him in that business u/s 16(b). [Leading case: Loch v. Lynam]

- 13.12** A, B, C, D and E are partners. A and B executed a promissory note in favour of C agreeing to pay him a certain sum due to him on taking partnership accounts. Are D and E bound by the promissory note?

**Answer:** No, the principle of agency is applicable only to the act done by partners for the purpose of the business of the firm u/s 18. [Leading case: Hoshiar Singh V. Udairam]

- 13.13** It was in the course of the business of a firm of grain merchants to obtain by legitimate means information in regard to contracts made by competing firms and one of the partners obtained such information by bribing a clerk of a competitor in the business. Consequently, competitor lost some business and sued the firm for damages. Will the competitor succeed?

**Answer:** Yes, because the firm is liable for the wrongful act of partner done in the ordinary course of the business. [Leading case: Hamlyn.v. Houston & Co.]

- \*13.14** X, Y, Z are partners in a trading firm. They decide that no partner shall have the right to borrow beyond ₹ 20,000 without the consent of other partners. X without consulting Y and Z borrows from W ₹ 25,000 in the name of the firm and utilized the same in paying off the debts of the firm. Is the firm liable to pay to W? Would it make any difference if W was aware of this restriction?

**Answer:**

**Part (a):** As per Sec 20, the firm is liable to pay to W because W was unaware of the restriction.

**Part (b):** As per Sec 20, the firm is not liable to pay to W because W was aware of the restriction.

- \*13.15** Virat Kohli, a renowned sportsman assumed the honorary presidentship of a publishing business bringing out a sports magazine because other partners requested him to do so. A supplier gave credit to the firm in the bonafide belief that

Virat Kohli was a partner in the firm. Is Virat Kohli liable to the supplier?

**Answer:** Yes, because Virat Kohli is a partner by estoppel. Both the conditions of Section 28 are fulfilled.

- (i) Virat Kohli has knowingly permitted himself to be represented as a partner.
- (ii) Supplier has acted on the faith of such representation. [Leading case: Lake v. Duke of Argyll]

**\*13.16** X, Y, Z, P and Q are partners. The firm ordered W to supply a machine to the firm. After the order was placed, but before the machine was delivered, Z retires, P dies and Q is declared as insolvent. W delivered the machine without having notice of the change. State the name of partners who can be sued by W in the following cases:

- (a) Z gives notice of retirement to the other partners but no public notice of Z's retirement, P's death and Q's insolvency is given and Z, P and Q are active partners,
- (b) Z gives notice of retirement to the other partners but no public notice of Z's retirement, P's death and Q's insolvency is given and Z is a dormant partner (sleeping partner) but P and Q are active partners.

**Answer:**

- (a) As per Sec 32(3), a retiring partner is **liable** for firm's acts done after his retirement if no public notice is given. As per Sec 45, No public notice is required on the death /insolvency of a partner. As per Sec 35, the estate of the deceased partner is not liable for any act of the firm done after the date of his death. As per Sec 34, the estate of an insolvent partner is not liable for any act of the firm done after the date of order of adjudication. Hence, W can sue X, Y and Z.
- (b) As per Sec 32(3), a retiring partner is **not liable** to any third party who deals with the firm without knowing that he was a partner. As per Sec 45, No public notice is required on the death /insolvency of a partner. As per Sec 35, the estate of the deceased partner is not liable for any act of the firm done after the date of his death. As per Sec 34, the estate of an insolvent partner is not liable for any act of the firm done after the date of order of adjudication. Hence, W can sue only X and Y.

**\*13.17** X, Y and Z are partners sharing the profits in the ratio of 3:4:1. X becomes bankrupt and Y and Z continued the business without settling accounts with his estate. X's estate claims 3/8th of the profits made from the date of X's insolvency? Will this claim sustain?

**Answer:** Yes. As per Sec 37, Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary, the outgoing partner or his estate is **entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of**

**his share of the property of the firm or to interest at the rate of 6% p. a. on the amount of his share in the property of the firm.**

**13.18** X, Y and Z are partners in a firm. State whether the court may pass an order for dissolution of a firm in each of the following alternative cases:

- (a): If X (a dormant partner) becomes insane and the suit is filed by Y.
- (b): If X has adulterous relations with W's wife.
- (c): If X continuously omits to enter receipts of money in the books of accounts.

**Answer:**

- (a) No, as per Sec 44, the court may not pass an order for dissolution because such a partner does not take an active part in the conduct of firm's business.
- (b) No, as per Sec 44, the court may not pass an order for dissolution as X's conduct does not affect prejudicially the carrying on of the business. [Snow v. Milform]
- (c) Yes, as per Sec 44, the court may pass an order for dissolution since there was persistent breach.

**\*13.19** X paid Y and Z a premium of ₹ 20 lacs on entering into partnership for 10 years and the firm is dissolved at the end of 8 years. State whether X is entitled to repayment of proportionate premium in each of the following alternative cases:

- (a): If the dissolution is by the death of Y.
- (b): If the dissolution is due to X's own misconduct.
- (c): If the dissolution is in pursuance of an agreement which contains no provision for the return of the premium.
- (d): If the dissolution is due to Y's misconduct.
- (e): If the dissolution is due to the insolvency of Y.

**Answer:**

(a), (b) and (c): As per Sec 51, X is not entitled to claim any return of premium because the right to return of premium is not available under these three cases.

(d) and (e): As per Sec 51, X is entitled to claim ₹ 4 lacs (i.e., ₹ 20 lacs × 2/10).

**\*13.20** A, B, C, D and E are partners in a firm. They decided to dissolve the firm from 1st January but failed to give a public notice of its dissolution and continued the business of the firm even after that date. C, a dormant partner retired on 4th Jan, D died on 5th January and E was declared insolvent on 10th January. On 11th January, A borrowed in the firm's name ₹ 20 lacs from R who was ignorant of the dissolution. Discuss the liability of partners for ₹ 20 lacs.

**Answer:** As per Sec 45, A and B are liable but C being a dormant partner and the estate of D and E are not liable for ₹ 20 lacs because Partners continues to be liable to third parties for any act done by any of them after the dissolution until public notice is given of the dissolution but this provision is not applicable to the estate of deceased partner, insolvent partner and dormant partner who had retired.

**13.21** State with reason whether the following agreements are valid or void:

- (i) An agreement among the partners that no partner shall not carry on any

business other than that of the firm while he is a partner.

- (ii) An agreement with an outgoing partner that he will not carry on any business similar to that of the firm in the same locality for the next 3 years.
- (iii) An agreement among the partners upon the dissolution of the firm that some or all of them will not carry on a business similar to that of the firm in the same locality for the next 3 years.
- (iv) An agreement by a partner with the buyer of goodwill of the firm that he will not carry on any business similar to that of the firm in the same locality for the next 3 years.

**Answer:**

- (i) The agreement is valid as per Sec 11(2) of The Indian Partnership Act, 1932.
- (ii) The agreement is valid as per Sec 36(2) of The Indian Partnership Act, 1932 as the restrictions in regard to time and vicinity seem to be reasonable.
- (iii) The agreement is valid as per Sec 54 of The Indian Partnership Act, 1932 as the restrictions in regard to time and vicinity seem to be reasonable.
- (iv) The agreement is valid as per Sec 55(3) of The Indian Partnership Act, 1932 as the restrictions in regard to time and vicinity seem to be reasonable.

#### **14.0 THE COMPANIES ACT, 2013**

- 14.1** The paid-up share capital of SAB Private Limited is ₹ 1 crore, consisting of 8 lacs Equity Shares of ₹ 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of ₹10 each, fully paid-up. JVN Private Limited and SARA Private Limited are holding 3 lacs Equity Shares and 50,000 Equity Shares respectively in SAB Private Limited. JVN Private Limited and SARA Private Limited are the subsidiaries of PQR Private Limited. With reference to the provisions of the Companies Act, 2013 examine whether SAB Private Limited is a subsidiary of PQR Private Limited? Would your answer be different if PQR Private Limited has 8 out of 9 Directors on the Board of SAB Private Limited?

**Answer:** In terms of section 2 (87) of the Companies Act 2013 "subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company—

- (i) controls the composition of the Board of Directors; or
- (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

Explanation.—For the purposes of this clause,—

- (a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
- (b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors. In the present case, JVN Pvt. Ltd. and SARA

Pvt. Ltd. together hold less than one half of the total share capital. Hence, PQR Private Ltd. (holding of JVN Pvt. Ltd. and SARA Pvt. Ltd) will not be a holding company of SAB Pvt. Ltd. However, if PQR Pvt. Ltd. has 8 out of 9 Directors on the Board of SAB Pvt. Ltd. i.e. controls the composition of the Board of Directors; it (PQR Pvt. Ltd.) will be treated as the holding company of SAB Pvt. Ltd.

**\*14.2** K Ltd. was in the process of incorporation. Promoters of the company signed an agreement for the purchase of certain furniture for the company and payment was to be made to the suppliers of furniture by the company after incorporation. The company was incorporated and the furniture was received and used by it. Shortly after incorporation, the company went into liquidation and the debt could not be paid by the company for the purchase of the above furniture. As a result supplier sued the promoters of the company for the recovery of money. Examine whether promoters can be held liable for the payment under the following situations:

- (i) When the company has already adopted the contract after incorporation?
- (ii) When the company makes a fresh contract with the suppliers in substitution of pre incorporation contract?

**Answer:** The promoters remain personally liable on a contract made on behalf of a company which is not yet in existence. Such a contract is deemed to have been entered into personally by the promoters and they are liable to pay damages for failure to perform the promises made in the company's name, (Scot v. Lord Ebury) even though the contract expressly provided that only the company shall be answerable for performance. In *Kelner v. Baxter* also it was held that the persons signing the contracts viz. Promoters were personally liable for the contract. Further, a company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purported to have been made on its behalf before it came into existence as ratification by the company when formed is legally impossible. The company can, if it desires, enter into a new contract, after its incorporation with the other party. The contract may be on the same basis and terms as given in the preincorporation contract made by the promoters. The adoption of the pre-incorporation contract by the company will not create a contract between the company and the other parties even though the option of the contract is made as one of the objects of the company in its Memorandum of Association. It is, therefore, safer for the promoters acting on behalf of the company about to be formed to provide in the contract that: (a) if the company makes a fresh contract in terms of the pre-incorporation contract, the liability of the promoters shall come to an end; and (b) if the company does not make a fresh contract within a limited time, either of the parties may rescind the contract. Thus applying the above principles, the answers to the questions as asked in the paper can be answered as under:

- (i) the promoters will be liable to the suppliers of furniture since there was no fresh contract entered into with the suppliers by the company.
- (ii) The liability of promoters comes to an end since the fresh contract was entered into on the same terms as that of pre-incorporation contract.

- \*14.3** The Articles of Association of XYZ Ltd. provides the Board of Directors has authority to issue bonds provided such issue is authorized by the shareholders by a necessary resolution in the general meeting of the company. The company was in great need of funds and therefore, it issued the bonds to Mr. X without passing any such resolution in general meeting. Can Mr. X recover the money from the company? Decide referring the relevant provisions of the Companies Act, 2013.

**Answer:** According to the Doctrine of Indoor Management, if an act is authorised by the articles or memorandum, an outsider is entitled to assume that all the detailed formalities for doing that act have been observed. As per the case of the Royal British Bank vs. Turquand [1856] 6E & B 327, the directors of R.B.B. Ltd. gave a bond to T. The articles empowered the directors to issue such bonds under the authority of a proper resolution. In fact, no such resolution was passed. Notwithstanding that, it was held that T could sue on the bonds on the ground that he was entitled to assume that the resolution had been duly passed. This is the doctrine of indoor management, popularly known as Turquand Rule. Since, the given question is based on the above facts, accordingly here in this case Mr. X can recover the money from the company considering that all required formalities for the passing of the resolution have been duly complied.

