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# Legal Aspects of Business

**MGO-1202**

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# CONTENT

# UNIT 1: THE INDIAN CONTRACT ACT 1872

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**Structure:**



## 1.0 OBJECTIVES

After reading this Unit. you will be able to:

- Explain the contract act, 1872 : meaning and essentials of a valid contract;
- Discuss the offer and acceptance;
- Understand the contractual capacity, free consent;
- Describe the void agreements and quasi contracts;
- Analysis the contract of indemnity and guarantee.

## 1.1 INTRODUCTION

The Indian Contract Act occupies the most important place in the Commercial Law. Without contract Act, it would have been difficult to carry on trade or any other business activity and in employment law. It is not only the business community which is concerned with the Contract Act, but it affects everybody.The objective of the Contract Act is to ensure that the rights and obligations arising out of a contract are honored and that legal remedies are made available to those who are affected. According to Indian Contract Act, 1872 Section 1, this Act may be called the Indian Contract Act, 1872.

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## 1.2 CONTRACT ACT, 1872

### 1.2.1 Meaning

The Indian Contract Act, 1872 defines the term "Contract" under its section 2 (h) as "An agreement enforceable by law". In other words, we can say that a contract is anything that is an agreement and enforceable by the law of the land.

This definition has two major elements in it viz – "agreement" and "enforceable by law". So in order to understand a contract in the light of The Indian Contract Act, 1872 we need to define and explain these two pivots in the definition of a contract.

**Agreement :** In section 2 (e), the Act defines the term agreement as "every promise and every set of promises, forming the consideration for each other".

Now that we know how the Act defines the term "agreement", there may be some ambiguity in the definition of the term promise.

**Promise :** The Act in its section 2(b) defines the term "promise" here as: "when the person to whom the proposal is made signifies his assent thereto, the proposal becomes an accepted proposal. A proposal when accepted, becomes a promise".

In other words, an agreement is an accepted promise, accepted by all the parties involved in the agreement or affected by it. This definition says that in order to establish or draft a contract, we need to initiate some steps :

(i) The definition requires a person to whom a certain proposal is made.

(ii) The person (parties) in step one has to be in a position to fully understand all the aspects of a proposal.

(iii) "signifies his assent thereto" – means that the person in point one accepts or agrees with the proposal after having fully understood it.

(iv) Once the "person" accepts the proposal, the status of the "proposal" changes to "accepted proposal".

(v) "accepted proposal" becomes a promise. Note that the proposal is not a promise. For the proposal to become a promise, it has to be an accepted proposal.

To sum up, we can represent the above information below:

Agreement = Offer + Acceptance.

**Enforceable By Law :** Now let us try to understand this aspect of the definition as is present in the Act. Suppose you agree to sell a bike for 30,000 bucks with a friend. Can you have a contract for this?

Well if you follow the steps in the previous section, you will argue that once you and your friend agree on the promise, it becomes an agreement. But in order to be a contract as per the definition of the Act, the agreement has to be legally enforceable.

Thus we can say that for an agreement to change into a Contract as per the Act, it must give rise to or lead to legal obligations. In other words, must be within the scope of the law. Thus we can summarize it as Contract = Accepted Proposal (Agreement) + Enforceable by law (defined within the law).

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### 1.2.2 Essentials of a Valid Contract

A contract that is not a valid contract will have many problems for the parties involved. For this reason, we must be fully aware of the various elements of a valid contract. In other words, here we shall ponder on all the ramifications of the definition of the contract as provided by The Indian Contract Act, 1872.

The Indian Contract Act, 1872 itself defines and lists the Essentials of a Contract either directly or through interpretation through various judgments of the Indian judiciary. Section 10 of the contract enumerates certain points that are essential for valid contracts like Free consent, Competency Of the parties, Lawful consideration, etc.

Other than these there are some we can interpret from the context of the contract which is also essential Let us see.

**1. Two Parties :** So you decide to sell your car to yourself! Let us say to avoid tax or some other sinister purpose. Will that be possible ? Can you have a contract with yourself ? The answer is no, unfortunately. You can't get into a contract with yourself.

A Valid Contract must involve at least two parties identified by the contact. One of these parties will make the proposal and the other is the party that shall eventually accept it. Both the parties must have either what is known as a legal existence e.g. companies, schools, organizations, etc. or must be natural persons.

**For Example :** In the case State of Gujarat vs Ramanlal S & Co. – A business partnership was dissolved and assets were distributed among the partners as per the settlement. However, all transactions that fall under a contract are liable for taxation by the office of the State Sales Tax Officer. However, the court held that this transaction was not a sale because the parties involved were business partners and thus joint owners. For a sale, we need a buyer (party one) and a seller (party two) which must be different people.

**2. Intent of Legal Obligations :** The parties that are subject to a contract must have clear intentions of creating a legal relationship between them. What this means is those agreements that are not enforceable by the law e.g. social or domestic agreements between relatives or neighbors are not enforceable in a court of law and thus any such agreement can't become a valid contract.

**3. Case Specific Contracts :** Some contracts have special conditions that if not observed would render them invalid or void. For example, the Contract of Insurance is not a valid contract unless it is in the written form.

Similarly, in the case of contracts like contracts for immovable properties, registration of contract is necessary under the law for these to be valid.

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**4. Certainty of Meaning :** Consider this statement "I agree to pay Mr. X a desirable amount for his house at so and so location". Is this a valid contract even if all the parties agree to this term? Of course, it can't be as "desirable amount" is not well defined and has no certainty of meaning. Thus we say that a valid contract must have certainty of Meaning.

**5. Possibility of Performance of an Agreement :** Suppose two people decide to get into an agreement where a person A agrees to bring back the person B's dead relative back to life. Even when all the parties agree and all other conditions of a contract are satisfied; this is not valid because bringing someone back from the dead is an impossible task. Thus the agreement is not possible to be enforced and the contract is not valid.

**6. Free Consent :** Consent is crucial for an agreement and thus for a valid contract. If two people reach a similar agreement in the same sense, they are said to consent to the promise. However, for a valid contract, we must have free consent which means that the two parties must have reached consent without either of them being influenced, coerced, misrepresented or tricked into it. In other words, we say that if the consent of either of the parties is vitiated knowingly or by mistake, the contract between the parties is no longer valid.

**7. Competency of the Parties :**

Section 11 of the Indian Contract Act, 1872 is :

"Who are competent to contract — Every person is competent to contract who is (1) of the age of majority according to the law to which he is subject, and who is (2) of sound mind and is (3) not disqualified from contracting by any law to which he is subject."

Let us see these qualifications in detail :

(i) refers to the fact that the person must be at least 18 years old or more.

(ii) means that the party or the person should be able to fully understand the terms or promises of the contract at the time of the formulation of the contract.

(iii) states that the party should not be disqualified by any other legal ramifications. For example, if the person is a convict, a foreign sovereign, or an alien enemy, etc., they may not enter into a contract.

**8. Consideration :** Quid Pro Quo means 'something in return' which means that the parties must accrue in the form of some profit, rights, interest, etc. or seem to have some form of valuable "consideration".

For example, if you decide to sell your watch for Rs. 500 to your friend, then your promise to give the rights to the watch to your friend is a consideration for your friend. Also, your friend's promise to pay Rs. 500 is a consideration for you.

**9. Lawful Consideration :** In Section 23 of the Act, the unlawful considerations are defined as all those which :

(i) it is forbidden by law.

(ii) is of such a nature that, if permitted, it would defeat the provisions of any law, or is fraudulent.

(iii) involves or implies, injury to the person or property of another

(iv) the Court regards it as immoral or opposed to public policy

These conditions will render the agreement illegal.

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### 1.2.3 Kinds of Contract

**Types of Contract : Based on Performance**

There are various types of contract, one such type are contacts based on their performance. The basis for this type is whether the contract is performed or still to be performed. Accordingly, the two types are known as executed contracts and executory contracts.

**Executed Contracts :** A contract between two or more parties is said to be executed when the act or forbearance promised in the contract has been performed by one, both or all parties. Basically, it means that whatever the contract stipulated, has been carried out. Thus the contract has been executed.

Let us see an example of an executed contract. Alex goes to the local coffee shop and buys a cup of coffee. The barista sells her the coffee in exchange for the cash payment. So it can be said that this is an executed contract. Both parties have done their part of what the contract stipulates.

In most executed contracts the promises are made and then immediately completed. The buying of goods and/or services usually falls under this category. There is no confusion about the date of execution of the contract since in most cases it is instantaneous.

**Executory Contracts :** In an executory contract, the consideration is either the promise of performance or an obligation. In such contracts, the consideration can only be performed sometime in the future, hence the name executory contract. Here the promises of consideration simply cannot be performed immediately.

The best example of an executory contract is that of a lease. All the conditions of a lease cannot be fulfilled immediately. They are performed over time. Similarly, say Alex decides to tutor some students in Physics. They pay her Rs 2500/- at the start of the month. But here the contract isn't executed since Alex has to still carry out her promise. So such a contract is an executory contract.

Now even in executory contracts, there are two types, namely unilateral and bilateral contracts.

**Unilateral Contracts :** As the name suggests these are one-sided contracts. It usually comes into existence when only one party makes a promise, which is open and available to anyone who wishes to or can fulfil the said promise. The contract will only be fulfilled once someone fulfils the promise.

Let us see an example. Alex lost his bag pack on the metro. So he decided to announce a reward of Rs. 1000/- to anyone who finds and returns his bag

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with all its contents. Here the is only one party to the contract, namely Alex. If someone finds and returns his bag he is obligated to pay the reward. This is a unilateral contract.

**Bilateral Contracts :** By contrast, a bilateral contract is one that has two parties. It is a traditional type of contract most commonly known and occurring. Here both parties agree to the terms of the agreement and thus enter into a contract. Hence it is also known as a reciprocal contract

In bilateral contracts, both parties have usually agreed to a time frame to carry out the said contract. Say for example the contract of sale of a house. The buyer pays a down payment and agrees to pay the balance at a future date. The seller gives possession of the house to the buyer and agrees to deliver the title against the specified sale price. This is a bilateral contract.

**Types of contracts based on validity or enforceability.**

**Valid Contract :** The Valid Contract is an agreement which is legally binding and enforceable. An invalid contract may lead to obstruction of businesses and unlawful insincere dealings. The Indian Contract Act, 1872, lists the essentials of a Contract either directly or by interpretation through various judgments. A contract must qualify all the essentials of a contract. Section 10 of the contract reckons particular points which are essential for valid contracts like

- Free consent,
- Competency of the parties,
- Lawful consideration, etc.

Section 2(j) of the Act defines a void contract as "a contract which ceases to be enforceable by law becomes void when it ceases to be enforceable". It voids all the contracts which are not enforceable by the court of law due to riding /enforceable conditions not mentioned in the contract.

**Voidable Contract :** The voidable contract, in Section 2(i) of the Act, is defined as "an agreement which is enforceable by law at the option of one or more of the parties to it, but not at the option of the others, is a voidable contract". A voidable contract is a Valid Contract till the time an affected party chooses to rescind the same on legitimate grounds. In any voidable contract, minimum one party has to be bound to the terms of the contract.

**Illegal Contract :** An agreement which leads to one or more parties to break the law or public policy or societal morality is deemed to be illegal by the court. Illegal contracts are considered as void and not enforceable by law. Section 2(g) of the Act defines them as an agreement not enforceable by law is said to be void. Illegal contracts are void ab initio (from the start or the beginning), and they are punishable under the law because of the criminal aspects of the illegal contracts.

**Unenforceable Contracts :** Unenforceable contracts are extracted unenforceable by law due to some technical aspects and cannot be enforced against any of the parties.