- \*14.4** X Limited was registered as a public company. There are 220 members in the company as noted below:

(a) Directors and their relatives	190
(b) Employees	10
(c) Ex-Employees (Shares were allotted when they were employees)	5
(d) 5 Couples holding shares jointly in the name of husband and wife (5 × 2)	10
(e) Others	5

The Board of Directors of the company propose to convert it into a private company. Also advise whether reduction in the number of members is necessary.

**Answer:** Relevant Provision: A public company may be converted into a private company only if the total members of the company are limited to 200 excluding employees members and person who became members during the course of their employment and continue to be members even after their employment ceased. Moreover, when two or more persons hold one or more shares jointly, they shall be treated as a single member.

Total No. of Members

(i) Directors and their relatives	190
(ii) 5 Couples (5 × 1)	5
(iii) Others	5
	<hr/>
	200

**Advise:** There is no need for reduction in the number of members since existing no. of members are 200 which does not exceed maximum limit of 200.



- \*14.5** A company was incorporated on 6th October. The certificate of incorporation of the company was issued by the Registrar on 15th October. The company on 10th October entered into a contract which created its contractual liability. The company denies for the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide, under the provisions of The Companies Act, 2013, whether the company can be exempted from the said contractual liability.

**Answer:** Relevant date of incorporation of the company is 6th October since the date specified in the certificate of incorporation shall be taken as the date of incorporation of the company even though the certificate of incorporation was issued at a later date. Hence, The company is bound by the contracts entered into by it after date of incorporation [**Leading Case Law: Jubilee Cotton Mills v Lewis.**]

- \*14.6** 'A' on the instructions of promoters of a company, prepared "Memorandum of Association and Articles of Association, paid the registration fees and got the company incorporated. 'A' claims his costs and charges from the company. The company refuses to pay. Will 'A' succeed?

**Answer:** The company is not bound to pay 'A' because the expenses were incurred and services were rendered at a time when the company was not in existence, Moreover, since the company has not accepted the contract the case is not fully covered by the provisions of sections 15 (h) and 19 (e) of the Specific Relief Act 1963.

- \*14.7** The Memorandum and Articles of Association of a company were delivered to the Registrar of Companies for registration on January 6. On January 8th, the Registrar issued the certificate of incorporation but dated it January 6th.

On that very day (January 6th) the company made allotment of its shares. The allotment was challenged that it was made before the actual issue of the certificate of incorporation. How would you decide and why?

**Answer:** Allotment of shares is valid because Certificate of Incorporation is conclusive evidence of all that it contains as per Sec 9. In the eyes of law the company was formed on January 6th.

- \*14.8** Four of the seven signatures to the Memorandum of Association of a company are forged. The memorandum is duly presented, registered and a certificate of incorporation is issued. Can the existence of the company be subsequently questioned on the ground that registration is void. Decide.

**Answer:** The company's existence cannot be now challenged on the ground that registration was void since as per Sec. 9 the certificate of incorporation, once issued is conclusive evidence of the fact that the company has been duly registered. Once the certificate is issued, no one can question the validity of incorporation.

- \*14.9** A company was formed on the basis of a certificate of incorporation obtained by threatening the Registrar of Companies. Is the company legally formed?

**Answer:** The company's existence cannot be now challenged on the ground that registration was void since as per Sec 9 the certificate of incorporation, once issued is conclusive evidence of the fact that the company has been duly registered. Once

the certificate is issued, no one can question the validity of incorporation.

- 14.10** The principal business of XYZ Company Ltd. was the acquisition of vacant plots of land and to erect the houses. In the course of transacting the business, the chairman of the Company acquired the knowledge of arranging finance for the development land. The XYZ Company introduced a financier to another company ABC Ltd. and received an agreed fee of Rs. 2 lakhs for arranging the finance. The memorandum of Association of the company authorises the company to carry on any other trade or business which can in the opinion of the board of directors, be advantageously carried on by the company in connection with the company's general business. Referring to the provisions of the Companies Act, 1956 examine the validity of the contract carried out by XYZ Company Ltd. with ABC Ltd.

**Answer:**

1. Arranging finance or financier is an ultra vires act since It falls outside the object clause of memorandum. An object contained in the object clause is not valid if it authorises the company to carry on any other trade or business which can be advantageously carried on by the company.
2. The Contract entered into by the company is ultra vires since (a) The company has no power to arrange finance or financier. (b) The Board cannot take the defence that the memorandum authorises the company to carry on any business which can be advantageously carried on in connection with company's present business (since, it is a 'specified purpose' for alteration of object clause, but it cannot be the ground or basis for carrying on a business which is outside the object clause);

- \*14.11** The articles of association of a limited company provided that 'X' shall be the law officer of the company and he shall not be removed except on the ground of proved misconduct. The company removed him even though he was not guilty of misconduct. Decide, whether company's action is valid?

**Answer:** Company's action is valid, and 'X' has no remedy against the company because:

- (i) The memorandum and articles do not bind a company to the outsiders.
- (ii) Unless 'X' proves a contract independent of the articles, he cannot enforce any right against the company as he has no right to rely on the articles **[Leading**

**Case Law: Eley v Positive Govt. Security Life Assurance Co.]**

- \*14.12** The secretary of company issued a share certificate to 'A' under the Company's seal with his own signature and the signature of Director forged by him. 'A' borrowed money from 'B' on the strength of this certificate. 'B' wanted to realise the security and requested the company to register him as a holder of the shares. Explain whether 'B' will succeed in getting the share registered in the name.

**Answer:** A or B is not entitled to shares since in case of forgery, there is not a defect in consent, but absence of consent, and therefore the share certificate issued by way of forgery is invalid. The judge observed that the doctrine of indoor management applies to irregularities and not to illegalities. **[Leading Case Law: Rubben v. Great Fingall Consolidated Co.]**



# BUSINESS LAW [SECTION A]

## Tulsian's Model Test Papers

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### TULSIAN'S MODEL TEST PAPER 1

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*Questions **No. 1** is compulsory.*

*Answer any **four** questions from the remaining five questions.*

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#### QUESTION 1

- (a) X placed an order with Y for supply of Urid Dhall on 10.1.2018 at a contracted price of ₹ 80 per kg. The order was for the supply of 20 tonnes within a month's time viz. before 09.2.2018. On 05.02.2018 Y informed X that the price of Urid Dhall was sky rocketing to ₹ 100 Per. Kg. and he would not be able to supply as per original contract. The price of Urid Dhall rose to ₹ 106 on 09.02.2018. Advise X citing the legal position.
- (b) The Articles of Association of XYZ Ltd. provides the Board of Directors has authority to issue bonds provided such issue is authorized by the shareholders by a necessary resolution in the general meeting of the company. The company was in dire need of funds and therefore, it issued the bonds to Mr. X without passing any such resolution in general meeting. Can Mr. X recover the money from the company? Decide.
- (c) Explain the rules relating to the Sale by action.

#### QUESTION 2

- (a) "An agreement in restraint of trade is void." Examine this statement mentioning exceptions if any.
- (b) Distinguish between a Limited Liability Company and LLP.
- (c) Explain: Quasi Contracts and Quantum Meruit.

#### QUESTION 3

- (a) Mention the position of a minor partner in a partnership firm.
- (b) Explain the consequences of non-registration of a partnership firm.
- (c) X entered into an agreement with Y to deliver him X 10,000 bags to be manufactured in his factory. The bags could not be manufactured because of strike by the workers and X failed to supply the said bags to Y. Decide whether X can be exempted from liability under the provisions of the Indian Contract Act, 1872.

#### **QUESTION 4**

- (a) Distinguish between Right of Lien and Right of Stoppage in transit.
- (b) Anand and Ravi are carrying on business in partnership. In the partnership deed it is provided that neither of the partners should borrow money except with the consent of both. Anand borrowed a sum of ₹ 10,000 from Suresh for the business of the firm without the consent of Ravi. Is the firm liable? Give reasons for your answer.

#### **QUESTION 5**

- (a) Ashish of Bombay enters into an agreement with Jyoti of New Delhi to supply five motor-cycles to be delivered to the later at New Delhi. Ashish sends these motor-cycles through Messers Deepak Transport Ltd., a leading transporter. The motor-cycle reach New Delhi on time but Jyoti delays to take the delivery. M/s Deepak Transporter informs Jyoti that the motor cycles are lying at their godown at Jyoti's risk. Before taking the delivery of these motor-cycles, Jyoti becomes insolvent. Ashish wants to exercise his right of stoppage of goods in transit, under the Sale of Goods Act. Advise.
- (b) Explain One Person Company(OPC), Association not for profit, Small Company, Government Company, Producer Company.

#### **QUESTION 6**

- (a) What is a contingent contract? What are the rules relating to such contracts?
- (b) What is meant by 'Implied Authority of a Partner'? What are the statutory restrictions on the implied authority of a partner?
- (c) Explain the doctrine of ultra vires.

**ANSWERS TO TULSIAN'S MODEL TEST PAPER – 1**

- 1(a)** The stated problem is a case of 'Anticipatory breach of Contract' as per Sec. 39 of the Indian Contract Act, 1872.

The case law applicable here is Frost vs. Knight.

The answer to the problem is that

- (i) X can repudiate the contract on 05.02.2018 and can claim damages @ ₹ 20 per kg [₹ 100 – ₹ 80].
- (ii) He could wait till 09.02.2018 and claim damages @ ₹ 26 per kg. [₹ 106 – ₹ 80].
- (iii) If the Government, in the interim period i.e. between 05.02.2018 and 09.02. 2018 imposes a ban on the movement of the commodity to arrest rise of prices, the contract becomes void and X will not be able to recover any damages whatsoever.

- 1(b)** According to the Doctrine of Indoor Management, if an act is authorised by the articles or memorandum, an outsider is entitled to assume that all the detailed formalities for doing that act have been observed. As per the case of the Royal British Bank vs. Turquand [1856] 6E & B 327, the directors of R.B.B. Ltd. gave a bond to T. The articles empowered the directors to issue such bonds under the authority of a proper resolution. In fact, no such resolution was passed. Notwithstanding that, it was held that T could sue on the bonds on the ground that he was entitled to assume that the resolution had been duly passed. This is the doctrine of indoor management, popularly known as Turquand Rule. Since, the given question is based on the above facts, accordingly here in this case Mr. X can recover the money from the company considering that all required formalities for the passing of the resolution have been duly complied.

**1(c)**

**MEANING OF AUCTION SALE**

Auction sale means a public sale where intending buyer (known as the 'bidder') assemble at one place and offer the purchase price (known as 'bid') at which they are ready to buy the goods. The owner of the goods may himself sell them by auction or appoint a person to sell the goods by auction on his behalf. The person so appointed is known as 'auctioneer.' The relationship between the owner of the goods and the auctioneer is that of the principal and agent. It may be noted that an advertisement to sell the goods by auction is simply an invitation to the public to make offers and not an offer to sell. That is why the intending buyers have no right to sue the auctioneer if auctioneer cancels or postpones the sale by auction.

**RULES REGARDING SALE BY AUCTION [SECTION 64]**

<b>Separate Contract</b>	Where goods are put up for sale in lots, each lot is prima facie deemed to be the subject of a separate contract of sale [Section 64(1)].
<b>Completion of Sale</b>	A sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner. For example, by saying one, two and three, or by shouting going, going, gone etc. [Section 64(2)].

**APP4.4** Tulsian's Business Laws for CA Foundation Course

<b>Right to Withdraw bid</b>	Until the announcement of completion of sale is made, any bidder may withdraw his bid [Section 64(2)].
<b>Seller's Right to bid</b>	A right to bid may be reserved expressly by or on behalf of the seller and, where such right is expressly so reserved, the seller or anyone person on his behalf may bid at the auction [Section 64(3)].
<b>Fraudulent Sale</b>	Where a sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person, and any sale contravening the rule may be treated as fraudulent by the buyer [Section 64(4)].
<b>Reserve Price</b>	A sale may be notified to be subject to a reserve or upset price [Section 64(5)]. The term 'reserve' or 'upset' price may be defined as the minimum price below which the auctioneer will not sell the goods put up for auction sale.
<b>Voidable Sale</b>	If a seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer [Section 64(6)].

**2(a)**

<b>Validity</b>	"Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void." [Sec 27 of The Indian Contract Act, 1872]
<b>Meaning of Expression 'that extent'</b>	The expression 'that extent' may be interpreted in the sense that only that portion of such agreement is void which is considered <i>either</i> as unreasonable <i>or</i> as opposed to public policy being in restraint of trade. The rest of the agreement would continue to be valid.
<b>Exceptions</b>	
<b>Exceptions under Statutory Provisions</b>	
1. Agreement with seller of Goodwill 2. Agreements with Partners (a) Restriction on Existing Partner to carry a any business other than that of firm while he is a partner. (b) Restrictions on outgoing Partner to carry on similar business within specified period or local limits if restrictions are reasonable. (c) Restriction on Partners on dissolution of firm to carry on similar business within specified period or local limits if restrictions are reasonable. (d) Restriction on Partners in case of sale of firm's goodwill, to carry on similar business within specified period or local limits if restrictions are reasonable.	
<b>Exceptions under Judicial Interpretations</b>	
1. Trade Combinations to regulate the business or to fix prices (but not to create monopoly) 2. Sole Dealing Agreements on reasonable terms. 3. Service Agreements	

**2(b)**

<b>Basis of Distinction</b>	<b>Limited Liability Company</b>	<b>LLP</b>
<b>1. Regulating Law</b>	It is governed by ' <b>The Companies Act, 2013</b> '	It is governed by 'The Limited Liability Partnership Act, 2008'
<b>2. Motive</b>	It can be formed for <b>Profit or Service motive</b> .	It can be formed <b>only for Profit motive</b> .
<b>3. Number of Members</b>	<b>Private Company</b> : Minimum 2 members(OPC1) & maximum 200 members. <b>Public Company</b> : Minimum 7 members but their is <b>no limit on maximum</b> number of partners.	<b>Minimum 2</b> but their is <b>no limit on maximum</b> number of partners.
<b>4. Liability of Partners/ Members</b>	Generally <b>limited to</b> the amount remaining <b>unpaid</b> on each share.	Liability of Partner is Limited, <b>to the extent their contribution</b> towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
<b>5. Name of Entity</b>	Name of Public Co to contain ' <b>Limited</b> ' and Name of Private Co to contain ' <b>Private Limited</b> '.	Its Name to contain ' <b>Limited Liability Partnership</b> ' or ' <b>LLP</b> ' as suffix.
<b>6. Formalities of Incorporation</b>	1. Memorandum & Articles of Association 2. <b>Various e Forms</b> 3. <b>Prescribed Fee</b> . required to be filled with Registrar of Companies.	1. <b>LLP Agreement</b> 2. <b>Various e Forms</b> 3. <b>Prescribed Fee</b> . required to be filled with Registrar of LLP.
<b>7. Filing of Annual Statement of Solvency</b>	Annual Statement of Solvency is <b>not required</b> to be filed with the Registrar of Companies every year.	Annual Statement of Solvency is <b>required</b> to be filed with the Registrar of LLP every year.
<b>8. Minimum No. of Directors/ Designated Partners</b>	Public Co to have at least 3 directors. Private Co to have at least 2 directors.	LLP must have at least 2 Designated Partners.
<b>9. Whistle Blowing</b>	<b>No such provision</b> is provided under the Companies Act, 1956.	<b>Provision</b> has been <b>made</b> to provide protection to employees & partners, providing useful information during an investigation or convicting any partner or firm.

<b>10. Audit of Accounts</b>	Companies are required to get their accounts audited <b>annually</b> as per the provisions of the Companies Act, 1956.	An LLP is required to get their accounts audited annually as per the provisions of LLP Act 2008 <b>if its turnover exceeds ₹ 40 Lacs or its capital contribution exceeds ₹ 25 Lacs in any financial year.</b>
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## 2(c) Meaning and kinds of Quasi-Contracts

<b>Meaning</b>	A Quasi-contract is an obligation imposed by law upon a person for the benefit of another even in the absence of a contract. It is based on the principle of equity.
<b>Features</b>	<ul style="list-style-type: none"> <li>(a) It is imposed by law and does not arise from any agreement.</li> <li>(b) The duty of a party and not the promise of any party is the basis of such contract.</li> <li>(c) The right under it is always a right to money and generally, though not always, to a liquidated sum of money.</li> <li>(d) The right under it is available against specific person(s) and not against the world.</li> <li>(e) A suit for its breach may be filed in the same way as in case of a complete contract.</li> </ul>
<b>Similarity</b>	The outcome of quasi-contracts resemble that created by a contract. So far as claim for damages are concerned, there is a similarity between a Quasi-contracts and contract because in case of breach of a quasi-contract, Section 73 provides for the same remedies as provided in case of breach of a contract.
<b>Kinds</b>	<ol style="list-style-type: none"> <li><b>1. Right to Recover the Price of Necessaries Supplied</b> to a person who is incapable of contracting or anyone whom such incapable person is legally bound to support, from the property of such incapable person.[Sec 68]</li> <li><b>2. Right to Recover Money Paid for Another Person</b>[Sec 69]</li> <li><b>3. Right to Recover for Non-Gratuitous Act</b>[Sec 70]</li> <li><b>4. Responsibility of Finder of Goods as Bailee</b>[Sec 71]</li> <li><b>5. Right to Recover from a Person to whom Money is Paid or thing is Delivered, by Mistake or Under Coercion</b>[Sec 72]</li> </ol>
<b>Right of Injured Party</b> [Sec 73]	When an obligation created by a Quasi-contract is not discharged, the injured party is entitled to receive the same compensation from the party in default as if such person had contracted to discharge it and had broken his contract.



## QUANTUM MERUIT

**Meaning :** The term '*quantum meruit*' means as much as merited or 'as much as earned'. In other words, it means payment in proportion to the amount of work done. The right to claim on '*quantum meruit*' does not arise out of a contract as the right to damages does. It is a claim on the quasi contractual obligations which is implied by the circumstances. The claim for *quantum meruit* arises only when the original contract is discharged.

### CASES IN WHICH THE CLAIM OF QUANTUM MERUIT ARISE

1. **In Case of Void Agreement, or Contract that becomes Void [Section 65]** When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it.
2. **In Case of Non-gratuitous Act [Section 70]** The obligation to pay arises if the following three conditions are satisfied:
  - (i) The thing must have been done or delivered lawfully;
  - (ii) The person who had done or delivered the thing must not have intended to do so gratuitously; and
  - (iii) The person for whom the act is done must have enjoyed the benefit of the Act.
3. **In Case of Act Preventing the Completion of Contract** If a party does not complete the contract or prevents the other party to complete the contract, the aggrieved party can sue on quantum meruit.
4. **In Case of Divisible Contract** The party at default may sue on a quantum meruit if the following conditions are satisfied:
  - (i) If the contract is divisible; and
  - (ii) If the party not at default has enjoyed benefits of the part performance.
5. **In Case of Indivisible Contract Performed Completely but Badly** The party at default may claim the lumpsum less deduction for bad work if the following conditions are satisfied:
  - (i) If the contract is indivisible;
  - (ii) If the contract is for lumpsum;
  - (iii) If the contract is completely performed; and
  - (iv) If the contract is performed badly.

### 3(a) CAN A MINOR ENTER INTO A PARTNERSHIP AGREEMENT?

Since a minor is not capable of entering into a contract, an agreement by or with a minor is void *ab-initio* (*Mohni Bibi v. Dharamdas Ghosh*). Since partnership is formed by an agreement, a minor cannot enter into a partnership agreement.

### CAN A MINOR BE ADMITTED AS PARTNER?

On the basis of the general rule that a minor cannot be a promisor, but can be a promisee or a beneficiary, Section 30 of the Indian Partnership Act 1932, provides as under:

**“With the consent of *all* the partners for the time being, a minor may be admitted to the benefits of partnership.”**

An analysis of the above provision highlights the following three conditions:

- (a) Before admission of a minor as a partner, there must be an existence of partnership;
- (b) There must be mutual consent of *all* the partners;
- (c) A minor can be admitted only to the benefits of partnership.

**Note:** There cannot be a partnership consisting of all the minors or of one major and all other minors. [*Shivaram v. Gaurishanker*]

### **WHAT ARE THE RIGHTS AND LIABILITIES OF A MINOR PARTNER BEFORE ATTAINING MAJORITY?**

<b><i>Rights</i></b>	<b><i>Liabilities</i></b>
(a) He has a right to share the profits and property of the firm in accordance with the agreement. [Section 30(2)]	(a) He is liable only to the extent of his share in the profits and the property of the firm. He is not personally liable to third parties. [Section 30(3)]
(b) He has a right to have access to, and inspect and copy, any of the accounts of the firm. But he does not enjoy such rights in respect of books other than account books. [Section 30(2)]	(b) He cannot be declared insolvent on declaration of firm's insolvency, his share vests in the Official Receiver or Official Assignee.
(c) He has a right to file a suit for his share of profits or the property of the firm when he is not given his due share of profits. However, he can exercise this right only when he decides to sever his connections with the firm [Section 30(4)].	

### **WHAT ARE THE RIGHTS AND LIABILITIES OF A MINOR PARTNER ON ATTAINING MAJORITY?**

Within six months of date of his attaining majority or date of his obtaining knowledge that he had been admitted to the benefits of firm, whichever is later, the minor partner has to exercise his option whether or not to become a partner. Such option is required to be exercised by giving a public notice within the said six months. If he fails to give a public notice, he is deemed to have become a partner in the firm on the expiry of the said six months [Section 30(5)]. The various rights and liabilities of a minor partner on his attaining majority are given below:

<b><i>When he elects to become a partner</i></b>	<b><i>When he elects not to become a partner</i></b>
(a) He becomes personally liable to third parties for all acts of the firm since he was admitted to the benefits of partnership [Section 30(7)(a)].	(a) His rights and liabilities continue to be those of minor up to the date of giving public notice [Section 30(8)(a)].

(b) His share in the property and profits of the firm remains the same as he was entitled as a minor [Section 30(7)(b)].	(b) His share is not liable for any acts of the firm done after the date of the public notice [Section 30(8)(b)].  (c) He is entitled to sue the partners for his share of the property and profits in the firm [Section 30(8)(c)].
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**3(b)****EFFECTS OF NON-REGISTRATION OF A FIRM**

Under the Indian Partnership Act 1932, the registration of a firm is not compulsory. But, indirectly, by creating certain liabilities (also termed as effects of non-registration u/s 69) from which an unregistered firm suffers, the law has made the registration of firms desirable. **The effects of non-registration of a firm are as follows:**

- 1. No suit by a partner against the firm or the other partner [Section 69(1)]** A partner of an unregistered firm cannot file a suit against the firm or any partner of the firm to enforce any right arising from contract.  
**Note:** Section 69(1) prohibits the institution of civil suit and not the criminal suit.
- 2. No suit by the firm against third parties [Section 69(2)]** An unregistered firm cannot file a suit against a third party to enforce any right arising from contract. In case of *Puran Mal v. Central Bank of India*, it was held that a subsequent registration could not cure the defect that existed at the time of filing the suit.
- 3. No right to claim set off in excess of ₹ 100 [Section 69(3)]** An unregistered firm or any partner thereof cannot claim a set off (if value exceeds ₹ 100) in proceeding instituted against the firm by a third party to enforce a right arising from a contract.