Before entering any agreement it is essential that the parties understand the basic tenets of the contract law so as not cause a future dispute among themselves or incur losses due to the unenforceability of the other party's duties under the agreement. It is also necessary that the object of the agreement, the rights and duties of each party is demarcated and clear from the very inception of the agreement and that same follows the diktat of the law of land so as not to attract any penalties or tribulations from the courts or any other authorities as ignorance of the law is no excuse, more so for people trying to legally bind them through the vicissitudes of the law.

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### 1.2.4 Offer and Acceptance

**Offer :** An offer is the first step in the formation of a contract, it marks the beginning of contractual obligation between the parties. As is a known fact that Acceptance can only be made to a prior offer, an offer is essential for the formation of a contract.

An offer is defined under Section 2(a) of **The Indian Contract Act (here in after, ICA)** as :

When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal.

The words Proposal and Offer can be used interchangeably for Brevity. The person who makes the promise is called the "Promisor", and the person to whom the offer is made is called the "Promisee". From the definition itself, it can be construed that an offer can be both positive as well as negative, i.e. the doing of an act as well as the "not doing" of an act.

**Types of Offer :** An offer can be of many types, ranging across the spectrum. There are basically 7 kinds of offers :

- Express offer
- Implied offer
- General offer
- Specific Offer
- Cross Offer
- Counter Offer
- Standing Offer

**Express offer and Implied offer :** Section 9 of The ICA defines both of them as : In so far as the proposal or acceptance of any promise is made in words, the promise is said to be express. In so far as such a proposal or acceptance is made otherwise than in words, the promise is said to be implied.

Therefore, any offer that is made with words, it may be regarded as express. Any promise that is made otherwise than in words is implied. A bid at an auction is an example of an Implied offer. A case in this regard is Upton-on-Servern RDC v. Powell, wherein the defendant called a fire brigade assuming that those services would be free to him, however it was found that his Farm did

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not come under that of Upton. The court held that the truth of the matter is that the Defendant wanted the services of Upton, he asked for the services of Upton and in response to that they offered their services and they were rendered on an implied promise to pay for them.

In **Ramji Dayawala& Sons (p) Ltd v. Invest Import,** a case between an Indian and Yugoslavian party the notice for revocation of an arbitration clause in the contract between the parties was made by the Indian party, to which the other party gave no reply. It was held that this would amount to an implied acceptance i.e.- the arbitration clause was deleted from the contract, and a suit would lie in the court of law. Similarly entering into an omnibus also amounts to implied acceptance, same as consuming edibles at a self-service restaurant. Therefore in simpler terms a contract that is entered into because of actions on the offerors part, may be referred to as an implied offer, any contract entered into otherwise is an express offer.

**General Offer :** A General Offer is an offer that is made to the world at large. The genesis of a General Offer came about from the Landmark case of **Carlill v. Carbolic Smoke Ball Co.** A company by the name Carbolic Smoke Ball offered through an Advertisement to pay 100 Pounds to anyone who would contract increasing epidemic Influenza, colds or any disease caused by cold after taking its Medicine according to the prescribed instructions. It was also added that 1000 Pounds have been deposited in Alliance bank showing our sincerity in the matter. One customer Mrs Carlill used the medicine and still contracted Influenza and hence sued the company for the reward. The Defendants gave the argument that the offer was not made with an intention to enter into a legally binding agreement, rather was only to Puff the sales of the company. Moreover, they also contended that an offer needs to be made to a specific person, and here the offer was not to any specific person and hence they are not obliged to the Plaintiff.

Setting aside the arguments of the Defendant, the bench stated that in cases of such offers i.e- general offers, there is no need for communication of acceptance, anyone who performs the conditions of the contract is said to have communicated his/her acceptance, and moreover, the money deposited by the Defendant in Alliance Bank clearly shows that they intended to create a legally binding relationship. Hence the Plaintiff was awarded with the amount. An Indian authority in this regard is **Laiman Shukla v. Gauri Dutt,** wherein a servant was sent by his master to trace his missing nephew. In the meanwhile, he also announced a reward for anyone finding his nephew, this in itself is an example of an offer that is made to the world at large and hence a General Offer.

**Valid acceptance based on fulfillment of condition**

This concept has been given statutory authority under section 8 of the ICA :

Performance of the conditions of a proposal, or the acceptance of any consideration for a reciprocal promise which may be offered with a proposal, is an acceptance of the proposal.

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This section was applied by YEARS CJ of Allahabad high court in the case of **Har Bhajan Lal v. Har Charan Lal,** wherein the father of a young boy who ran from home issued a pamphlet for a reward for anyone who would find him. The Plaintiff found him at the railway station and sent a Telegram to his father. The Court held that the handbill was an offer that was made to the world at large and anyone who fulfilled the conditions is deemed to have accepted it. In **State of Bihar v. Bengal Chemical and Pharmaceutical Works LTD,** the Patna HC held that where the acceptance consists of an act, e.g- dispatching some goods, the rule that there shall be no communication of acceptance will come into play.

**General offer of continuing nature :** When a general offer is of continuing nature, like it was in a carbolic smoke ball case, it can be accepted by a number of people till it is retracted. However, when a similar offer requires information regarding a missing thing, it is closed as soon as the first information comes in.

**Specific Offer :** A Specific offer is an offer that is made to a specific or ascertained person, this type of offer can only be accepted by the person to whom it is made. This concept was seen briefly in the case of **Boulton v. Jones,** wherein the Plaintiff had taken the business of one Brocklehurst, the defendant used to have business with Brocklehurst and not knowing about the change in ownership of business, sent him an order for certain goods. The Defendant came to know about the change only after receiving an invoice, at which point he had already consumed the goods. The Defendant refused to pay the price, as he had a set off against the original owner, for which the plaintiff sued him.

The Judges gave a unanimous judgement holding the defendant not liable. Pollock CB held that the rule of law is clear, if you intend to contract with A, B cannot substitute himself as A without your consent and to your disadvantage. It was also held that whenever a person makes a contract with a specific personality, a specific party, so to say, for writing a book, for painting a picture or for any personal service or if there is any set off due from any party, no one has the authority to come in and maintain that he is the party contracted with.

**Cross Offer :** When two parties make an identical offer to each other, in ignorance to each other's offer, they are said to make cross offers. **Cross offers are not valid offers.** For example- if A makes an offer to sell his car for 7 lakhs to B and B in ignorance of that makes an offer to buy the same car for 7 Lakhs, they are said to make a cross offer, and there is no acceptance in this case, hence it cannot be a mutual acceptance.

**Basic essentials of a cross offer**

1. Same offer to one another- When the offeror makes an offer to the offeree and the offeree without prior knowledge makes the same offer to the offeror, then both the object and the party remain the same.
2. Offer must be made in ignorance of each other- The two parties must make their offer in ignorance of each other.

An important case in this aspect is the English case of **Tinn v. Hoffman**, the defendant wrote to the complainant an offer to sell him 800 tons of iron at 69s per

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ton, at the same time the complainant also wrote to the defendant an offer to buy the iron at similar terms. The issue in this case was that, was there any contract between the parties, and would simultaneous offers be a valid acceptance. The court held that these were cross offers that were made simultaneously without knowledge of one another and would not bind the parties.

Here it is imperative to deduce that for a valid contract to be formed there needs to be an offer and acceptance of the same, whereas in a cross offer there is no acceptance, but only simultaneous offers being and therefore a cross offer will not lead to the formation of a contract.

**Counter offer :** When the offeree offers a qualified acceptance of the offer subject to modifications and variations in terms of the original offer, he is said to have made a counter offer. A counter offer is a rejection of the original offer. An example of this would be if A offers B a car for 10 Lakhs, B agrees to buy for 8 Lakhs, this amounts to a counter offer and it would mean a rejection of the original offer. Later on, if B agrees to buy for 10 Lakhs, A may refuse. Sir Jenkins CJ in **Haji Mohd Haji Jiva v. Spinner,** held that any departure from original offer vitiates acceptance. In other words, an acceptance with a variation is not acceptance, it is simply a counter proposal which must be accepted by the original offeror, for it to formulate into a contract.

The Bombay High court gave this decision based upon the landmark judgement of **Hyde v. Wrench,** in which an offer to sell a farm for 1000 Pounds was rejected by the Plaintiff, who offered 950 for it. Subsequently the Plaintiff gave an acceptance to the original offer. Holding that the Defendant was not bound by a contract, the court said that the Plaintiff accepted the original offer of buying the farm at the price of 1000 pounds, it would have been a completely valid contract, however he gave a counter proposal to it, thus rejecting the original offer.

**Partial Acceptance :** Counter offer also includes within its contours Partial acceptance, meaning that a party to the contract cannot agree to those conditions of the agreement that favour him and reject the rest, the acceptance should be of the complete agreement i.e., all its parts. In **Ramanbhai M. Nilkanth v. GhashiramLadliprasad,** the plaintiff made an application for certain shares in a company with the underlying condition that he would be made the cashier in its new branch. The Company did not comply with this and hence the suit. The court held that the Petitioners application for shares was condition on him being made the cashier and that he would have never applied for the shares had there been no such condition.

**Acceptance of a counter proposal :** In **Hargopal v. People's Bank of Northern India LTD,** an application for shares was made on a conditional undertaking by the bank that the applicant would be made the director of the new branch. The shares were allotted to him without fulfilling the condition. The applicant did not say anything and took his dividends, a subsequent suit by him failed as the court held that he through his conduct had waived the

condition. **When a counter proposal is accepted the contract arises in terms of the counter proposal and not in terms of the original contract.**

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**Standing offer :** An Offer which remains open for acceptance over a period of time is called a standing offer. Tenders that are invited for supply of goods is a kind of Standing Offer. In **Percival Ltd. V. London County Council Asylums and Mental deficiency Committee,** the Plaintiff advertised for tenders for supply of goods. The defendant took the tender in which he had to supply to the company various special articles for a period of 12 months. In-between this the Defendant didn't supply for a particular consignment. The Court held that the Tender was a standing offer that was to be converted into a series of contracts by the subsequent acts of the company and that an order prevented pro tanto the possibility of revocation, hence the company succeeded in an action for breach of contract.

**Difference between an offer and Invitation to offer :** Although Invitation to Offer is not a type of offer per se, it is imperative to distinguish both to even construe what an actual offer is. An invitation to offer is an offer to negotiate, an offer to receive offers, offers to chauffeur. An offer is a final expression of willingness to get into a contract upon those following terms. The concept of Invitation to offer was explained in the Privy Council case of **Harvey v. Facey,** the Plaintiffs in this asked two questions from the defendant i.e.- Would you sell me your Bumper Hall pen , telegram me the lowest price? , the Defendant only gave the answer to the latter question , post which he refused to sell. The Court held that the defendant was not to sell as he had only answered the second question and reserved the same for his first question. Thus, this clearly shows the distinction between an offer and invitation to offer.

In **Adikanda Biswal v. Bhubaneswar Development Authority,** when a development authority made an announcement for allotment of plots on first come first serve basis on payment of full consideration. An application against this with full consideration was only considered to be an offer, as the Development authority only gave an invitation to offer, and the offer can only be formalized into a contract when it is accepted by the development authority.

**Rules regarding display of goods in shops :** In ***Pharmaceutical Society of Great Britain v. Boots Cash Chemists Southern Ltd.,*** lord GODDARD CJ, said that it would be wrong to say that a shopkeeper intends to sell everything that is displayed in his shop. Meaning that the customer makes an offer, to which the shopkeeper has the discretion to accept or deny. The shopkeeper may say that he doesn't have enough stock of that good and therefore may not sell. Similarly, a bankers catalogue of charges is also not an offer, the auction held by a person is also only an invitation to offer and he may not be liable for the transportation costs that people may have to pay to come to the place of auction, in case he cancels at the end moment.

**Acceptance**

Section 2(h) of the Indian Contract Act, 1872, defines the term contract. According to the Section, a contract is an agreement enforceable by law.

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Therefore, according to the Section, there are two essentials for the formation of a contract.

- Firstly, there should be an agreement to do or abstain from doing an act; and
- Secondly, the agreement should be enforceable by law.

Therefore, the law of contracts is that branch of law which decides the circumstances in which the promise made by a person shall be legally binding on the person who makes the promise. While all the contracts are agreements but not all agreements are contracts. An agreement, in order to turn into a contract, should have its legal enforceability. The agreements which are not legally enforceable are not contracts but are mere void agreements which are not enforceable by law or are voidable at the option of one party.

**Section 2(b)** of the Indian Contract Act talks about the acceptance of an offer. According to the Section, the person to whom an offer is made to do or abstain from doing an act with a view to obtain the assent of such a person, if gives his assent thereto, is said to have accepted the offer. This article talks about acceptance, which is one of the essentials of a valid contract according to the Indian Contract Act, 1872.

**Essentials of a valid contract : Section 10** of the Indian Contract Act enlists the conditions which are essential for a valid contract. The essential conditions for a valid contract are as follows :

- **Offer : Section 2(a)** of the Indian Contract Act defines the meaning of the term offer or proposal. According to the Section an offer or proposal is said to be made by a person who signifies to the other person his willingness to do or abstain from doing an act with a view to obtain the assent of the other person;
- **Acceptance :** Section 2(b) of the Indian Contract Act talks about "acceptance". According to the Section, when the person to whom an offer is made gives his assent thereto is said to have accepted the offer;
- **Consent : Section 13** of the Indian Contract Act defines the term consensus, as the agreement of the parties to the contract upon the same thing in the same sense. For the formation of a valid contract, it is essential that they should have "consensus ad idem" i.e. they should agree to the same thing in the same sense;
- **Capacity to contract : Section 11** lays down the criteria for competency to contract. To enter into a valid contract, the parties entering into a contract should have the capacity to enter into a contract;
- **Lawful consideration :** Consideration essentially means 'quid pro quo' which means something done in the return of the other. It is the compensation for the act or omission committed by a person for the fulfilment of the terms of the contract;
- **The agreement should not be expressly declared void :** The agreement which is entered into by the parties should not be expressly declared as void or illegal by any law in force.

**Mode of acceptance :** The term "Acceptance" has been defined under Section 2(b) of the Indian Contract Act,1872. According to the Section, an offer or proposal is said to have accepted when the person to whom the proposal or offer to do or not to do an act is made if gives his assent to such an act or omission. Therefore, acceptance of the contract is said to have taken place when the person to whom the offer is made gives his assent or consent to the terms of the contract. Under the Indian Contract Act, acceptance can be by following two ways :

- Implied acceptance: Acceptance which is not explicitly made by means of speech or writing but, by the conduct of the person to whom an offer is made. The striking of hammer thrice by the auctioneer in order to show his acceptance to the offer made by a bidder is an example of implied acceptance to the offer made by the bidder at an auction to the auctioneer;
- Express acceptance: Acceptance which is made by means of words, oral or written is known as an express acceptance. For example, A offers B his watch for sale through a mail and A replies in positive to the offer by email.

**Acceptance : absolute and unqualified**

Acceptance to be legally enforceable must be absolute and unqualified. **Section 7(1)** of the Indian Contract Act provides that in order to turn an offer into an agreement the acceptance to the offer must be absolute and unqualified. The logic behind the principle that the acceptance to the offer must be absolute and unqualified is that when acceptance is not absolute and is qualified it results into a counter offer which leads to the rejection of the original offer made by the offeror to the offeree. If the offeree makes any variations in the original terms of the contract proposed to him and then accepts the contract, such an acceptance would result in the invalidity of the contract.

For example, if A offers to sell his bike to B for Rupees 10,000. But B persuades A to sell him the bike for 7,000 rupees to which A denies and if B at any later point of time agrees to buy the bike for 10,000 rupees. Then A is under no obligations to sell him the bike as the counteroffer made by B puts an end to the original offer.

It is also important that the acceptance made by the offeree should be in toto, i.e. acceptance should be given to all the terms and conditions of the offer as acceptance of only a part of the offer is not a good acceptance under the law. For example, A makes an offer to B of sale of 30 kg of wheat at Rupees 700 but B agrees to buy only 10 kg of wheat. Here the acceptance made by B is not in toto with respect to the terms of the contract and therefore, the acceptance made by B is no acceptance in the eyes of law and therefore, A is under no obligation to sell him wheat since there is no contract between them.

**Counter proposals :** Section 2(a) of the Indian Contract Act defines the meaning of a proposal. According to the Section, a proposal is signifying of the

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willingness by a person to another person to do or abstain from doing an act with the view of obtaining the assent of another person to such an act or omission. The person who signifies his willingness to obtain the assent of the other person is said to be an "offeror" and the person to whom the offer is made is called "offeree".

Counteroffer or proposal arises when the person to whom an offer is made instead of accepting it straightway imposes any condition which results in modification or alteration of the original terms of the contract. The person who makes such alterations or modifications is said to have made a counteroffer. Counteroffer results in a rejection of the original offer and as a result, the person who makes the original offer shall no longer remain bound by the terms of the contract.

**Partial acceptance :** It is a settled principle of law of contract that the offer which is put before the offeree should be accepted by him in entirety and he can not accept the offer partially by agreeing only to the terms of the contract which are favourable to him while rejecting the rest of the conditions under the offer as an incomplete acceptance of the offer would result into counter-proposal and therefore, it will not bind the offeror as there is no binding contract between him and the offeree.

In **Ramanbhai M. Nilkanth vs Ghashiramladliprasad,** an application was made in a company for certain shares was made on the condition that the applicant would be appointed as a cashier in the new branch of the company. The company without fulfilling the condition made an allocation of the shares to the applicant and demanded the share money from him. The court, in this case, held that the petitioner's application for 100 shares was conditional and there was no intention on the part of the company to accept the terms of the contract in entirety where he applied for shares until he was appointed as a cashier by the company and therefore, there was only a partial acceptance of the offer.

**Inquiry into terms of proposals :** The "Mirror image" rule is the traditional contract law rule under common law. According to the Rule, the acceptance must be a mirror image of the offer. Attempts made by the offeree to change or alter the original terms of the offer are treated as counteroffers as they impliedly indicate the offeree not to be bound by the contract which is put before him. However, in recent times the attitude of the judiciary towards the application of the Rule has turned out to be more liberal by holding that only those variations which directly hit the material terms of the contract are to be regarded as counteroffer which is a result of the purported acceptance.

Even under the Mirror image rule, no rejection of the offer is considered to have taken place if the offeree merely inquires the terms of the contract without showing any intention of rejecting the offer. Practically, differentiating between a counteroffer and making an enquiry as to the terms of the contract. However, the fundamental issue which has to be considered while making the differentiation is whether the offeree objectively indicates his intention of not to abide by the terms of the contract.

**Acceptance with subsequent condition :** In the law of contract, the term "condition" is used in a loose sense and it is used synonymously as "terms", "condition" or "clause". In its proper sense, the term condition means some operative term subsequent to acceptance and prior to acceptance, it is a fact on which the rights and duties of the parties to the contract depend on. The fact can be any act or omission by any of the contracting parties, an act of the third party or happening or not happening of any natural event. Conditions are of three types, which are as follows :

- **Express condition :** In an express condition, certain facts can operate as condition as it has been expressly agreed upon by the parties to the contract;
- **Implied condition :** When certain facts which operate as a condition are not expressly mentioned by the parties but can be inferred by the conduct of the parties to contract is known as an implied condition;
- **Constructive condition :** When the court believes that the parties to a contract must have intended to operate certain conditions because the court believes that the Justice requires the presence of the condition. These conditions are known as constructive conditions.

A contract comes into force by the acts or conduct of one party to the other party. The acts or conduct of the party can be turned into a promise only by meeting of mind or an agreement between both the parties. An acceptance that carries a subsequent condition may not have the effect of counter-proposal. Thus, where a person 'A' accepted the terms of the contract for the sale of a good by accompanying the acceptance with the warning that if money was not delivered to him by a particular date then, the contract will remain repudiated. The acceptance of the offer would not be deemed to be a counter-proposal.

**Acceptance of counter proposals :** In certain cases, the person whose proposal or offer has not been accepted absolutely or unqualifiedly by the offeree as the offeree attaches a counter-proposal to the original proposal; the offeror becomes bound by the counter-proposal. If, by the conduct of the offeror, he indicates that he has accepted the terms of the counter-proposal laid down by the offeree.

In the case of **Hargopal v. People's Bank of Northern India Ltd.**, an application for shares was made with a conditional undertaking by the bank that the applicant would be appointed as a permanent director of the local branch. The shares were allotted to the applicant by the Bank without fulfilment of the condition and the applicant was given his shares and the applicant accepted the same without any protest regarding the non-fulfilment of the terms of the contract. When there arose a dispute between the parties in a court of law. The applicant contended that the allotment was void on the ground of non-fulfilment of the conditions which were stipulated in the original contract. The court rejected the contention from the applicant's side by holding that the same can not be pleaded by him as he has waived the condition by his conduct.

In **Bismi Abdullah and sons v. FCI**, the court held that where tenders were invited subject to the deposit of money. It was open to the tenderers to waive the requirement and acceptance given to a tender without making the deposit is binding upon the tenderer.

In **D.S. Constructions Ltd. v. Rites Ltd**, the court held the where the tenderer made variations to the terms of his tender within the permissible period, but the variations were only partly accepted by the other side without the tenderer's consent lead to repudiation of the contract and so there was no contract at all. Therefore, the earnest money deposited by the party can not be forfeited.

**Provisional Acceptance :** Provisional acceptance is the type of acceptance by the offeree which is made subject to the final approval. A provisional acceptance does not ordinarily bind either party to the contract until the final approval is given to the provisional acceptance made by the offeree. Until the approval is given, the offeror is at liberty to cancel the offer made to the offeree.

In **Union of India v. S. Narain Singh**, the High Court of Punjab held that where the condition attached to the auction sale of the liquor was that the acceptance of the bid shall be subject to confirmation by the Chief Commissioner. The contract will not be complete till the highest bid is confirmed by the Chief Commissioner and till the confirmation is made the person whose bid is provisionally accepted is at liberty to withdraw the bid.

Similarly, in **Mackenzie Lyall And Co. vs Chamroo Singh And Co.**, the bid at an auction was of provisional acceptance in nature ad the terms of the contract stated that the bid shall be referred to the owner of the goods for his approval and sanction.the court in this case,also, allowed the person to revoke his bid whose bid was provisionally accepted.

In **Somasundaram Pillai vs The Provincial Government of Madras**, the court held that the bidder would be at liberty to withdraw his will prior to the final approval of the provisional acceptance where the terms of the contract expressly mention that a bid which has been provisionally accepted can not be canceled subsequently.

When a provisional acceptance is subsequently ratified or accepted then it is the duty of the offeree to inform the same to the offeror, as it is then when the offeror becomes bound by the terms of the contract. Acceptance is not complete until it is communicated by the offeror.

**Acceptance and withdrawal of tenders :** A Tender is a legal offer or proposal to do or abstain from doing an act and it binds the party to performance to the party to whom the offer is made. A tender can be made with respect to money or specific articles. If the tender is not an offer than it falls in the same category as a quotation of price. When the tender is accepted it becomes a standing offer. A contract can arise only when an offer is made on the basis of the tender.