**WHAT ARE THE RIGHTS NOT AFFECTED BY NON-REGISTRATION**

- 1. Rights of unregistered firm or partners thereof**
  - (i) Right of firm or partner of a firm having no place of business in India. [Section 69(4)(a)].
  - (ii) Right to file a suit or claim of set-off if the value of suit does not exceed ₹ 100 [Section 69(4)(b)].
  - (iii) Right of a partner to sue (a) for the dissolution of the firm, (b) for the accounts of a dissolved firm, or (c) for claiming share of the assets of a dissolved firm [Section 69(3)(a)].
  - (iv) Right to enforce a right arising otherwise than out of a contract, e.g. infringement of a Patent right by a third party. The firm may file a suit to restrain the third party from misusing the Patent right.
- 2. Right of a third party to file a suit against the unregistered firm or partners thereof.**
- 3. Power of an Official Assignee or Receiver or Court to realise the property of an insolvent partner [Section 69(3)(b)].**

**3(c)** As per Sec. 56 (Para 2) of the Indian Contract Act, 1872 when the performance of a contract becomes impossible or unlawful subsequent to its formation, the contract becomes void, this is termed as 'supervening impossibility' (i.e. impossibility which does not exist at the time of making the contract, but which arises subsequently).

But impossibility of performance is, as a rule, not an excuse from performance. It means that when a person has promised to do something, he must perform his promise unless the performance becomes absolutely impossible. Whether a promise becomes absolutely impossible depends upon the facts of each case.

The performance does not become absolutely impossible on account of strikes, lockout and civil disturbances and the contract in such a case is not discharged unless otherwise agreed by the parties to the contract (*Budget V Bennington*; *Jacobs V Credit Lyonnais*).

In this case X could not deliver the bags as promised because of strike by the workers. This difficulty in performance cannot be considered as impossible of performance attracting Section 56 (Para 2) and hence X is liable to Y for non-performance of contract.

**4(a)**

#### **DISTINCTION BETWEEN RIGHT OF LIEN AND RIGHT OF STOPPAGE IN TRANSIT**

<b>Basis of Distinction</b>	<b>Right of Lien</b>	<b>Right of Stoppage in transit</b>
<b>1. Possession of goods</b>	The goods must be in actual possession of the seller.	The goods must be in the possession of a carrier or other bailee who is acting as an independent person.
<b>2. Solvency</b>	The right can be exercised even when the buyer is solvent but refuses to pay the price.	This right can be exercised only when the buyer has become insolvent.
<b>3. End vs. Commencement on delivery to carrier</b>	This right comes to an end when the seller delivers the goods to a carrier.	This right commences only when the seller delivers the goods to a carrier.
<b>4. Purpose</b>	The purpose of right is to retain possession of the goods.	The purpose of this right is to regain the possession of the goods.
<b>5. Mode of exercising the right</b>	This right can be exercised by the seller himself.	This right can be exercised by the seller through the carrier or the other bailee.

***Right of Stoppage in Transit as an Extension of the Right of Lien:*** The right of stoppage in transit is an extension of the right of lien in the sense that the right of stoppage in transit begins when the right of lien ends and the purpose of the right of stoppage in transit is to regain possession of the goods.

- 4(b) The firm is liable to Suresh as he was not aware of the restriction (Motilal v. Unnao Commercial Bank).
- 5(a) Ashish cannot exercise the right of stoppage in transit as the transporter acknowledges holding goods on behalf of Jyoti.

**5(b) MEANING OF ONE PERSON COMPANY [OPC]**

As per section 2(62) of the Companies Act, 2013, "One Person Company" means a company which has only one person as a member.

**CONDITIONS FOR ONE PERSON COMPANY [OPC]**

1. The memorandum of One Person Company is required to indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.[Proviso to Sec 3 (1)]
2. Only a natural person who is an Indian citizen and resident in India –
  - (a) shall be eligible to incorporate a One Person Company;
  - (b) shall be a nominee for the sole member of a One Person Company.

**Note:** "Resident in India" means a person who has stayed in India for at least 182 days during the immediately preceding one calendar year.
3. No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company.
4. No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.
5. Such Company cannot be incorporated or converted into a Licensed company u/s 8
6. Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of any body corporates.
7. No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of One Person Company, except threshold limit (paid up share capital) is increased beyond ₹ 50 lakh or its average annual turnover during the relevant period exceeds ₹ 2 crore .

**MEANING OF ASSOCIATION NOT FOR PROFIT**

In the case of 'association not for profit' the Central Government may by license allow a person or an association of persons to be registered as a limited liability company without using the words 'limited' or 'private limited' as part of its name.

**PROVISIONS RELATING TO ASSOCIATION NOT FOR PROFIT [SECTION 8]**

1. **Conditions for obtaining licence u/s 8 (1):** The Central Government will grant the license only if it is satisfied that a person or an association of persons proposed to be registered as a limited liability company:

- (i) has in its objects the promotion of commerce, art, science, religion, charity or any other useful object;
  - (ii) intends to apply its profits, if any, or other income in promoting its objects; and
  - (iii) prohibits the payment of dividend to its members.
2. The company registered u/s 8 shall enjoy all the privileges and be subject to all the obligations of limited companies. [Sec 8(2)]
  3. A firm may be a member of the company registered u/s 8. [Sec 8(3)]
  4. A company registered u/s 8 shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government. [Sec 8(4)(i)]
  5. A company registered u/s 8 may convert itself into company of any other kind only after complying with such prescribed conditions. [Sec 8(4)(ii)]
  6. **Conditions for Revocation of Licence u/s 8 (6):** The Central Government may, by order, revoke the licence granted to a company registered u/s 8 and direct the company to convert its status and change its name to add the word "Limited" or the words "Private Limited", as the case may be, to its name if :
    - (i) the company contravenes any of the requirements or any of the conditions subject to which a licence is issued or
    - (ii) the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest,
  7. **Effect of Revocation of Licence u/s 8 (7)** Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section. No such order shall be passed unless the company is given a reasonable opportunity of being heard.
  8. Such companies may be public or private companies and may or may not have share capital.

### **MEANING OF SMALL COMPANY [SEC. 2(85)]**

Small company is a new form of private company based on paid up capital and turnover. In other words, such companies are small sized private companies.

As per Section 2(85) "small company" means a private company –

- (i) paid-up share capital of which does not exceed ₹ 50 lakh or prescribed higher amount which shall not be more than ₹ 10 crore ; or
- (ii) turnover of which as per its last Profit and Loss Account does not exceed ₹ 2 crore or prescribed higher amount which shall not be more than ₹ 100 crore:

**NON APPLICABILITY OF SEC. 2(85)**

The provisions of Sec. 2 (85) are not applicable to:

1. a holding company or a subsidiary company;
2. a company registered u/s 8; or
3. a company or body corporate governed by any Special Act;

**Note:** Small Companies enjoy some special privileges, which other private companies do not have.

**MEANING OF GOVERNMENT COMPANY [Sec 2(45)]**

As per Sec 2(45) of the Companies Act, a government company means “**any company in which at least 51% of the paid-up share capital is held:**

- (a) **by the Central Government, or**
- (b) **by any State Government, or Governments, or**
- (c) **partly by the Central Government and partly by one or more State Governments and includes a company which is a subsidiary of a government company as thus defined”. For example,** Indian Telephone Industry, Hindustan Aeronautics Ltd. Even a subsidiary company of a government company is regarded as a Government company. A government company registered under this Act is a non-statutory company and is not an agent of the government. It may be registered as a public company or a private company.

**MEANING OF PRODUCER COMPANY**

According to Section 581A of The Companies Act, 1956, a producer company is a body corporate having objects or activities specified in Section 581B of The Companies Act, 1956, and which is registered as such under the provisions of the Act. The membership of producer companies is open to such people who themselves are the **primary producers**, which is an activity by which some agricultural produce is produced by such primary producers.

**6(a) MEANING OF A CONTINGENT CONTRACT [SECTION 31]**

A 'contingent contract' is a contract to do or not to do something if some event, collateral to such contract, does or does not happen. Insurance contracts provide the best example of contingent contracts.

**ESSENTIAL FEATURES OF A CONTINGENT CONTRACT**

- (a) **Dependence on a Future Event:** The performance of a contingent contract depends upon the happening or non-happening of some future event.
- (b) **Collateral Event:** The event must be collateral to the contract.
- (c) **Uncertain Event:** The event must be uncertain.

### RULES REGARDING CONTINGENT CONTRACTS

Kind of Contingent Contract	Rule regarding enforcement
<b>1. Contracts contingent upon the happening of an uncertain future event. [Section 32]</b>	Such contracts cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.
<b>2. Contracts contingent upon the non-happening of a certain future event. [Section 33]</b>	Such contracts can be enforced when the happening of that event becomes impossible and not before.
<b>3. Contracts contingent upon the future conduct of a living person. [Section 34]</b>	If the uncertain event is the future conduct of a living person, such event shall be considered impossible if that such person does anything by which it becomes impossible to perform the contract within any definite time.
<b>4. Contracts contingent upon the happening of an uncertain specified event within a fixed time. [Section 35]</b>	Such contracts become void if before the expiry of fixed time— (a) such event does not happen, or (b) such event becomes impossible.
<b>5. Contracts contingent upon the non- happening of an uncertain specified event within a fixed time. [Section 35]</b>	Such contracts can be enforced by law if before the expiry of fixed time— (a) such event does not happen, or (b) it becomes certain that such event will not happen.
<b>6. Agreements contingent upon impossible events. [Section 36]</b>	Such agreements are void whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

6(b)

#### MEANING OF IMPLIED AUTHORITY

The authority of a partner means the capacity of a partner to bind the firm by his act. This authority may be express or implied. The authority conferred on a partner by mutual agreement is called 'express authority'. The authority conferred on a partner by the provisions of Section 19 of the Indian Partnership Act is called 'implied authority'. Reading together Sections 19(1) and 22. Implied authority covers those acts of partners which fulfill the following three conditions:

- (a) The act must relate to the normal business of the firm;
- (b) The act must have been done in the usual way of carrying on the business of the firm;

(It may be noted that the question as to what is usual and what is unusual in a business depends on the nature of business and the usage of trade, e.g. taking loan is considered as usual activity in case of a trading concern but unusual activity in case of a professional concern of solicitors.)



- (c) The act must be done in the firm's name or in any other manner expressing or implying an intention to bind the firm.

### **STATUTORY RESTRICTIONS ON IMPLIED AUTHORITY[SECTION 19(2)]**

In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to do the following acts namely—

- (a) To submit a dispute to arbitration relating to the business of the firm;
- (b) To open a Bank Account on behalf of the firm in partner's own name;
- (c) To compromise or relinquish any claim or portion of the claim by the firm;
- (d) To withdraw a suit or proceedings filed on behalf of the firm;
- (e) To admit any liability in a suit or proceedings against the firm;
- (f) To acquire immovable property on behalf of the firm;
- (g) To transfer immovable property belonging to the firm; and
- (h) To enter into partnership on behalf of the firm. [Refer to Practical Problem 30]

**Note:** A partner can do any of the above-mentioned acts only if he is expressly authorised to do that act or the usage or custom of the trade permits him to do that act.

### **Liability of the Firm for the above Restricted Acts of Partner**

The firm is not liable to third party for the above mentioned restricted acts of a partner whether or not the person dealing with the firm knew about such restrictions.