In **Bengal Coal Co. v. Homee Wadia & Co.**, the defendant signed an agreement. One of the terms of the contract was that the undersigned from the

day of signing the contract has to abide by the condition stipulated by the contract which provides that they shall be required to provide a certain quality of coal to the other party for a period of 12 months. The defendant abided by the terms of the contract for some time but before the expiry of the term of the contract, the defendants refused to comply with the conditions which were stipulated under the contract. The plaintiff subsequently sued the defendant for breach of contract. The court held that there was no contract between the parties and the terms stipulated thereof were just the part of a standing offer and the successive orders given by the plaintiff was an acceptance of the offers of the quantity offered by the defendant and therefore the order given by the plaintiff and the offer of the defendant together constituted a series of contract. The defendants, in this case, are not free to revoke the offers which were actually given by them. But barring those offers aside, the defendants had the complete power of revocation.

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In **Rajasthan State Electricity Board vs Dayal Wood Work**, the purchase orders were issued in terms of an arrangement of supply. But the purchase offer itself contained the provision that the tenderer can refuse to supply the goods. The court, in this case, held that there was no concluded contract that came into force and therefore, the contractor was at liberty to refund his security deposit.

In a case where the tenderer has on some consideration promised not to withdraw the tender or where there is a statutory provision restraining the withdrawal of the tender, the tender becomes irrevocable. Just as the tenderer has the right to revoke his tender in the same way the acceptor of the tender also has the right to refuse to place any order.

In **Madho Ram vs The Secretary of State For India**, the military authorities accepted a tender for the supply of certain goods but during the period of tender, no requisition was ever issued. In an action against the military authorities, the court held that the military authority was not bound whatsoever by the acceptance of their offer to purchase any or all the goods specified under the contract without any covenant to that issue. And so the party giving his assent to the offer may at any time declare to the tenderer that they no longer want to place an order for the purchase of goods.

**Letter of intent to accept :** A letter of intent to accept an offer is sometimes issued prior to the final acceptance of the offer. Letter of intent does not have any binding effect on any of the parties to the contract. In **Dibakar Swain v. Cashew Development corp.** The letter of acceptance issued by the company only indicated their intention to enter into the tender. The acceptance was not clearly reduced into writing. The court held that there was no binding contract entered into by the parties and no work order can be issued and so the amount which was deposited by the tenderer can not be forfeited.

**Liability for failure to consider tender :** If a valid tender is opened then it must be duly considered by the inviting authority because if the valid tender is not duly considered it would be unfairness on the part of the tenderer. In **Vijai Kumar Ajay Kumar v. Steel Authority of India Limited**, the court of appeal

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observed that in certain circumstances, the invitation to tender can give rise to the binding contractual obligation on the part of the person who invited the tenders who conformed the conditions of the tender.

In **A. K. Construction v. State of Jharkhand,** the contract was awarded to a person who was not a qualified tenderer and he was chosen at the cost of a qualified tenderer who brought an action against the decision of granting the tender to the unqualified tenderer. The court, in this case, allowed the awardee of the tenderer to complete his work and also allowed the aggrieved party compensation of one lakh rupees to be recovered from the salary of the guilty officers who were guilty of awarding the tender unreasonably.

**Non-compliance with requirements :** In **Vijay Fire Protection Systems v. Visakhapatnam Port Trust And Anr.,** the authorities inviting the tender made it clear to the tenderers that only one brand of pump sets would be accepted. The authorities even gave the last minute opportunity to the tenderers to change the quotations. The tenderer to whom the tender for the supply of goods was given refuted to comply with the terms of the contract. Subsequently, the authorities who invited the tender cancelled the contract between them and the tenderer thereof. The court held that the decision made by the authorities was not arbitrary and they were having the right to do so.

In **Kesulal Mehta vs Rajasthan Tribal Areas,** one of the conditions in the tender was that the tenderer should have at least one year of work experience in the work in question. The court, in this case, held that such conditions could be relaxed and any otherwise competent contractor could be given the tender and he could be at a later point of time be required to produce the certificate of work.

In **KM PareethLabha.v. Kerala Livestock Development Board,** it was held that where a tender invited the quotations for disposal of trees. The tender should mention the approximate value of the trees which could be assessed by the tenderers who can quote their price.

**Tender with concessional rate :** In **Kanhaiya Lal Agrawal vs Union of India & Ors.,** in this case, tender offered firm rates, as well as concessional rate, provided the tender gets finalized within a shorter period of time than generally followed. The court held that it did not result in the formation of a conditional offer which hinges on the happening or non-happening of any event and the condition which was put forth was only meant for bringing about more expeditious acceptance.

**Certainty of terms :** An agreement regarding the sale of immovable property should identify the property with certainty. The agreement should be based on mutuality and should fix the price. In **New Golden Bus Service vs State of Punjab and Ors.,** the tender was made inviting the tender for hiring services for the vehicle but it did not stipulate any time period. The lowest tenderer was awarded the tenderer for a period of three years. The court, in this case, held that there was nothing wrong in it as an open-ended tender can not

be regarded as void because of the reason for its vagueness. The tender, in this case, specified that the tender can not be issued for a vehicle that is more than six months old and the tenderer who was awarded the tender complies with the specified conditions specified under the tender. The acceptance of substitute vehicles which were of equal efficiency and cost by the authority inviting the tender was not arbitrary.

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**Preventing from tendering and blacklisting :** In **Utpal Mitra vs The Chief Executive Officer**, a bidder was prevented by some elements inside the office from submitting the tender. The authorities carried on the enquiry confirming the allegations. The person who was so ruled out from the tender was later on permitted to submit his tender after two intervening holidays and his tender was later on accepted. The court held that no prejudice was caused to the other tenderers as the work issued to them was not interfered with.

In **Merittrac Services Private v. Post Graduate Institute,** it was held that the provision of blacklisting a contractor arises only when the contract is awarded and the tenderer fails to perform any conditions stipulated in the contract. For the purpose of seeking permission for making his proposal, some material facts may be required from the bidder about his experience.

The party allocating the contracts has the indispensable power of blacklisting the contractor. But when in cases where the party is the state, the decision to blacklist is open to judicial review to ensure proportionality and principle of natural justice.

### 1.2.5 Contractual Capacity

An agreement enforceable by law is a Contract. 'Capacity' is one of those often used terms while discussing about Law of Contract. In today's globalized era, it is of utmost importance for a party to have the capacity to contract in order to enter into commercial transactions. This article will be dealing with how one person is or is not competent to come into a valid contract with another, and will majorly revolve around the Indian Contract Act, 1872 (hereinafter 'the Act'), relating case laws, followed by a critical analysis of the subject in the Indian context. Moreover, every Indian aspect will be dealt along with its origin in English Law as well.

**What is capacity to contract?**

The term 'capacity' under English Law refers to the ability of the contracting parties to come into legally binding relations with each other. If any party fails to comply by this condition, the subsequent contracts may be deemed to be invalid, relying on the facts and circumstances of the case. Since the Indian Contract Law is primarily based on the English Common Law, hence Capacity to Contract carries the same importance as under the latter law, and qualifies to be one of the most essential elements of a valid contract.

A person is considered as capable to enter into a valid contract if he satisfies three conditions under the Act, namely, person has to be major, he or she should not be of unsound mind, and lastly he or she should not be disqualified by any

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law from entering into a contract. However, it is pertinent to note that the subject of the contract should not be illegal or even void for the reasons of public policy.

**Relevant legal provisions** : The Act lays down three provisions which makes capacity as its centre of attraction. The first in order is Section 10, which states the pre-requisites of a valid contract. One of the conditions laid down is that, an agreement is a contract if they are made by the free consent of the parties who are competent to contract. Following this, Section 11 classifies the parties to contract into three categories who are competent to contract. And lastly, it is Section 12 which lays down the situations when a person is considered to be of unsound mind, in order to give clarity to Section 11.

The first factor is the **age of majority**. It provides that a minor i.e. eighteen years old, is not competent to contract. It is presumed that a man is the best judge of his own interests, but this is inapplicable with respect to minors to protect themselves from fraud, unscrupulous traders, etc. Hence, Minor contracts under the Act are generally considered to be void or voidable, barring exceptions. So, minor agreements, being void are not capable of being ratified after attainment of majority. Under common law, the contracts benefiting the minors are valid. For instance, if an infant enters into a contract in order to provide himself or herself with the means of self-support, then it shall be valid.

However, a guardian can step into the shoes of the minor to supplement for the minor's incapacity to contract. When contract is entered into, on behalf of the minor, such as contracts of marriage, then those contracts have been held to be valid on the ground of customs. Also, a contract which is completely executed from the minor's side can be enforced by the minor because there exists no liabilities and nothing needs to be done by him or her further, because it would end up as being for the benefit for the incapacitated persons. Furthermore, Section 68 of the Act is the provision which relates to the position of necessities supplied to the minor.

The second factor concerns with **soundness of mind**. Consent is considered to be an act of reason which has to be combined with deliberation. It is possible for a man to behave normally, but he may be incapable of understanding the transaction, and thus being unable to form a rational judgment, which results in unsoundness of mind. According to Section 12 of the Act, a person is considered to be one of a sound mind if he is capable of understanding and making a rational judgment at the time when he comes into a contract. This implies that a person who is usually of unsound mind and partially of sound mind, then he or she should come into a contract when he is of sound mind, and if it is vice-versa, then the person should avoid making a contract when he or she is of unsound mind. Unsoundness of mind goes on to further render the contract as a void one. But, sanity is presumed in favour of that person, which implies the capacity to understand and make rational decisions as to their interests. For instance, if a person alleges the other that the person has become incapable of understanding his business due to old age, then the onus is on the person to prove

the unsoundness of mind of the other. Unsoundness of mind can be because of various reasons such as insanity, drunkenness, mental idiocy and old age.

The last factor is with respect to the **persons disqualified by law** to enter into a contract. These include several types of people. First is alien enemies i.e. according to Section 83 of Civil Procedure Code (hereinafter 'CPC'), no one is allowed to come into a contract with an alien if any war is subsisting, unless the government allows for the same. The second is regarding the foreign sovereigns which is embodied under Section 86 of the CPC. The next is an insolvent person, who cannot be subject to any contractual agreement because when he is declared insolvent, his properties are with the official assignee and that he or she can only enter into a contract in correspondence with that property as per Section 141(1) (b) of the Insolvency and Bankruptcy Code, 2016. And lastly, contracts with the government is also to be complied with some formalities, and if not done, then it would be deemed to be void. This is not the exhaustive list, but some of the categories which come under the ones who are disqualified by law.

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### 1.2.6 Free Consent

There have to be two parties to a contract, who willingly and knowingly enter into an agreement. But how does the law determine if the parties are both these things? This is where the concept of free consent comes in. Let us learn more about free consent and the elements vitiating free consent.

In the Indian Contract Act, the definition of Consent is given in Section 13, which states that "it is when two or more persons agree upon the same thing and in the same sense". So the two people must agree to something in the same sense as well. Let's say for example A agrees to sell his car to B. A owns three cars and wants to sell the Maruti. B thinks he is buying his Honda. Here A and B have not agreed upon the same thing in the same sense. Hence there is no consent and subsequently no contract.

Now Free Consent has been defined in Section 14 of the Act. The section says that consent is considered free consent when it is not caused or affected by the following :

1. Coercion
2. Undue Influence
3. Fraud
4. Misrepresentation
5. Mistake

**Elements Vitiating Free Consent**

Let us take a look at these elements individually that impair the free consent of either party.

**1. Coercion (Section 15) :** Coercion means using force to compel a person to enter into a contract. So force or threats are used to obtain the consent of the party under coercion, i.e it is not free consent. Section 15 of the Act describes coercion as

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- committing or threatening to commit any act forbidden by the law in the IPC
- unlawfully detaining or threatening to detain any property with the intention of causing any person to enter into a contract

For example, A threatens to hurt B if he does not sell his house to A for 5 lakh rupees. Here even if B sells the house to A, it will not be a valid contract since B's consent was obtained by coercion.

Now the effect of coercion is that it makes the contract voidable. This means the contract is voidable at the option of the party whose consent was not free. So the aggravated party will decide whether to perform the contract or to void the contract. So in the above example, if B still wishes, the contract can go ahead.

Also, if any monies have been paid or goods delivered under coercion must be repaid or returned once the contract is void. And the burden of proof proving coercion will be on the party who wants to avoid the contract. So the aggravated party will have to prove the coercion, i.e. prove that his consent was not freely given.

**2. Undue Influence (Section 16) :** Section 16 of the Act contains the definition of undue influence. It states that when the relations between the two parties are such that one party is in a position to dominate the other party, and uses such influence to obtain an unfair advantage of the other party it will be undue influence.

The section also further describes how the person can abuse his authority in the following two ways,

- When a person holds real or even apparent authority over the other person. Or if he is in a fiduciary relationship with the other person
- He makes a contract with a person whose mental capacity is affected by age, illness or distress. The unsoundness of mind can be temporary or permanent

Say for example A sold his gold watch for only Rs 500/- to his teacher B after his teacher promised him good grades. Here the consent of A (adult) is not freely given, he was under the influence of his teacher.

Now undue influence to be evident the dominant party must have the objective to take advantage of the other party. If influence is wielded to benefit the other party it will not be undue influence. But if consent is not free due to undue influence, the contract becomes voidable at the option of the aggravated party. And the burden of proof will be on the dominant party to prove the absence of influence.

**3. Fraud (Section 17) :** Fraud means deceit by one of the parties, i.e. when one of the parties deliberately makes false statements. So the misrepresentation is done with full knowledge that it is not true, or recklessly without checking for the trueness, this is said to be fraudulent. It absolutely impairs free consent.

So according to Section 17, a fraud is when a party convinces another to enter into an agreement by making statements that are

- suggesting a fact that is not true, and he does not believe it to be true
- the active concealment of facts
- a promise made without any intention of performing it
- any other such act fitted to deceive

Let us take a look at an example. A bought a horse from B. B claims the horse can be used on the farm. Turns out the horse is lame and A cannot use him on his farm. Here B knowingly deceived A and this will amount to fraud.

One factor to consider is that the aggravated party should suffer from some actual loss due to the fraud. There is no fraud without damages. Also, the false statement must be a fact, not an opinion. In the above example if B had said his horse is better than C's this would be an opinion, not a fact. And it would not amount to fraud.

**4. Misrepresentation (Section 18) :** Misrepresentation is also when a party makes a representation that is false, inaccurate, incorrect, etc. The difference here is the misrepresentation is innocent, i.e. not intentional. The party making the statement believes it to be true. Misrepresentation can be of three types

- A person makes a positive assertion believing it to be true
- Any breach of duty gives the person committing it an advantage by misleading another. But the breach of duty is without any intent to deceive
- when one party causes the other party to make a mistake as to the subject matter of the contract. But this is done innocently and not intentionally.

### 1.2.7 Consideration

Consideration is defined under Section 2d of the Indian Contracts Act, 1872. It is defined as when the promisee at the request to the promisor has :

- Done or abstained from doing something,
- Does or abstains from doing something,
- Promises to do or abstain from something,

**Why do we need consideration**

Only the promises that are backed by consideration are enforceable because any promise made without any obligation is usually very rash and without any sort of deliberation. The reason for making consideration an essential part of a contract is because it levies a sort of burden on the parties to fulfil the terms of the contract. For Example, if, A promises to give B a car without B doing or abstaining to do anything for it, makes the promise by an unenforceable. This will be a gift and not a contract per se.

**Legal requirements as to consideration**

- **Must move at the desire of the promisor :** Section 2d of the Indian Contract Act, 1872, clearly mentions that the consideration should be

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at the desire of the promisor if the consideration is made at the will of the third person or is not according to the promisor then it is not a good consideration.

- Can move from the promisee or another person- Unlike English law in which the consideration must move at the desire of the promisor, in Indian law as long as there is consideration it is immaterial as to who has furnished it. Moreover, in the case of Chinnaya vs Rammyya the consideration can also move at the desire of the third party but only in the condition where he is the beneficiary of the contract.
- Can be an act, abstinence or even a promise- If the promisee does something or abstains from doing something for the promisor, at his desire, then it will be a good consideration.
- Can be past, present or future :

  PAST- When the consideration is given before the promise was made. For example- A saves B at the latter's desire. B after a month promises to pay A. the act of A will amount to past consideration for the payment made by B.

  PRESENT- When the consideration is given at simultaneously to the promise made, then this is present consideration or executed consideration. For example- cash sales.

  FUTURE- When the consideration of the promise made is to be passed at a future date then that is called future or executory consideration. For example- A promises to pay B, when the latter will fetch newspaper for him.

- **Consideration need not be adequate :** It is not necessary that the consideration is equal or adequate for the promise made. However, it is mandatory that the consideration should be something in which the law attaches some value. It is for the parties to decide the value of the consideration and not a court of law. For example- A sells table to B and B gave him rs 500. It will be difficult for the court to ascertain the value of the table, so if A is satisfied with the amount given then the consideration is valid.
- Should be real- although the consideration need not be adequate it should be real and not illusory. The consideration should not be physically impossible, legally not permissible or based on an uncertain event or condition.
- Should not be something which the promisor is already bound to do- a consideration to do something which the promisor is already required to do is not a good consideration. For example- the public duty done by a public servant.
- Should not immoral, or against the public policy of the state- under Section 23 of the Indian contract it is given that consideration should not be illegal, immoral or against public policy. the court should decide the legality of the consideration and if found to be illegal than no action on the agreement should be allowed.

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**Stranger to a contract :** It is a general principle that the contract can be enforced only at the behest of the parties to the contract. No third party could enforce it. It arises from the contractual relationship between the two parties. However, Lord Dennings has criticised this rule a number of times as this rule has never benefited the third party whose roots go deeper in the contract. This rule has two consequences :

- No third party could enforce the contract.
- The contract between the parties cannot levy an obligation on any person other than those party to a contract.

**Exception**

There are three exceptions to this rule :

- **Marriage settlements :** When an agreement is made with regards to marriage, family settlement or partition and is made in such a way that it benefits another person who is not a party to the contract then he may sue for the enforcement of the contract.
- **Covenants running with the land :** in cases of the contract of property the purchaser will be bound by all the conditions and covenants of the land, even though he was not a party to the original contract.
- **Acknowledgement of estoppels :** in case the terms of the contract require that an agreement has to be made with the third party, then this has to be acknowledged. This acknowledgement could be expressed or implied. This exception covers the areas where the promisor either expressly or by conduct has posed himself to be an agent.

**Past Consideration**

It is the consideration which is made before the agreement. It is something which the promisee has already done at the desire of the promisor.

For example- A rescues B. B promises to give him Rs. 1000 for the same. Here it is a past consideration as the act of rescuing happened before any agreement.

In English law past consideration is no consideration. If A saves B and B promises him to pay but later refuses to do so, then under English law, A cannot enforce it in a court of law. B can give him the money, but that would not be considered as a past consideration but it would be by way of gratitude. This, however, causes a lot of inconveniences, as if a person would pay for the past act then he shall have to recognise the past consideration which is not valid under English Law. the report of the law commission of England proposes to remove this rule.

In India however, there is no compulsion to follow the English law and past consideration is regarded to be valid.

**Past act at request good consideration :** The past act done for consideration would be a good consideration. In the case of Lampleigh vs Brathwait, in which the defendant requested the plaintiff to help him get a pardon from the king.

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The plaintiff put in efforts, travelled up to the king etc.his request was not sanctioned. The defendant promised to pay him for the same. Later he refused to do so. Plaintiff sued him in a court of law. The court held that the defendant must pay the plaintiff because he has himself requested him to help him. Hence the act of the plaintiff, although done in the past, would still be regarded as a valid consideration.

**Past voluntary service :** If a person renders voluntary services without any request or promise from another and the person receiving the services makes a promise to pay for the services, then such a promise is enforceable in India under Section 25(2) of the Indian Contract Act, 1872 which states: "An agreement made without consideration is void unless it's a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do; or unless."

For Example- Peter finds Noah's wallet on the road. He returns it to him and Noah promises to pay Peter Rs 500. This is a valid contract under the Indian Contracts Act, 1872.

**Past service at request past and executed :** An act done before the giving of a promise to make a payment or to confer some other benefit can be a consideration for the promise. The act must have been done at the promisor's request, the parties must have understood that the act was to be remunerated either by a payment or the conferment of some other benefit, and payment or the conferment of a benefit must have been legally enforceable had it been promised in advance.

**Executory Consideration :** Consideration may be something which is done or in the process of being done. It also consists of an act which is promised to be done in the future. There may be promises which form the consideration for each other. Before the completion of a promise which forms a part of the consideration of the other promise, then such consideration is called executory consideration.

For example- if A promises to pay B when he will sell the goods to him. Until time A does not get the goods; the consideration is executory, when he got the goods and paid for the same, the consideration is executed. If B does not sell the goods then A could also breach for the suit.

**Value need not be adequate :** Consideration is defined as an act of abstinence from doing something, at the desire of the promisor. The consideration should be of some value in the eyes of law, but the courts have been very liberal in interpreting and anything of value by the parties is regarded as a valid consideration.

The value need not be adequate for the promise made. The court will not enquire whether the value of the consideration is equivalent to the promise that is made. If the parties agree to the value of the consideration then it is sufficient. This rule is applicable as per Indian and English law.

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**Inadequacy as evidence of imposition :** The inadequacy of consideration is regarded to check whether the consent is freely given. For example- A agrees to sell his property worth Rs 1 crore to B for Rs 10,000. denies that his consent for the sale of the property was not freely given. A party seeking to set aside the transaction based on the inadequacy of the consideration must show that he was unable to understand it or was by way of some imposition. If the court is satisfied that the contract was freely entered into then it would not matter whether the consideration was adequate or not.

Where the consideration is inadequate it could be because of fraud, coercion, mistake etc. the same would be the case when the consideration is so low that it shows some serious inequality of the bargaining power.

**Forbearance to sue :** The most usual form of forbearance is the forbearance to sue within a reasonable time. This promise to forebear can be expressed or implied from the circumstances. Sometimes it is very difficult to construe from the fact whether it was an agreement to forbearance (which is not a good consideration until not backed by the request of the promisor) or actual forbearance. Hence to clarify in the case Bittan Bibi vs Kuntu Lal, it was held that the promise of forbearance should move at the desire of the promisor.

Forbearance to sue on a claim which is void is not a consideration. Moreover, abstaining to sue could be valid consideration only when the person who is abstaining, has a valid right to sue. Also, it is not necessary to specify the time for such abstinence. A request for forbearance without specifying the length is understood to be a forbearance for a reasonable time.

**Compromise good irrespective of merits :** It is an important kind of forbearance which is undertaken by way of a compromise of a doubtful claim. The important element here is to ascertain the limits of which the compromise will function and will still be a good consideration. The difference between forbearance and compromise is that in the latter claim is not admitted and the claimant promises to abandon the claim.

The abandonment of a doubtful or disputed claim is a good consideration even if it later turns out to be unsustainable. The test is to find whether the person thought in good faith and he has a case which he was abandoning. A compromise of a claim arising out of an illegal contract is insufficient as a consideration unless the compromise arises out of a dispute of fact as to whether the contract is illegal.