**6(c)**

### **MEANING OF ULTRA VIRES**

The term '*ultra*' means '*beyond*' and the term '*vires*' means the '*powers*'. Thus, *ultra vires* a company means '**beyond the powers of a company**'. Any act which is beyond the objects stated in the memorandum is *ultra vires* the company and, therefore, **null and void**. The company shall not be bound by such acts which are *ultra vires* the company. The purpose of the doctrine of *ultra vires* is to protect the interests of members, outsiders and creditors.

### **EFFECTS OF ULTRA VIRES TRANSACTIONS**

1. Act which is *ultra vires* the company shall be *void-abinitio* and cannot be ratified even by an unanimous resolution of all the members.
2. The company *cannot be sued* on an *ultra vires* transactions.
3. The company *cannot sue* on an *ultra vires* transactions.
4. **Injunction** Any member can bring injunction against the company to restrain it from doing *ultra vires* acts.
5. **Personal Liability of Directors** The directors of the company can be held personally liable for any loss caused by an *ultra vires* transaction. If a director makes an *ultra vires* payment, he can be compelled to make good the funds used [Re *Sharpee*, (1892) 1 Ch. 154]. But the directors who refunded the money could get indemnity as against the person who received the payment with the

knowledge that payment to him was *ultra vires*. [**Russell v. Wakefield Water Works Co. (1975) L.R. 20 Eq. 474**]

- 6. Liability for Breach of Warranty of Authority** The directors can be held personally liable for breach of warranty of authority if it can be established that their act amounts to an implied misrepresentation of facts and not of law.

Where the Memorandum of Association of a non-trade company did not give any power to borrow but its directors borrowed, directors are not personally liable since their act amounts to an implied misrepresentation of law as a non-trading company has no implied power to borrow.

Where the Memorandum of Association of a trading company did not give any power to borrow but its directors borrowed, directors are personally liable since their act, amounts to an implied misrepresentation of fact as a trading company has implied power to borrow.

In case of **Weeks v. Property**, (1873): LR 8 CP 427, the directors having power to borrow up to £ 60,000, further borrowed £ 500. Loan of £500 was held to *ultra vires* and void and therefore not binding on the company. The directors were held personally liable for breach of warranty of authority.

- 7. On Ultra Vires Lending by Company** If money is lent by a company having no power to lend, the company can sue the debtors for the recovery of loan since the debtors will be estopped from taking the plea that the company had no power to lend. [**Re. Coltman** (1818) 119 Ch. D. 64]
- 8. On Ultra Vires Borrowing by the Company** The effect on *ultra vires* borrowing by company depends upon whether the money borrowed has been expended or not.

Where the company has no borrowing power, any borrowing and where the memorandum fixes a limit on borrowing powers of the Board of Directors of a Company, any borrowing in excess of that limit is known as *ultra vires borrowing*. Such borrowings are void and the securities given for them are inoperative. In such a case the lender cannot sue the company because it does not create any relation of debtor and creditor. The borrowings which are *ultra vires* cannot be ratified by a resolution passed at a general meeting.

Case	Effect
(a) <i>If ultra vires borrowings have not been used.</i>	<b>Right of Restitution</b> The lender may bring injunction against the company to restrain it from using the amount of loan since the lender remains the owner of the money which is <i>ultra vires</i> the company, he can take back the property in specie. (i.e. in the same form) [ <b>Sinclair v. Borughman</b> , (1914) A.C. 398]

<b>(b) If ultra vires borrowings have been used to pay-off lawful debt of the company.</b>	<b>Right of Subrogation</b> The lender steps into the shoes of paid off creditor and consequently he would be entitled to recover his loan to that extent from the company [ <i>Naeth Building Society v. Luce</i> (1889) 43 Ch. D. 158] But he cannot claim any right to any securities held by the original creditor. [ <i>Re. Wrexham Rly. Co.</i> (1889) 1 Ch. 440].
<b>(c) If ultra vires borrowings have been used for the purchase of any asset or assets.</b>	The lender may claim repayment of his money out of the asset or assets purchased out of his money. In addition to aforesaid rights, the lender can sue the directors for breach of warranty of authority.

**9. On Ultra Vires Torts:** A company will be liable for tort of its employees if—

- (a) the tort is committed in pursuance of its stated objects, and
  - (b) the tort is committed by employees within the course of their employment.
- In other words, a company will not be liable for any torts committed outside its objects.

## TULSIAN'S MODEL TEST PAPER 2

### QUESTION 1

- (a) X, Y and Z jointly borrowed ₹ 60,000 from L. Decide in the light of The Indian Contract Act, 1872:
  - (i) whether L can compel only Y to pay the entire loan of ₹ 60,000,
  - (ii) If X, Y and Z died, whether L can compel only the Legal representatives of X to pay the loan of ₹ 60,000,
  - (iii) If the whole amount was repaid to L by Y, How much Y can recover from X and Z?
  - (iv) If the whole amount was repaid to L by Y and Z became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts. How much Y can recover from X and Z?
  - (v) If the whole amount was repaid to L by Y, Z became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts and X died and his son W inherited the assets of ₹ 17,000. How much Y can recover from X and Z?
  - (vi) If L releases X from his liability and sues Y and Z for payment. whether Y and Z are also released from their liability to L and X is released from his liability to Y and Z for contribution.
- (b) The Memorandum and Articles of Association of a company were delivered to the Registrar of Companies for registration on January 6, 2018. On January 8th 2018, the Registrar issued the certificate of incorporation but dated it January 6th 2018. On that very day (January 6th 2018) the company made allotment of its shares. The allotment was challenged that it was made before the actual issue of the certificate of incorporation. How would you decide and why?
- (c) "No seller of goods can give a better title to the purchaser than what the himself possesses." Examine this statement, bringing out its exceptions.

### QUESTION 2

- (a) What is supervening impossibility? State its effects upon a contract.
- (b) Distinguish between a Partnership Firm and LLP.
- (c) State the law relating to minor's agreements. What is the legal effect of a minor's misrepresentation of his age while entering into an agreement?

### QUESTION 3

- (a) Sharing of profit is a prima facie evidence of existence of partnership but it is not the conclusive evidence. Examine this statement.
- (b) Explain Partner by Estoppel, Property of a firm, Rights of a transferee of partners' interest, and Right a partner to get return of premium on premature dissolution
- (c) 'X' entered into a contract with 'Y' to supply him 1,000 water bottles @ ₹ 10.00 per water bottle, to be delivered at a specified time. Thereafter, 'X' contracts with 'Z' for

the purchase of 1,000 water bottles @ ₹ 9 per water bottle, and at the same time told 'Z' that he did so for the purpose of performing his contract entered into with 'Y'. 'Z' failed to perform his contract in due course and market price of each water bottle on that day was ₹ 10.50 per water bottle. Consequently, 'X' could not procure any water bottle and 'Y' rescinded the contract. What would be the amount of damages which 'X' could claim from 'Z' in the circumstances? What would be your answer if 'Z' had not informed about the 'Y's contract? Explain with reference to the provisions of the Indian Contract Act, 1872.

#### QUESTION 4

- (a) Explain the Doctrine of Caveat Emptor. Are there any exception to this rule?
- (b) X, Y and Z are partners in a registered firm. X died and D was admitted as a partner. The firm filed a suit against W, in the name and on behalf of firm without notifying to the Registrar of Firms about the changes in the constitution of the firm. Is the suit maintainable?

#### QUESTION 5

- (a) Goods are delivered by A to B on 'sale or return' basis. They are further delivered by B to C and then by C to D on similar terms. The goods are stolen while in the custody of D. Who is to bear the loss of goods and why?
- (b) Discuss the legal position of Promoters & Preliminary Contracts in case of a company.

#### QUESTION 6

- (a) Explain Novation', 'Rescission', 'Alteration', 'Remission' and Waiver.
- (b) State the circumstances under which unanimous consent of all partners is required and the consequences if a public notice is not given under The Indian Partnership Act, 1932.
- (c) State with reason whether the following statements are Correct or Incorrect:
  - (i) Member of a limited company may nevertheless have unlimited liability.
  - (ii) A limited liability company can become a partner in a firm
  - (iii) A limited company can be formed without the word 'limited' as the last word of its name.
  - (iv) A firm can never be member of any company.
  - (v) A subsidiary company can be the member of its holding company.

**Or**

List any five privileges available to an independent private company only.

## ANSWERS TO TULSIAN'S MODEL TEST PAPER – 2

1(a) Section to which the given problem relates: Section 42 to 45

**Decision:**

- (i) Yes. L can compel only Y to pay ₹ 60,000 since as per Sec. 43 in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise.
- (ii) No. L can compel the Legal representatives of X, Y and Z **jointly** to pay the loan of ₹ 60,000, since as per Sec. 45 unless a contrary intention appears from the contract, the right to claim performance rests, as between him and them, with them during their joint lives, and, after the death of any of them, with the representative of such deceased person jointly, with the survivor or survivors and after the death of the last survivor, with the representatives of all jointly.
- (iii) Y can recover the contribution of ₹ 20,000 each from X and Z since as per Sec. 43 in the absence of express agreement to the contrary, the promisors, may compel every joint promisor to contribute equally to the performance of the promise (unless a contrary intention appears from the contract).
- (iv) Y can recover the contribution of ₹ 28,000 (i.e. ₹60,000 × 1/3) + (16,000 × 1/2) from X and ₹ 4,000 (i.e. ₹ 60,000 × 1/3 × 1/5) from Z since as per Sec. 43 in the absence of express agreement to the contrary, if any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.
- (v) Y can recover the contribution of ₹ 17,000 from X and ₹ 4,300 [i.e. (₹60,000 × 1/3) + (3,000 × 1/2)] × 1/5 from Z since as per Sec. 43 in the absence of express agreement to the contrary, if any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

**Note:** A legal representative is liable only to the extent of property of the deceased received by him as per Sec. 42.

- (vi) If L releases X from his liability and sues Y and Z for payment **neither** Y and Z are released from their liability to L **nor** X is released from his liability to Y and Z for contribution since as per Sec. 44 a release of one of such joint promisors by the promisee, does not discharge the other joint promisors neither does it free the joint promisor so released from responsibility to the other joint promisors.

1(b) Section to which the given Problem relates: Sec. 9

**Decision & Reason:** Allotment of shares is valid because Certificate of Incorporation is conclusive evidence of all that it contains. In the eyes of law the company was formed on January 6th 2018.

1(c)

### MEANING OF GENERAL RULE

The general rule is expressed by the latin maxim "Nemo dat quod non habet," which means that "no one can give what he does not himself possess." If the seller's title to the goods is defective, the buyer's title will also be defective because the buyer

acquires his title to the goods from the seller. Hence, the seller cannot give a better title to the buyer than he himself has.

### **EXCEPTIONS TO THE GENERAL RULE 'NAMO DAT QUOD NON HABET'**

The circumstances under which a seller can give a better title than what he himself has are discussed below:

#### **1. Sale by a Mercantile Agent [Section 27]**

- (i) The agent must be in possession of goods or a document title (e.g., Railway receipt, Bill of Lading) to the goods with the consent of the owner.
- (ii) The agent must have sold the goods in the ordinary course of business as a mercantile agent.
- (iii) The buyer must have acted in good faith.
- (iv) The buyer must have no knowledge that the seller had no authority to sell.

#### **2. Sale by one of the Joint Owners [Section 28]**

- (i) The joint owner must be in the sole possession of goods with the consent of other co-owners.
- (ii) The buyer must have bought the goods in good faith.
- (iii) The buyer must have no knowledge that the seller had no authority to sell.

#### **3. Sale by a Person in possession under voidable contract**

- (i) The seller must be in possession of goods under a contract voidable u/s 19 or 19A of Indian Contract Act, 1872 on ground of coercion, undue influence, misrepresentation or fraud.
- (ii) The goods must have been sold before the contract is rescinded.
- (iii) The buyer must have bought the goods in good faith.
- (iv) The buyer must have no knowledge that the seller's title is defective.

#### **4. Sale by a Seller in possession after sale [Section 30(1)]**

- (i) The seller must be in possession of goods or of a document of title to the goods, in the capacity of a seller and not in any other capacity such as bailee.
- (ii) The buyer must have bought the goods in good faith.
- (iii) The buyer must have no knowledge about the previous sale.

#### **5. Sale by a Buyer in possession before the transfer of ownership [Section 30(2)]**

- (i) The buyer must be in possession of the goods or a document of title to the goods, with the consent of the original seller and must have bought or agreed to buy the goods.
- (ii) The new buyer must have bought the goods in good faith.
- (iii) The new buyer must have no knowledge about any lien or other right of the original seller in respect of goods.

**6. Sale by an Unpaid Seller [Section 54(3)]**

An unpaid seller must have exercised his right of lien or stoppage in transit.

**7. Sale by a Finder of Goods [Section 169 of Indian Contract Act 1872]**

- (i) The owner cannot be found with reasonable diligence; or
- (ii) The owner, if found refuses to pay the lawful charges of finder; or
- (iii) If the goods are in danger of perishing or of losing the greater part of its value; or
- (iv) If the lawful charges of the finder in respect of the thing found amounts to two third of its value.

**8. Sale by a Pawnee or Pledgee**

- (i) The pawnor or pledger must have made a default in the payment of the debt or the performance of the promise at the stipulated time.
- (ii) The pawnee or pledgee must have given a reasonable notice to the pawnor or pledger.

**9. Sale by Official Receiver or Assignee or Liquidator**

The involvement person must be the owner of goods.

**10. Sale by Owner by Estoppel**

The owner of the goods by his statement or conduct must have lead the buyer to believe that the seller has the authority to sell.

**2(a) EFFECTS OF SUPERVENING IMPOSSIBILITY [SECTION 56, PARA 2]**

Supervening impossibility means impossibility which does not exist at the time of making the contract but which arises subsequently after the formation of the contract and which makes the performance of the contract impossible or illegal. The effects of supervening impossibility are as under:

Case	Effect
<b>I. Where an act becomes impossible after the contract is made</b>	The contract to do such an act becomes void when the act becomes impossible. [Section 56, Para 2]
<b>II. Where an act becomes unlawful by reason of some event beyond the control of promisor</b>	The contract to do such an act becomes void when the act becomes unlawful. [Section 56, Para 2]
<b>III. Were the promisor alone knows about the impossibility</b>	Such promisor must compensate the promisee for any loss which such promisee might have suffered on account of non-performance of the promise. [Section 56, Para 3]
<b>IV. Where an agreement is discovered to be void or where a contract becomes void</b>	Any person who has received any benefit under such agreement or contract is bound to restore it or to make compensation for it, to the person from whom he received it. [Sec. 65]



**2(b)** A Partnership Firm and LLP may be distinguished as follows:

<b>Basis of Distinction</b>	<b>Partnership Firm</b>	<b>LLP</b>
<b>1. Regulating Law</b>	It is governed by ' <b>The Indian Partnership Act, 1932</b> '	It is governed by ' <b>The Limited Liability Partnership Act, 2008</b> '
<b>2. Body Corporate</b>	It is not a Body Corporate.	It is a Body Corporate.
<b>3. Separate Legal Entity</b>	<b>It has no</b> separate legal entity.	<b>It has</b> separate legal entity.
<b>4. Perpetual Succession</b>	It does <b>not have perpetual succession</b> . The death, insolvency or unsoundness of its members may affect its existence.	<b>It has</b> perpetual succession. The death, insolvency or unsoundness of its members does not affect its existence. Members may come and go but LLP goes forever.
<b>5. Liability of Partners</b>	Liability of Partner is <b>unlimited</b> . Partners are severally and jointly liable for actions of other partners and the firm and liability extend to their personal assets.	Liability of Partner is <b>limited</b> , to the extent their contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner.
<b>6. Registration</b>	Registration is <b>optional</b> .	Registration is <b>compulsory</b> .
<b>7. Creation</b>	It is created <b>by agreement</b> .	It is created <b>by Law</b> .
<b>8. Designated Partners</b>	<b>It need not have</b> Designated Partners.	<b>It must have</b> at least 2 individuals as Designated Partners, of whom at least one must be resident in India. Each Designated Partner is required to have a DPIN before appointment.
<b>9. Digital Signature</b>	There is <b>no requirement</b> of obtaining Digital Signature	At least one Designated Partner <b>must have</b> Digital Signatures since e forms are filled electronically.
<b>10. Liability of Partners for Legal Compliance</b>	<b>All Partners</b> are liable for Legal Compliance.	<b>Only Designated Partners</b> are liable for Legal Compliance.
<b>11. Name of Entity</b>	It can have <b>any name</b> as per choice.	Its Name to contain ' <b>Limited Liability Partnership</b> ' or ' <b>LLP</b> ' as suffix.

<b>12. Mutual Agency</b>	Partners are <b>agents of the firm and other partners.</b>	Partners act as <b>agents of LLP and not of other partners.</b>
<b>13. Admission of Minor</b>	Minor <b>can be admitted</b> to the benefits of Partnership as per its Agreement.	Minor <b>can not be admitted</b> to the benefits of LLP.
<b>14. Can Foreign National become partner?</b>	Foreign National <b>can not become</b> a partner in a Partnership Firm in India.	Foreign National <b>can become a Partner</b> in a LLP.
<b>15. Number of Members</b>	Minimum <b>2</b> and Maximum <b>10</b> for Banking business & <b>20</b> for non- Banking business.	<b>Minimum 2</b> but there is <b>no limit on maximum</b> number of partners.
<b>16. Whistle Blowing</b>	<b>No such provision</b> is provided under The Indian Partnership Act, 1932	<b>Provision has been made</b> to provide protection to employees & partners, providing useful information during an investigation or convicting any partner or firm.
<b>17. Annual Filing with Registrar</b>	No Return is required to be filed with Registrar of Firms	1. Annual Statement of Accounts 2. Statement of Solvency 3. Annual Return required to be filed with Registrar of LLP every year.

2(c)

### POSITION OF AGREEMENTS BY A MINOR

The law protects minor's rights because they are not mature and may not possess the capacity to judge what is good and what is bad for them. The position of agreements with or by a minor may be summarised as under:

- 1. Void:** An agreement with a minor is void ab-initio

[Leading case Law **Mohiri Bibee v. Dharmodas Ghosh**]

Facts D, a minor borrowed a sum from M by executing a mortgage of his property in favour of M. Subsequently, D sued for setting aside the mortgage. The privy council held that Sections 10 and 11 of the Indian Contract Act make the minor's agreement void and therefore the mortgage was not valid. M prayed for refund of the amount by the minor. It was held that the money advanced to minor cannot be recovered because minor's agreement was void.

- 2. No Estoppel:** A minor is not estopped from setting up the plea of minority. He may plead infancy to escape from being liable.

**3. In case of fraudulent representation of age by minor:** According to Sections 30 and 33 of the Specific Relief Act, 1963, in case of a fraudulent

misrepresentation of his age by the minor inducing the other party to enter into a contract, the court may award compensation to the other party. The Lahore High Court in *Khan Gul v. Lakha Singh* held that where the contract is set aside, the status quo ante should be restored and the court may direct the minor on equitable grounds to restore the money or property to the other party if the money or property could be traced.

4. **No Ratification on attaining the age of majority:** An agreement with a minor cannot be ratified even after he attains majority. Ratification relates back to the date of the making of the agreement and therefore an agreement which was then void cannot be made valid by subsequent ratification.
5. **Contract for supply of necessities**
  - (a) A person who has supplied the necessities to a minor or to those who are dependent on him is entitled to be reimbursed from the property of such minor. [Section 68]
  - (b) **Meaning of Necessaries:** The term necessities includes articles required to maintain a particular person in the state, degree and station in life in which he is. In India, food, clothing, shelter, education and marriage of a female have been held to be necessities.
  - (c) Section 68 covers the reimbursement for the supply of such items or loans for the same. Example: In case of *Nash v. Inman*, a minor bought eleven fancy coats from N for his own use. It was held that eleven coats at a time cannot be a necessity. Section 68 also covers the rendering of necessary services to a minor. For example, the lending of a money to a minor for the purpose of defending him in prosecution is deemed to be a service rendered to the minor.
  - (d) **'Claim against property and not against person':** A claim for the payment of necessities supplied can be made against the minor's property and not against the minor personally. In other words, a minor cannot be asked to expend labour in exchange.
  - (e) **Liability of minor's guardian:** The parent or guardian of a minor cannot be held liable unless those goods/services are supplied/rendered to a minor as the agent of the parent or guardian.
6. **Contract by minor's guardian:** The contracts entered into on behalf of a minor by his guardian or manager of his estate can be enforced by or against the minor if the contract (a) is within the scope of the authority of guardian or manager, and (b) is for the benefit of the minor. It may also be noted that his guardian cannot enter into a valid contract for purchase of the immovable property for his/her service.
7. **Contract for the benefit of a minor:** A minor can be a promisee. Thus, he may be a promisee but not promisor on a promissory note or a drawer but not drawee on a bill of exchange.
8. **Minor as a partner:** A minor cannot become a partner in a partnership firm. However, according to Section 30 of Indian Partnership Act 1932, with the

consent of all the partners for the time being be admitted to the benefits of partnership.

9. **Minor as an agent:** A minor can act as an agent and bind his principal by his acts without incurring any personal liability.
10. **Minor as a shareholder or member of a company:** A minor can become a shareholder or member of a Company if (a) the shares are fully paid up and (b) the articles of association do not prohibit so.
11. **Minor as an insolvent:** A minor cannot be declared insolvent because he is not competent to contract.
12. **Minor as an Apprentice:** A minor can be apprentice if he is of at least 14 years of age.
13. **Minor as an Employee:** A minor can not be an employee because minor's promise to serve is not a consideration for employer's promise to pay salary. [Raj Rani vs. Prem Adib]
14. **Minor as guarantor:** A minor can not be a guarantor.
15. **Validity of minor's agreement jointly with a major person:** The agreements made by a minor jointly with a major person are void vis-a-vis the minor but can be enforced against the major person who has jointly promised to perform.
16. **Minor's liability in Tort:** A minor may be held liable in Tort (civil wrong). But if in the course of doing what he is entitled to do under the contract, he is found guilty of negligence, he cannot be made liable on tort if he is not liable on the contract,

3(a) The sharing of profits is *prima facie* evidence. This statement is true in the sense that some persons though sharing the profits of a business, are not regarded as partners since they do not have mutual agency relationship. Such persons are:

- (i) a lender of the firm (who has lent money) who receives a share of profits; [Molloy March & Co. v. The Court of Wards]
- (ii) a widow or child of a deceased partner who receives a share of profits; [I.T. Commissioner v. Kesharmal Keshardeo]
- (iii) a servant or an agent who receives a share of profits as part of his remuneration; and [Munshi Abdul Latif v. Gopeshwar Chatteraj]
- (iv) a person who receives a share of profits in consideration of sale of business or goodwill of the business. [Rawlinson v. Clarke]

**Conclusion:** The true test of partnership is not the sharing of profits but the existence of mutual agency relationship, i.e., the capacity of a partner to bind other partners by his acts done in firm's name and be bound by the acts of other partners in firm's name.

3(b) Two Conditions for Partner by Estoppel or Holding out [Sec 28(1)]

A person is held liable as a partner by estoppel or holding out if the following two conditions are fulfilled:

- (a) He must have represented himself to be a partner by word spoken or written or by his conduct (such type of representation may be called as active representation),

or

He must have knowingly permitted himself to be represented as a partner (such type of representation may be called as tacit representation); and

- (b) The other person acting on the faith of such representation must have given credit to the firm. It is immaterial whether the person so representing to be a partner, is aware or not that the representation has reached the other person.