**Performance of Existing Duties**

**Performance of legal obligations :** The performance of what one is already bound to do, either by general law or by a specific obligation to the other party, is not a good consideration for a promise, because such performance is not a legal boundation a person. Moreover, on the performance of a legal obligation, a reward from the private organisation is taken then it would be against the public policy. It should be ensured that the legal duty actually exists. But if a man who already has a legal obligation undertakes to do something or to do

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something in any of the admissible way i.e. the person has forgotten the choice that the law allows him to take is a good consideration.

Moreover, the actual performance of an existing duty may confer a factual benefit, because on actual performance the promise is saved of pursuing a legal remedy for its breach.

**Performance of Contractual Obligations**

**Pre-existing contract with the promisor :** Usually, the performance of a duty already owed under the contract to the promisor is not good consideration. Even in terms of public policy, it is necessary to discourage a tendency to use improper pressure or threatening to break one's contract unless another party complies by paying or promising to do so. The promise must find it beneficial to perform the promise immediately rather than paying for its breach which may not fully compensate the promisor.

**Promise to pay less than the amount due :** A promise to pay less than what is due in the contract cannot be regarded as consideration. This rule was given in Pinnel's case. The court held that a smaller amount cannot in whole satisfy a larger sum. However, a gift of the horse, robe etc can be considered as a good satisfaction because under certain circumstances it is considered to be more beneficial than money, otherwise, the person would not accept it.

This holding was criticised in a way wherein several cases the jurist held that if the party is content to receive any amount be it less than the sum and he is satisfied by the same, then it should be considered to be a valid consideration. However, in spite of all this criticism, the Pinnel's Case was applied unanimously in various circumstances.

**Exceptions to the rule in Pinnel Case**

**Part-payment by the third party :** The part payment by the third party may be a good consideration for the whole debt.

**Composition :** Payment of a lesser amount would be a good consideration for the larger sum where this is done for some already entered compromise.

**Payment before time :** Payment of a lesser sum before the time or in a different mode, a different place than agreed by the parties or the gift of a horse or robe etc is a valid satisfaction of the goods.

**Promissory estoppel :** The doctrine of promissory estoppel is considered to be a departure from the doctrine of consideration. A promise that was made in future is estoppel. If the promise is made with the intention that it would be acted upon and it was in actuality acted on, then the promisor cannot be allowed to back out and it could be enforced in a court of law as well.

Promissory estoppels differ from traditional contract theory. It protects reliance. This doctrine was developed to prevent injustice if the promisee suffers from any injustice due to the reliance on the promise of the promisor, even though it was not required a consideration. However, in English law, the doctrine of promissory estoppel is used only as passive equity and is invoked only in the cases of defence.

**Position under the Indian contract act is different than under English Law**

**Under English Law :** It is an established rule under English law that the third party cannot sue a contract made for his own benefit. Apart from special circumstances. A person who is not a part of the contract cannot enforce or rely for protection on its provisions. Such right can be conferred to a property by way of trust but it cannot be on a stranger to a contract as a right to enforce the contract.

**Under Indian Law :** It is established that the consideration can move from a third party but it cannot sue for its own agreement. However, there was lots of confusion on this point. Although the definition of "consideration" is wider in the Indian than in the English law since common law is applicable, therefore it is generally applied that the third party cannot enforce the contract.

Law Commission of India in one of its reports mentioned that the contract must be enforceable by a third party if it expressly for his benefit but the defences of the party to the contract must also be considered. It is also proposed that the parties cannot alter the terms of the contract once the third party takes over the contract.

**Pre-existing contract with the third party**

A promise to perform a pre-existing contractual obligation with a third party can be a valid consideration for another contract. The point of conflict in these kinds of arrangements is regarding the presence of consideration for the promisor. This conflict was settled in the case of Shadwell vs Shadwell, where the plaintiff got engaged and his uncle wrote him a letter promising him to pay 150 pounds throughout his lifetime.

The jurists in the above case held that there was adequate consideration for the contract as it could be construed from the fact that it was made because of the engagement of his nephew. Moreover, marriage is of great interest to the near relatives. Also, the contract is binding on the uncle as it is possible that the plaintiff has undertaken many liabilities on account of the promise given by the uncle and if the payment is withheld then the plaintiff could face a lot of embarrassment.

Under these provisions, the person should be safeguarded from any further payment which is not enforceable as per the contract. Like in the case of Syros Shipping vs Elaghil Trading co. a vessel which was prepaid had to deliver tractors to Yemen. The charters defaulted their payment to the shipowner because of the congestion in the ports. During this period the shipowner asked for extra payment, the consignees agreed to pay but later refused. The court held that since there was no consideration for the promise, moreover no estoppel was created hence the contract is not enforceable.

**Consideration and Motive**

Consideration is not the same thing as motive or a mere desire. The requirement of consideration is vital and the contract could not be satisfied with

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just a moral obligation. Consideration for a promise is always a motive for the promise, unless it is nominal or invented, while a motive for a promise may not always be a consideration for it. Motive induces a promise to be given. Similar holding was given in the case of DwarampudiNagarathnamma vs KurukuRamayya, where the Karta of a Hindu Undivided Family gifted his concubine a portion of the property beyond the cohabitation was a motive and not a consideration, and it should be considered as invalid because it was motivated by the desire to compensate for his past services.

**Absence of Consideration**

If the promissory note is neither genuine nor fraud then it is recoverable under the provision of this code, with interest. The court said that mere denial of the passing of consideration does not make any defence. Something which is probable has to be brought on record.

**Exceptions under Section 25, Indian Contract Act**

In English law, a contract which is under the seal is enforceable without consideration. In Indian law, there are no such provisions but still, The general rule is the *ex nudopacto non-oritur action*, which means that no right of action arises from the contract which is entered into without any consideration. Still, under Section 25 of the Indian Contract Act,1872.it provides certain exceptions under Section 25 of the Indian Contract Act.

**Fiduciary relation :** In case of a contract entered into between the relatives or on account of natural love and affection is enforceable without consideration. The meaning of love and affection is not judicially construed but parties who are nearly related would have instinctive love and affection. However, this could be overruled with regards to some external circumstances, like between the wife and husband who are compelled to live separately because of quarrelling. But a settlement to be given to a man by the wife by way of maintenance could be enforced without any consideration because it will result in peace and family harmony.

The term "family" (in this context) should be understood as a group of people living together and possessing a right of succession, inheritance etc., but the family could be construed as a people who are bonded by natural love and affection.

**Past voluntary services :** A promise to compensate the person who has done something voluntary, in the past for the promisor, is enforceable. This exception is attracted in the cases when the services are rendered voluntarily. Thus where a service is rendered on behalf of a company which is not in existence, a subsequent promise to pay would not attract this provision. Even where the promisee has done something for the promisor, which he had to do legally, then it will also be covered under this exception.

**In Case of a Minor :** In Karam Chand vs Basant Kaur, the court held that even where the promisor after attaining majority, promises to pay for the goods attained in minority will also fall under this provision. The court said that

although the promise made by a minority is void but is the promise is made by a person of full age to the promisee who has done something for him voluntarily when the promisor was a minor, then it will also attract this exception.

**Time barred debt :** A promise to pay a time-barred debt is enforceable and it should be signed by the person or his agent. It could be to pay for the whole debt or in part. The debt to be enforced could be paid except for the law of limitation. However, the person who is under no obligation to pay to another person is under no obligation under this clause.

The promise to pay the debt must be expressed, it is not sufficient if the intention to pay could not be gathered from the circumstances.

Acknowledgement of the debt is different from the promise to pay the debt. The acknowledgement of the person should be done before the period of limitation. Promise to pay a time-barred debt is a new contract. It is not just merely an acknowledgement of the existing liability.

**Gift actually made :** The provisions of "Consideration" do not affect the gift actually made. Under this Section, gift is defined as :

- The gift is of movables then it should be accompanied by its delivery.
- The gift is of immovables then should be along with registration.

If the above conditions of gifts are fulfilled then lack of consideration would not affect the validity of these gifts. However, apart from the consideration, they could be questioned otherwise.

Where the gift of the property was made by a registered deed and is attested by two witnesses, it was not allowed to be questioned on the ground that she was the victim of fraud, moreover, she was not able to establish it.

**Inadequacy of consideration :** Adequacy of the consideration means that the consideration which is paid is equal in value to the value for which it is paid. Consideration can be terms of money, property etc. inadequate consideration is not void but it renders the contract unenforceable because of the improper bargaining or by itself.

Inadequate consideration must be distinguished from nominal consideration. Nominal consideration is deliberately given to make the contract effective but inadequate consideration is less than the amount promised. Although the act does not make any distinction between the nominal and inadequate consideration but it was made in the case.

### 1.2.8 Void Agreements

All agreements may not be enforceable at law. Only those agreements which fulfil the essentials laid down in Section 10 can be enforced. The Indian Contract Act specifically declares certain agreements to be void. According to Section 2(g), an agreement not enforceable by law is void. Such an agreement does not give rise to any legal consequences and is void ab initio.

It will be useful to distinguish between illegal and void agreement. An unlawful or illegal agreement is one which is actually forbidden by law. A void

agreement, on the other hand, is not forbidden by law as in the case of a contract with a minor. But both illegal and void agreements are not enforceable. Thus, an illegal agreement is both unenforceable and forbidden but a void agreement is only unenforceable but not illegal.

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Another material difference between an illegal and void agreement relates to their effect upon the collateral transactions. A collateral transaction means a transaction subsidiary to the main transaction. Thus, where money is lent to a loser to enable him to pay a wagering debt, the wager is the main transaction and the loan is subsidiary to it. If the main transaction is forbidden by law, for example, smuggling, a collateral transaction like money given to enable a person to smuggle, will also be tainted with the same illegality and the money will be irrecoverable. But if the main transaction is void only (as in the case of wagering), its collateral transaction will remain enforceable.

The following agreements have been expressly declared as void by the Indian Contract Act.

1. Agreement made by incompetent parties (Sec. 10&11).
2. Agreement made under a mutual mistake of fact (Sec. 20).
3. Agreement, the consideration or object of which is unlawful (Sec. 23).
4. Agreements, the consideration or object of which is unlawful in part (Sec. 24).
5. Agreements made without consideration (Sec. 25).
6. Agreements in restraint of marriage (Sec. 26).
7. Agreements in restraint of trade (Sec. 27).
8. Agreements in restraint of legal proceedings (Sec. 28).
9. Agreements the meaning of which is uncertain (Sec. 29).
10. Agreements by way of wager (Sec. 30).
11. Agreements contingent on impossible events (Sec. 36).
12. Agreements to do impossible acts (Sec. 56).

**Void agreement**

**Agreement Made by Incompetent Parties**

**Minor :** An infant or a minor is a person who is not a major. According to the Indian Majority Act, 1875, a minor is one who has not completed his or her 18th year of age. A person attains majority on completing his 18th year in India. In the following two cases, a person continues to be a minor until he completes the age of 21 years.

(a) Where a guardian of minor' person or property has been appointed under the Guardians and Wards Act, 1890; or

(b) Where the superintendence of a minor's property is assumed by a Court of Wards.

**Why should minors be protected ?** A minor has an immature mind and cannot think what is good or bad for him. Minors are often exploited and their

properties stolen. As such he must be protected by law from any exploitation or ill design. But at the same time, law should not cause unnecessary hardship to persons who deal with minors.

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**Effects of minor's agreement :** A minor's agreement being void is wholly devoid of all effects. When there is no contract there should be no contractual obligation either side. The various rules regarding minor's agreement are discussed below :

**1. An agreement with or by a minor is void :** Section 10 of the Contract Act requires that the parties to a contract must be competent and Section 11 says that a minor is not competent. But neither Section makes it clear whether the contract entered into by a minor is void or voidable. Till 1903, courts in India were not unanimous on this point. The Privy Council made it perfectly clear that a minor is not competent to contract and that a contract by a minor is void ab initio.

**2. No ratification :** An agreement with minor is completely void. A minor cannot ratify the agreement even on attaining majority, because a void agreement cannot be ratified. A person who is not competent to authorise an act cannot give it validity by ratifying it. Thus, where a minor borrowed a sum of money by executing a simple pronote for it and after attaining majority executed a second pronote in respect of the original loan plus interest thereon, a suit upon the second pronote was not maintainable. If on coming of age, a minor makes a new promise and not merely an affirmation of the old promise, for a fresh consideration, the new promise will be binding.

**3. Minor can be a promisee or beneficiary :** If a contract is beneficial to a minor it can be enforced by him. There is no restriction on a minor from being a beneficiary, for example, being a payee or a promisee in a contract. Thus a minor is capable of purchasing immovable property and he may sue to recover the possession of the property upon tender of the purchase money. Similarly a minor in whose favour a promissory note has been executed can enforce it.

**Example :** X, a minor, insured his goods with an insurance company. The goods were damaged. X filed a suit for claim. The insurance company took the plea that the person on whose behalf the goods were insured was a minor. The court rejected the plea and allowed the minor to recover the insurance money.

The infancy of one party to a contract does not affect the other party's liability, the plea of infancy being a privilege personal to the infant, so that although an infant may avoid a contract, he can, nevertheless, hold liable and, if necessary, sue the other party to the contract.

**Contracts of apprenticeship :** Contracts of apprenticeship are also for the benefit of minors. Such contracts, according to the Apprenticeship Act, are binding on minors. But the Act requires that the contracts be made by guardians on behalf of minors. In English Law, contracts of service and apprenticeship are treated as similar to contracts for necessaries.

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**4. No estoppel against a minor :** Where a minor by misrepresenting his age has induced the other party to enter into a contract with him, he cannot be made liable on the contract. There can be estoppel against a minor. In other words, a minor is not estopped from pleading his infancy in order to avoid a contract. It has been held by a Full Bench of the Bombay High Court in the case of Gadigeppa v. Balangowala that where an infant represents fraudulently that he is of age and thereby induces another to enter into a contract with him, then in an action founded on the contract, the infant is not estopped from setting up infancy.

The court may, however, require the minor to compensate the other party on the ground of equity. This is based on the rule that a minor can have no privilege to cheat men. Fraudulent misrepresentation as to age by an infant will operate against him in certain cases. If a minor obtains property or goods by misrepresenting his age, he can be compelled to restore it but only so long as the same is traceable in his possession.

If by misrepresenting himself to be of full age, a minor has obtained money from a trustee and given release, the release is good and he cannot compel the trustee to make payment a second time.

**5. No Specific performance :** A minor's contract being absolutely void, there can be no question of the specific performance of such a contract. A guardian of a minor cannot bind the minor by an agreement for the purchase of immovable property; so the minor cannot ask for the specific performance of the contract which the guardian had no power to enter into.

**6. Liability for torts :** A minor is liable in tort. Thus, where a minor borrowed a horse for riding only he was held liable when he lent the horse to one of his friends who jumped and killed the horse. Similarly, minor was held liable for his failure to return certain instruments which he had hired and then passed on to a friend. But a minor cannot be made liable for a breach of contract by framing the action on tort. You cannot convert a contract into a tort to enable you to sue an infant.

**7. No insolvency :** A minor cannot be declared insolvent even though there are dues payable from the properties of the minor.

**8. Partnership :** A minor being incompetent to contract cannot be a partner in a partnership firm, but under Section 30 of the Indian Partnership Act, he can be admitted to the benefits of partnership.

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

**10. Minor cannot bind parent or guardian :** In the absence of authority, express or implied, an infant is not capable of binding his parent or guardian, even for necessaries.

**11. Joint contract by minor and adult :** In such a case, the adult will be liable on the contract but not the minor.

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**12. Liability for necessaries :** The case of necessaries supplied to a minor or to any person whom such minor is legally bound to support is governed by Section 68 of the Indian Contract Act. A claim for necessaries supplied to a minor is enforceable at law. But a minor is not liable for any price that he may promise and never for more than the value of the necessaries.

There is no personal liability of the minor, but only his property is liable. A minor is also liable for the value of necessaries supplied to his wife. Necessaries mean those things that are essentially needed by a minor. They cannot include luxuries or costly or unnecessary articles. Necessaries extend to all such things as reasonable persons would supply to an infant in that class of society to which the infant belongs.

Expenses on minor's education, on funeral ceremonies of the wife, husband or children of the minor come within the scope of the word 'necessaries'. Not only must the goods supplied by such as are suitable to the minor's status, they must also be actually necessary. Ten suits of clothes are necessaries for a minor whereas even three suits may not be deemed necessary for another. The whole question turns upon the minor's status in life. Utility rather than ornament is the criterion.

**Example :** Inman an infant undergraduate in Cambridge bought eleven fancy waistcoats from Nash. He was at that time adequately provided with clothing. Held the waistcoats were not necessary and the price could not be recovered.Certain services rendered to a minor have been held to be 'necessaries'. These include education, medical advice, a house given to a minor on rent for the purpose of living and continuing his studies, etc.

Goods necessary when ordered might have ceased to be necessary by the time they are delivered. e.g., where a minor orders a suit from a tailor but buys other suits before that ordered is actually delivered. Here the minor could not be made to pay the tailor. The following have been held to be necessaries :

(i) Livery for an officer's servant.
(ii) Horse, when doctor ordered riding exercise.
(iii) Goods supplied to a minors wife for her support.
(iv) Rings purchased as gifts to the minor's fiancee.
(v) A racing bicycle.

On the other hand, following have been held not to be necessaries :

(i) Goods supplied for the purpose of trading.
(ii) A silver-gift goblet.
(iii) Cigars and tobacoo.
(iv) Refreshment to an undergraduate for entertaining.

**Persons of unsound mind :** Section 11 disqualifies a person who is not of sound mind from entering into a contract. Contracts made by persons of unsound mind like a minor's contract are void. The reason is that a contract requires assent of two minds but a person of unsound mind has nothing which the law

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recognizes as a mind. Section 12 deals with the question as to what is a sound mind for the purpose of entering into a contract. It lays down that, "A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it he is capable of understanding it and of forming a rational judgement as to its effect upon his interests."

A person who is usually of unsound mind but occasionally of sound mind may make a contract when he is of sound mind. Thus a patient in a lunatic asylum, who is at intervals of sound mind may make a contract during those intervals. A person who is usually of sound mind but occasionally of unsound mind is not considered competent to make a contract when he is of unsound mind. Thus a sane man who is so drunk that he cannot understand the terms of a contract or form a rational judgement as to its effect on his interests is incompetent to make a contract, whilst such drunkenness lasts.

Unsoundness of mind does not mean weakness of mind or loss of memory. It means not only lack of capacity to understand the terms of the contract but also lack of understanding to realize the effect of the terms of the contract. There is always a presumption in favour of sanity. The person who relies on the unsoundness of mind must prove it. Persons who are idiots, drunk or lunatic cannot enter into contracts. All these persons stand on the same footing as minors and their contracts are void. A person of unsound mind to whom necessaries are supplied is liable to pay a reasonable price.

**Example :** A property worth about Rs.25,000 was agreed to be sold by a person for Rs.7,000 only. His mother proved that he was a congenital idiot, incaptable of understanding the transaction. The sale was held to be void. (Inder Singh v. Parmeshwardhari Singh AIR 1957 Pat. 491).

**Agreement Made Under A Mutual Mistake of Fact**

A mistake of fact in the minds of both parties negatives consent and the contract becomes void. Section 20 provides that, "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." Four conditions must be fulfilled before a contract can be avoided on the ground of mistake which are as follows :

(a) There must be mistake as to the formation of contract;

(b) The mistake must be of both the parties i.e., bilateral and not unilateral;

(c) It must be mistake of fact and not of law;

(d) It must be about a fact essential to the agreement.

**Example :** A man and a woman made a separation deed under which the man agreed to pay a weekly allowance to the woman under a mistaken assumption that they were lawfully married. It was held that the agreement was void as there was common mistake on a point of fact which was material to the existence of the agreement.

However, an erroneous opinion as to the value of the thing which forms the subject matter of the agreement is not deemed to be a mistake as to a matter of fact.

**Example :** X buys a painting believing it to be worth Rs.2,000 while actually it is worth Rs. 200 only. The agreement cannot be avoided on the ground of mistake. The cases falling under bilateral mistakes are as follows :

1. Mistake as to the subject matter Mistake as to subject matter falls into six heads, namely :

(a) existence,
(b) identity,
(c) title,
(d) price,
(e) quantity,
(f) quality.

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**(a) Mistake as to the existence of the subject matter :** The parties may be mistaken as to the existence of the subject matter of the contract, at the date of the contract. The contract is void if without the knowledge of the parties, the subject matter does not exist at the date of the contract.

**Examples :** There is an agreement between A and B for the purchase of a certain horse. But the horse is dead at the time of the contract. The agreement is void.

**(b) Mistake as to the identity of the subject matter :** A mistake of both parties in relation to the identity of the subject matter (as where one party had one subject in mind and the other party another) prevents a consens us ad idem and invalidates the agreement.

**Example :** A agreed to buy from B 125 bales of cotton "to arrive ex pear less from Bombay". There were two ships of that name sailing from Bombay, one of which was in the mind of A and the other in the mind of B. It was held that there was a bilateral mistake and there was no contract. The result would be the same even if the mistake is caused by the negligence of a third party.

**(c) Mistake as to the title of the subject matter :** Where unknown to the parties the buyer is already the owner of the flat which the seller wants to sell him, the contract is void.

**Example :** There was a contract for lease between X and Y. The rent was inadvertently mentioned as Rs.10 though the agreement was to pay rent of Rs. 230. The contract was held to be void.

**(d) Mistake as to the quantity of the subject matter :** There is no contract between the parties if there is a difference between the quantity sold and purchased. Thus, where a broker gave two invoices under a contract to a seller and buyer, and if the two invoices differed as to quantity sold and purchased, there was no enforceable contract.

**(e) Mistake as to the quality of the subject matter :** Mistake as to the quality of the thing does not affect consent unless it is the mistake of both parties and it is as to the existence of some quality which makes the thing without the quality essentially different from the thing as it was believed to be. But if the

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mistake is fundamental it is void. A contract for the sale of a horse believed to be a race horse would be void if it turned out to be a cart horse.

2. Mistake as to the possibility of performing the contract :

(a) Physical impossibility. A contract for the hiring of a room for witnessing the coronation procession was held to be void because unknown to the parties the procession had already cancelled.

(b) Legal impossibility. A agreement is void if it provides that something should be done which cannot legally be done. Thus a person cannot take lease of his own land.