Meaning of Property of the Firm [Sec 14]

Unless otherwise agreed by the partners, the property of the firm includes:

- (a) all properties, rights and interests originally brought to the common stock of the firm,  
 (b) the property acquired by purchase or otherwise by or for the firm,  
 (c) the property acquired with money belonging to the firm, and  
 (d) the goodwill of the business of the firm. The Act does not define the term goodwill. But it is understood in the sense of value of reputation of the firm judged in respect of its capacity to bring super profits due to general public patronage. It is a part of the partnership property and can be sold either separately or alongwith the other property of the firm [Section 55(1)].

### USE OF THE PROPERTY OF THE FIRM [SECTION 15]

Unless otherwise agreed by the partners, the property of the firm shall be held and used by the partners exclusively for the purposes of the business of the firm.

Rights of Transferee of a Partner's Share [Section 29]

A partner may transfer his interest in the firm by sale, mortgage or charge fully or partially. The rights of such a transferee are as follows:

<b>(a) During the continuance of the partnership</b>	He is entitled to receive the share of the profits of the transferring partner and the account of profits agreed to by the partners. He is not entitled (a) to interfere with the conduct of the business (b) to require accounts; (c) to inspect the books of the firm.
<b>(b) On the dissolution of firm or on the retirement of the transferring partner</b>	He is entitled to receive (a) the share of the assets of the transferring partner and (b) an account as from the date of the dissolution for the purpose of ascertaining the share.

**Sub-partnership:** A sub-partnership arises when a partner of a firm agrees to share his share in the firm, with a stranger. It was assumed in *Venkatratnam v. Venkatratnam* (A.I.R. 1944, Madras, 394) that a sub-partner is a transferee within the meaning of Section 29. Thus, the rights of a sub-partner are the same as those of a transferee of partner's share under Section 29.

Right to Claim the Return of Premium on Premature Winding Up [Sec. 51]

If a partner joined a firm for a fixed term and had paid a premium and the firm is dissolved before the fixed term, he is entitled to return of the premium. The amount

of premium will depend upon (i) the terms upon which he became a partner, and (ii) the length of the time during which he was a partner. However, such a partner cannot claim any return of the premium in the following three circumstances:

- (i) When the dissolution is due to the death of partner;
- (ii) When the dissolution is mainly due to the misconduct of the partner who paid the premium; or
- (iii) The dissolution is according to an agreement which had no provision for the return of premium or any part thereof.

- 3(c)** As per Sec. 73 of the Indian Contract Act, 1872, when a contract has been broken the party who suffers by such breach is entitled to receive from the party who has broken the contract compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract to be likely to result from the breach of it.

The leading case on this point is "Hadley v. Baxendale" in which it was decided by the Court that the special circumstances under which the contract was actually made were communicated by the plaintiff to the defendant, and thus known to both the parties to the contract, the damages resulting from the breach of such contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from the breach of contract under these special circumstances so known and communicated.

The problem asked in this question is based on the provisions of Section 73 of the Indian Contract Act, 1872. In the instant case 'X' had intimated to 'Z' that he was purchasing water bottles from him for the purpose of performing his contract with 'Y'. Thus, 'Z' had the knowledge of the special circumstances. Therefore, 'X' is entitled to claim from 'Z' ₹ 1000 at (i.e. 1000 water bottles x ₹ 1) (difference between the procuring price of water bottles and contracted selling price to 'Y') being the amount of profit 'X' would have made by the performance of his contract with 'Y'.

If 'X' had not informed 'Z' of 'Y's contract then the amount of damages would have been the difference between the contract price and the market price on the day of default. In other words, the amount of damages would be ₹ 1500 (i.e. 1000 water bottles x ₹ 1.50).

**4(a)**

#### **MEANING OF 'CAVEAT EMPTOR'**

The expression means 'let the buyer beware.' The doctrine of caveat emptor has been given in the first para of Section 16 which reads as under:

*"Subject to the provisions of this Act and any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale".*

In other words, it is not part of the seller's duty to point out defects of the goods which he offers for sale, rather it is the duty of the buyer to satisfy himself about the quality as well as the suitability of the goods.

### EXCEPTIONS TO THE DOCTRINE OF CAVEAT EMPTOR

- (a) **In Case of Misrepresentation by the Seller** Where the seller makes a misrepresentation and the buyer relies on that representation.
- (b) **In Case of Concealment of Latent Defect** Where the seller knowingly conceals a defect which would not be discovered on a reasonable examination.
- (c) **In Case of Sale by Description [Section 15]** Where the goods are sold by description and the goods supplied by the seller do not correspond to the description.
- (d) **In Case of Sale by Sample [Section 17]** Where the goods are sold by sample and the goods supplied by the seller do not correspond with the sample.
- (e) **In Case of Sale by Sample as well as Description [Section 15]** Where the goods are sold by sample as well as description and the goods supplied do not correspond with sample as well as description.
- (f) **Fitness for a Particular Purpose [Section 16(1)]** Where the seller or a manufacturer is a dealer of the type of goods sold by him and the buyer has disclosed the purpose for which goods are required and relied upon the seller's skill or judgement.
- (g) **Merchantable Quality [Section 16(2)]** Where the goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that goods shall be of merchantable quality.

**Relevance :** The rule of **Caveat Emptor** appeared to play an important role in the past when trade was conducted on local scale and the buyer had every opportunity to examine the goods before buying. However, in the modern context, the rigours of the rule have been mitigated because of global dimensions of trade, government legislations on consumer protection, professional management, intense competition and consumer awareness. In fact, the rule of caveat emptor should be replaced by the rule of 'caveat vendor' (Let the seller beware).

- 4(b) The suit is not maintainable because first requirement of Section 69(2) that the suit must be instituted by or on behalf of the firm which had been registered, had been complied with, whereas the second requirement of Section 69(2) that all the partners at the date of instituting the suit have been shown in the Registrar of Firms, had not been complied with. [Leading case: VS. Behal v. Kapur & Co.]
- 5(a) B by delivering goods has accepted the goods and therefore, is liable to A but B may recover the loss from C. D cannot be held liable as he never became the owner of goods.

### 5(b) LEGAL POSITION OF PROMOTERS

The promoter's legal position is that he is **neither an agent nor a trustee** of the company he promotes because there is no company in existence.

The legal position of a promoter can be correctly described by saying that **he stands in a fiduciary position (relationship of trust and confidence) in relation to the**



**company he promotes. The fiduciary relation of a promoter really begins when the company is formed.**

The fiduciary obligation of a promoter begins as soon as he sets out to act for or promote the company. **The fiduciary obligation of promoters means an obligation of promoters to disclose fully all material facts relating to the nature and extent of contract and profit made by them either directly or indirectly.** Such disclosure must be express and actual and not merely constructive.

The promoters in their fiduciary capacity has the following important duties:

- 1 Not to make Secret Profit:** The law prohibits only the making of **secret profits** by promoter (i.e. the profits not disclosed to the company) and not the disclosed profits. The promoters of a company are perfectly free to make a profit provided they disclose this fact to an independent Board of Directors. If there is no independent Board of Directors, then he must disclose the profits to the intended shareholders.

**Remedies in case of secret profit:** When a promoter makes a secret profit, the company has the following **remedies against him:**

- (a) Recession of the Contract:** The company may on learning of the secret profit, rescind the contract even though the company had adopted the contract. However, rescission must be made within a reasonable time.
  - (b) Recovery of Secret Profit:** The company may require the promoter to refund the amount of secret profit.
  - (c) Suit for Breach of Trust:** The company may sue the promoter for misfeasance, as the promoter, by making the secret profit, has defaulted in his duty towards the company.
- 2. To make Full Disclosure to the Company of all Relevant Facts:** Since the promoter stands in fiduciary capacity, he must make full and fair disclosure of his personal interest in a transaction with company.  
In the case of *Erlanger v. New Sombrero Phosp*
  - 3. To give the Benefit of Negotiations to the Company:** The promoter must pass on to the company, the benefit of any negotiation or agreement that he has carried on in his capacity of a promoter.
  - 4. Duty of Promoters Towards Future Allottees:** The promoters stand in a fiduciary position not only to the company but they also stand in this position to the future allottees of shares. The promoters must ensure that the prospectus issued at their instance contains all materials facts and particulars and does not contain any mis-statements.

### MEANING OF PRELIMINARY CONTRACTS

**Preliminary contracts are those contracts which are entered into by the promoters for and on behalf of the proposed company before its incorporation.** These contracts are generally entered into by the promoters to acquire some property or some rights for the proposed company. *For example*, contract with the vendor



to sell his running business to the proposed company, contract for the purchase of property for the proposed company, contract for the grant of a lease for the proposed company.

### LEGAL POSITION OF PRELIMINARY CONTRACTS

The legal position of preliminary contracts can be explained as follows:

1. **The Company is not bound by the Preliminary Contracts:** A company is not bound by the preliminary contracts even if (a) the company has taken the benefit of the work on its behalf under the contract (b) the contract stipulates that the company, after incorporation shall be bound by it.
2. **The Company cannot enforce Preliminary Contracts:** The company cannot enforce preliminary contracts. The company does not get a right to sue the third party for fulfilment of a preliminary contract. Thus, preliminary contracts can not be enforced by or against the company.

**Exception to above Principles:** The provisions of **Sections 15(h) and 19(e) of The Specific Relief Act, 1963** provide an important exception to the general principle 'preliminary contracts can not be enforced by or against the company'. According to Sections 15(h) and 19(e) of the Specific Relief Act, 1963, where the promoters of the company have entered into contracts before its incorporation, specific performance may be obtained by or against the company if—

- (a) Such contracts are for the purposes of the company.

The term "*contracts for the purposes of the company*" means contracts which are necessary for the incorporation and working of the company. *For example*, contracts for the preparation and printing of the memorandum and articles or contracts for the supply of necessary raw material for the production work in the company are contracts for the purposes of the company.

- (b) Such contracts are warranted by terms of incorporation (i.e. the contract must fall within any of the clauses contained in object clause)
- (c) Such contracts are accepted by the company after its incorporation.
- (d) The acceptance of such contracts is communicated by the company to the other party to the contract.

However, the above provisions are not applicable for:

- (a) **Contract to take shares**
- (b) **Contract to render personal services.**

3. **The Company cannot ratify the Preliminary Contracts:** The company cannot ratify the preliminary contracts after incorporation because for valid ratification of a contract, the principal must have been in existence on the date when the contract is originally entered into.
4. **The Company cannot adopt Preliminary Contracts:** The company cannot adopt preliminary contracts after its incorporation *either* by passing a special

resolution *or* by making adoption of such contract as one of the objects of company in its memorandum of association.

- 5. Personal Liability of the Promoter for Preliminary Contracts:** The promoters are personally liable for the preliminary contracts. The reason for this is that the preliminary contract is made for a company which, as known to both the contracting parties, is as yet non-existent. The contract, therefore, is deemed to be personally entered into by the promoters and they will be held personally liable for the performance of these contracts. The promoters will continue to be personally liable until the company after its incorporation adopt preliminary contracts by entering into new contracts with the third parties on the same terms as were embodied in the original contracts.

The preliminary contracts made by the promoters generally contain a provision that if the company adopts the agreements on incorporation, the liability of the promoters shall come to an end and if the company does not adopt the preliminary contract within a specified period *either* party may rescind the contract. In such a case liability of the promoter will cease on the expiry of the specified period.

- 6(a)** Since a contract is created by mutual agreement, it can also be discharged by mutual agreement. A contract can be discharged by mutual agreement in any of the following ways:

#### **NOVATION [SECTION 62]**

Novation means the substitution of a new contract for the original contract. Such a new contract may be either between the same parties or between different parties. The term of contracts may or may not be changed. The consideration for the new contract is the discharge of the original contract.

#### **RESCISSION [SECTION 62]**

Rescission means cancellation of the contract by any party or all the parties to a contract.

#### **ALTERATION [SECTION 62]**

Alteration means a change in the terms of a contract with mutual consent of the parties. Alteration discharges the original contract and creates a new contract. However, parties to the new contract must not change.

#### **REMISSION [SECTION 63]**

Remission means acceptance by the promisee of a lesser fulfillment of the promise made. According to Section 63, "Every promisee-

- may dispense with or remit, wholly or in part, the performance of the promise made to him, or
- may extend the time for such performance, or

- may accept any other consideration than agreed to in the contract instead of it any satisfaction which he thinks fit."
- No consideration is necessary for remission.

### WAIVER

Waiver means intentional relinquishment of a right under the contract. Thus, it amounts to releasing a person of certain legal obligation under a contract.

### 6(b) CASES WHERE UNANIMOUS CONSENT OF PARTNERS REQUIRED

To Change the Nature of the Firm's Business	Consent of All Partners
To Change the Terms of Partnership	Consent of All Partners
To Admit Minor	Consent of All Partners
To Introduce a New Partner	Consent of All Partners
To Retire From a Particular Partnership	Consent of All Partners
To Dissolve Particular Partnership	Consent of All Partners

### CONSEQUENCES OF NOT GIVING A PUBLIC NOTICE

If a public notice is not given in cases in which it is required to be given, the consequences will be as follows:

Case	Consequences
<b>(a) On election to become or not to become a partner by a minor on his attaining majority</b>	Minor is deemed to have become a partner on the expiry of 6 months [Section 30(5)].
<b>(b) On retirement of a partner</b>	Retiring partner and the other partners continues to be liable as partner to the third parties for firm's acts done after retirement [Section 32(3)].
<b>(c) On expulsion of a partner</b>	The expelled partner and the other partners continue to be liable to third parties for firm's acts done after his expulsion [Section 33(2)].
<b>(d) On dissolution of a firm</b>	All the partners continue to be liable to third parties for firm's acts done after the dis-solution of firm [Section 45].

- 6(c) First Alternative:** (i) correct (ii) correct (iii) correct (iv) incorrect (v) correct if subsidiary company acquired the shares of its holding company before becoming its subsidiary.

### **Second Alternative: Privileges of an Independent Private Company**

Privileges available only to an independent private company (i.e. a private company which is *not* a subsidiary of a public company) are as follows:

1. **Definition of Related Party relaxed u/s 2(76):** Private company is not required to comply with provisions of the section 188 for transactions entered into by a private company with its holding company, the subsidiary company, the associate company or a fellow subsidiary company or an Investing Company/ Venturer of the Company.
2. **Free to Issue any kind of shares :** Private limited company is free to issue any kind of shares if its articles of association or the memorandum of association provides so [ Sec 43 & 47].
3. **Power to reduce Time Limits in Right Issue u/s 62:** Sending of offer letter Minimum 3 days period before opening of offer and Minimum & maximum offer period of 15 & 30 days respectively can be reduced, if 90% members give their consent in writing/ electronic mode.
4. **Need not comply with conditions of Sec 73(2)(a) to (e):** Private Companies accepting deposits from members upto 100% of Paid-Up Share Capital & Free-Reserves need not to comply with conditions mentioned in section 73(2)(a) to (e).
5. **Right to frame own rules for General Meetings:** Private company can frame own rules for General Meetings.
6. **Not included in Max Audit Limit:** Maximum No. of Audit Limit of 20 Companies u/s 141(3)(g) does not include one person company, a dormant company, small companies; and private limited companies which are having a paid up share capital of less than ₹ 100 Crore.
7. **Directorship without Notice & Deposit:** An individual for directorships in private companies can stand in for directorship without serving the notice of 14 days and a deposit of ₹1 lakh [ Sec 160].
8. **Appointment of Directors of a Private limited company need not to be voted individually:** No approval as provided u/s 162 is needed for the appointment of directors of a Private limited company.
9. **Need not file MGT-14:** Private Companies are exempted from filing MGT-14 with the ROC on various provisions under section 179(3) and Rule 8 of the amended Companies (Meetings of Board & its powers) Rules, 2014.
10. **No Restrictions on Board Power:** Restrictions on powers of Board u/s 180 do not apply to a Private company.
11. **Participation of an Interested Director:** An Interested Director of a private limited company can participate in the board meeting after disclosing interest [Sec 184(2)]
12. **Power to grant Loans etc. to Director etc. u/s 185:** Loans/Guarantee/Security can be given to Director and person in whom he is interested by a private Company which has:-
  1. No Body Corporate Shareholder

2. Not borrowed money from Bank/ Financial Institution/ Body Corporate exceeding lower of the following:-
  - (i) 200% of its Paid up capital
  - (ii) ₹ 50 crore
3. No repayment default subsisting of such borrowings at time of giving loan
- 13. No Restriction on Related Party's Voting Right [2nd Proviso to 188(1)] :** Member although being related party to the concerned resolution can still cast his vote at GM.
- 14. No Approval for Appointment of MD/WTM u/s 196(4) & (5):** No Approval is required for the appointment or the remuneration of the Managing Director, Whole time Director or the Manager even if the conditions for the appointment are not as per the requirements of Schedule V of the Act.  
**Note:** The moment a private company fails to comply with any of the statutory restrictions to be contained in its articles or it becomes a subsidiary of a public company, it shall lose these special privileges.





# BUSINESS LAW [SECTION A] CA FOUNDATION EXAMINATION PAPER MAY 2018

*Questions No. 1 is compulsory.*

*Answer any **four** questions from the remaining five questions.*

## QUESTION 1

- (a) X, Y and Z are partners in a firm. They jointly promised to pay ₹ 3,00,000 to D. Y become insolvent and his private assets are sufficient to pay 1/5 of his share of debts. X is compelled to pay the whole amount to D. Examining the provisions of the Indian Contract Act, 1872, decide the extent to which X can recover the amount from Z. (4 Marks)
- (b) Ravi Private Limited has borrowed ₹ 5 crores from Mudra Finance Ltd. This debt is ultra vires to the company. Examine, whether the company is liable to pay this debt? State the remedy if any available to Mudra Finance Ltd.? (4 Marks)
- (c) What is meant by delivery of goods under the Sale of Goods Act, 1930? State various modes of delivery. (4 Marks)

## QUESTION 2

- (a) State the exceptions to the rule "An agreement without consideration is void". (5 Marks)
- (b) What are the essential elements to form a LLP in India as per the LLP Act, 2008? (5 Marks)
- (c) (i) Distinguish between wagering agreement and contract of insurance. (2 Marks)

**Or**

- (ii) Examine with reason that the given statement is correct or incorrect "Minor is liable to pay for the necessities supplied to him". (2 Marks)

## QUESTION 3

- (a) Distinguish between dissolution of firm and dissolution of partnership. (2 Marks)
- (b) What are the consequences of Non-Registration of a Partnership Firm? Discuss. (4 Marks)
- (c) M Ltd., contract with Shanti Traders to make and deliver certain machinery to them by 30.6.2017 for ₹ 11.50 lakhs. Due to labour strike, M Ltd. could not manufacture and deliver the machinery to Shanti Traders. Later, Shanti Traders procured the machinery from another manufacturer for ₹ 12.75 lakhs. Due to this Shanti Traders

was also prevented from performing a contract which it had made with Zenith Traders at the time of their contract with M Ltd. and were compelled to pay compensation for breach of contract. Advise Shanti Traders the amount of compensation which it can claim from M Ltd., referring to the legal provisions of the Indian Contract Act, 1872. (6 Marks)

#### **QUESTION 4**

- (a) What is appropriation of goods under the Sale of Goods Act, 1930? State the essentials regarding appropriation of unascertained goods. (6 Marks)
- (b) X, Y and Z are partners in a Partnership Firm. They were carrying their business successfully for the past several years. Spouses of X and Y fought in ladies club on their personal issue and X's wife was hurt badly. X got angry on the incident and he convinced Z to expel Y from their partnership firm. Y was expelled from partnership without any notice from X and Z. Considering the provisions of the Indian Partnership Act, 1932, state whether they can expel a partner from the firm. What are the criteria for test of good faith in such circumstances? (6 Marks)

#### **QUESTION 5**

- (a) Mr. D sold some goods to Mr. E for ₹ 5,00,000 on 15 days credit. Mr. D delivered the goods. On due date Mr. E refused to pay for it. State the position and rights of Mr. D as per the Sale of Goods Act, 1930. (6 Marks)
- (b) Define OPC (One Person Company) and state the rules regarding its membership. Can it be converted into a non-profit company under Section 8 or a private company? (6 Marks)

#### **QUESTION 6**

- (a) Define Fraud. Whether "mere silence will amount to fraud" as per the Indian Contract Act, 1872? (5 Marks)
- (b) What is the conclusive evidence of partnership? State the circumstances when partnership is not considered between two or more parties. (4 Marks)
- (c) State the limitations of the doctrine of indoor management under the Companies Act, 2013. (3 Marks)



**ANSWERS**

1. (a) Refer to Sec 43 of The Indian Contract Act, 1872 in Chapter 8
  1. (b) Ravi Private Ltd. is liable to pay this debt amount upto the limit prescribed in the memorandum. As per the doctrine of ultra vires, a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, a company which deals with the other, is deemed to know about the powers of the company on the basis of doctrine of constructive notice. Hence, Mudra Finance Ltd. can claim for the amount within the expressed limit prescribed in its memorandum.
  1. (c) Refer to Sec 2(2) of the Sale of Goods Act, 1930 in Chapter 11
  2. (a) Refer to Section 25 of the Indian Contract Act, 1872 in Chapter 4
  2. (b) Refer to the LLP Act, 2008 in Chapter 14
  2. (c) Refer to Para 14.0 in Chapter 7
- Alternative:** Refer to Section 68 of the Indian Contract Act, 1872 in Chapter 11.
3. (a) Refer to The Indian Partnership Act, 1932 Para 23.0 in Chapter 13
  3. (b) Refer to Section 69 of The Indian Partnership Act, 1932 in Chapter 13(Para 13.0)
  3. (c) Refer to Section 73 of the Indian Contract Act, 1872 in Chapter 10 (Para 4.0)  
M Ltd. is obliged to compensate for the loss of ₹ 1.25 lakh (i.e. ₹ 12.75 minus ₹ 11.50 = ₹ 1.25 lakh) which had naturally arisen due to default in performing the contract by the specified date.  
  
If M Ltd., knew about the contract of Shanti Traders for supply of the contracted machinery to Zenith Traders on the specified date, M Ltd is also obliged to reimburse the compensation which Shanti Traders had to pay to Zenith Traders for breach of contract. Otherwise M Ltd is not liable.
4. (a) Refer to The Sale of Goods Act, 1930 in Chapter 14
  4. (b) Refer to Section 33 of The Indian Partnership Act, 1932 in Chapter 13(Para 22.0). According to the test of good faith as required under Section 33(1), expulsion of Partner Y is not valid.
  5. (a) Refer to Sec 45(1), 55, 56, 61 of The Sale of Goods Act, 1930 in Chapter 14(Para 36.0) 5(b) Refer to Sec 2(62) of The Companies Act, 2013 in Chapter 15(Para 21.0)
  6. (a) Refer to Section 17 of The Indian Contract Act, 1872 in Chapter 5(Para 6.0)
  6. (b) Refer to Section 6 of The Indian Partnership Act, 1932 in Chapter 13(Para 7.0).
  6. (c) Refer to The Companies Act, 2013 in Chapter 17(Para 15.0)