**Agreement, The Consideration or Object of Which is Unlawful**

According to Section 23 of the Indian Contract Act, an agreement of which the object or consideration is unlawful is void. The word 'object' in Section 23 is not used in the same sense as consideration. Object means purpose or design of the contract. It implies the manifestation of intention. Thus, if a person while in insolvent circumstances transfers to another for consideration some property with the object of defrauding his creditors, the consideration of the contract is lawful but the object is unlawful. Both the object and the consideration of agreement must be lawful, otherwise the agreement would be void. The word 'lawful means 'permitted by law'. Section 23 of the Contract Act speaks of three thing :

(i) consideration for the agreement;

(ii) object for the agreement; and

(iii) agreement

The consideration or the object of an agreement is unlawful in the following cases :

**1. If it is forbidden by law :** If the consideration or object for a promise is such as is forbidden by law, the agreement is void. The agreement is forbidden by law, if the legislature penalizes it or prohibits it. It is illegal and cannot become valid even if the parties act according to such agreement. Sections 26, 27, 28 and 30 of the Contract Act deal with cases where the consideration or object of an agreement is considered unlawful. Thus, where the lawful wife was alive, any agreement by the husband to marry another is unenforceable as being forbiden by law. Similarly, an agreement to sublet a telephone, in contravention of conditions is void because it is forbidden by law. Such agreements are illegal not because their consideration or objects is unlawful but because they are forbidden by law. Example: A promises to obtain for B an employment in the public service and B promises to pay Rs. 1000 to A. The agreement is void as the consideration for it is unlawful.

**2. If it is of such a nature that if permitted it would defeat the provisions of any law :** If the object or consideration of an agreement is of such a nature that if permitted it would defeat the provisions of any law, the agreement is void. A contract which seeks to exclude the application of a statutory provision to the

parties is not valid. An agreement to give an annual allowance to the parents of an adopted Hindu boy in order to induce them to consent to the adoption is void.

**3. If it is fraudulent :** Agreements which are entered into to promote fraud are void. Thus, an agreement for the sale of goods for the purpose of smuggling them out of the country is void and the price of the goods so sold, cannot be recovered.

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**4. If it involves or implies injury to the person or property of another :** The object or consideration of an agreement will be unlawful if it tends to injure the person or property of another. Thus, an agreement to pull down another's house is unlawful. The word 'injury' means criminal or wrongful harm. Loss which ensues to a trader as a result of competition by a rival trader is not injury within the meaning of this clause.

**5. If the court regards it as immoral :** Where the consideration or object of an agreement is such that the court regards it as immoral, the consideration is void. The word immoral means inconsistent with what is right. Rent due in respect of a flat let to a prostitute for the purpose of her trade cannot be recovered. Similarly money lent for the purpose of assisting the borrower to visit brothels and bring in prostitutes cannot be recorded in a court of law.

**6. If the court regards it as being opposed to public policy :** An agreement is unlawful if the court regards it as opposed to public policy. A contract which is opposed to public policy cannot be enforced by either of the parties to it. Any agreement which tends to promote corruption or injustice or is against the interests of the public is considered to be opposed to public policy. Public policy is that principle of law which holds that no citizen can lawfully do that which has a tendency to be injurious to the public. A contract having tendency to injure public interest or public welfare is opposed to public policy. Public policy is not capable of exact definition and, therefore, courts do not generally go beyond the decided cases on the subject. The courts do not invent a new head of public policy. The courts in India have declared certain agreements as opposed to public policy and hence unenforceable or void.

**Agreements for Which Object or Consideration is Unlawful in Parts (Section 24) :** Where consideration and object of an agreement is unlawful in part, the whole agreement is void. A promises to work on behalf of B, a legal manufacturer of indigo and an illegal traffic in other articles. B promises to pay to A a salary of Rs. 10,000 a year. The agreement is void. This rule is applicable where legal and illegal transactions cannot be separated and the whole transaction is void. But if a contract consists of a number of distinct promises, a few of which are legal and others illegal, the legal ones can be enforced.

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

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**1. Natural love and affection (Sec. 25(1)) :** An agreement though made without consideration will be valid if it is in writing and registered and is made on account of natural love and affection between parties standing in a near relation to each other. An agreement without consideration will be valid provided :

(i) it is expressed in writing;

(ii) it is registered under the law for the time being a force;

(iii) it is made on account of natural love and affection; and

(iv) it is between parties standing in a near relation to each other.

All these essentials must be present to enforce an agreement made without consideration. The presence of only one or some of them will not suffice. Thus, the mere registration of document in the absence of nearness of relationship or natural love and affection will not suffice.

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

**2. Compensation for services rendered (Sec. 25(2)) :** An agreement made without consideration may be valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promisor or something which the promisor was legally compellable to do. To apply this rule the following essentials must exist :

(a) the act must have been done voluntarily;

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

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

**Example :** A finds B's purse and gives it to him. B promises to give A Rs. 50. This is a contract.

**3. Time-barred debt (Sec. 25(3)) :** A promise to pay a time-barred debt is also enforceable. But the promise must be in writing and be signed by the promisor or his agent authorized in that behalf. The promise may be to pay the whole or part of the debt. An oral promise to pay a timebarred debt is unenforceable. The clause does not apply to promises to pay time-barred debts of third persons. It is restricted to the promisor who is himself liable for the debt. So, where a Hindu son agrees to pay his deceased father's time-barred debt, there is no personal liability for the son, for it is only the joint-family property in his hands that will answerable for the debt. The debt must be such which the creditor might have enforced in law for recovery of the payment. A person under no obligation cannot, therefore, promise to pay. An insolvent finally discharged is under no obligation to pay any debt. So any promise to pay by him is not a debt as there is no consideration for such a promise.

**Example :** D owes P Rs.1,000 but the debt is barred by the Limitation Act. D signs a written promise to pay Rs.500 on account of the debt. This is a contract. The promise to pay referred to in Section 25(3) must be an express one. Thus, a debtor's letter to his creditor 'to come and receive' what was due to him, was held to disclose no express promise. But where a tenant in a letter to the

landlord referred to the arrears of time-barred rent and said, "I shall send by the end of December", it was held that the document contained an express promise as required by Section 25(3).

**4. Completed gifts :** Explanation 1 to Section 25 provides that the rule 'no consideration, no contract' shall not affect validity of any gifts actually made between the donor and the donee. Thus if a person gives certain properties to another according to the provisions of the Transfer of Property Act, he cannot subsequently demand the property back on the ground that there was no consideration.

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5. Agency There is one more exception to the general rule. It is given in Section 185 which says that no consideration is needed to create an agency.

**Agreement In Restraint of Marriage**

Every individual enjoys the freedom to marry and so according to Section 26 of the Contract Act "every agreement in restraint of the marriage of any person, other than a minor, is void." The restraint may be general or partial but the agreement is void, and therefore, an agreement agreeing not to marry at all, or a certain person, or a class of persons, or for a fixed period, is void. However, an agreement restraining the marriage of a minor is valid under the Section. It is interesting to note that a promise to marry a particular person does not imply any restraint of marriage, and is, therefore, a valid contract.

**Illustration :** A agrees with B for good consideration that she will not marry C. It is a void agreement. It may be noted that an agreement which provides for a penalty upon remarriage may not be considered as a restraint of marriage.

**Agreements In Restraint of Trade**

The Constitution of India guarantees the freedom of trade and commerce to every citizen and therefore Section 27 declares "every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void." Thus no person is at liberty to deprive himself of the fruit of his labour, skill or talent, by any contracts that he enters into.It is to be noted that whether restraint is reasonable or not, if it is in the nature of restraint of trade, the agreement is void always, subject to certain exceptions provided for statutorily.

**Example :** An agreement whereby one of the parties agrees to close his business in consideration of the promise by the other party to pay a certain sum of money, is void, being an agreement is restraint of trade, and the amount is not recoverable, if the other party fails to pay the promised sum of money . But agreements merely restraining freedom of action necessary for the carrying on of business are not void, for the law does not intend to take away the right of a trader to regulate his business according to his own discretion and choice.

**Exception :** An agreement is restraint of trade is valid in the following cases :

**1. Sale of goodwill :** The seller of the 'goodwill' of a business can be restrained from carrying on a similar business, within specified local limits, so

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long as the buyer, or any person deriving title to the goodwill from him, carries on a like business therein, provided the restraint is reasonable in point of time and space (Exception to Sec. 27).

**Example :** A, after selling the goodwill of his business to B promises not to carry on similar business "anywhere in the world." As the restraint is unreasonable the agreement is void.

**2. Partners' agreement :** An agreement in restraint of trade amount the partners or between any partner and the buyer of firm's goodwill is valid if the restraint comes within any of the following cases :

(a) An agreement among the partners that a partner shall not carry on any business other than that of the firm while he is a partner (Section 11(2) of the Partnership Act).

(b) An agreement by a partner with his other partners that on retiring from the partnership he will not carry on any business similar to that of the firm within a specified period or within specified local limits provided the restrictions imposed are reasonable (Section 36(2) of the Partnership Act).

(c) An agreement among the partners, upon or in anticipation of the dissolution of the firm, 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, provided the restrictions imposed are reasonable (Section 54 of the Partnership Act).

(d) An agreement between any partner and the buyer of the firm's goodwill that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits, provided the restrictions imposed are reasonable (Section 55(3) of the Partnership Act).

**3. Trade combinations :** As pointed out, an agreement, the primary object of which is to regulate business and not to restrain it, is valid. Thus, an agreement in the nature of a business combination between traders or manufacturers e.g. not to sell their goods below a certain price, to pool profits or output and to divide the same in an agreed proportion, does not amount to a restraint of trade and is perfectly valid . Similarly an agreement amongst the traders of a particular locality with the object of keeping the trade in their own hands is not void merely because it hurts a rival in trade. But if an agreement attempts to create a monopoly, it would be void.

**4. Negative stipulations in service agreements :** An agreement of service by which a person binds himself during the term of the agreement, not to take service with anyone else, is not in restraint of lawful profession and is valid. Thus a chartered accountant employed in a company may be debarred from private practice or from serving elsewhere during the continuance of service . But an agreement of service which seeks to restrict the freedom of occupation for some period, after the termination of service, is void. Thus, where S, who

was an employee of Brahmputra Tea Co. Assam, agreed not to employ himself or to engage himself in any similar business within 40 miles from Assam, for a period of five years from the date of the termination of his service, it was held that the agreement is in restraint of lawful profession and hence void.

**Agreement in Restraint of Legal Preceding (Section 28)**

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Agreements entered into by private persons with the purpose of purporting to oust the jurisdiction of the court so as to enable them to alter their personal law or the statute law are void. Section 28 provides that every agreement by which any party thereto is restricted absolutely from enforcing his legal rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals or which limits the time within which he may thus enforce his rights, is void to that extent. Thus where a servant agrees not to sue for wrongful dismissal is void under this section. The exceptions to this rule are :

(a) This Section shall not render illegal a contract, by which two or more persons agree that any dispute which may arise between them in respect of any subject or class of subjects shall be referred to arbitration, and that only the amount awarded in such arbitration shall be recoverable in respect of the dispute so referred. In other words, an agreement to refer all future disputes in connection with a contract to arbitration shall be valid.

(b) This Section shall not render illegal any contract in writing, by which two or more persons agree to refer to arbitration any question between them which has already arisen, or affect any provision of any law in force for the time being as to references to arbitration.

**Uncertain Agreements**

Section 29 provides that an agreement the meaning of which is not certain or capable of being made certain is void. If there is ambiguity in the wording of the contract, it is not possible to read the exact intention of the parties to the contract. Where the term in an agreement is vague in the extreme and might be interpreted in as many ways as there are interpretations thereof, the agreement is certainly one which is void because of uncertainty. Thus an agreement to sell at a concessional rate is void for uncertainty. Similarly an agreement to pay rent in cash without the rate being definitely fixed is void for uncertainty.

**Example :** A agrees to sell to B "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty. Agreements in which price is to be based on luck or an certain event are void for uncertainty. Similarly an agreement to agree in future is also void for there is no certainty whether the parties will be able to agree.

**Wagering Agreements**

An agreement by way of wager is void. No suit will lie for recovering anything alleged to be won on any wager or entrusted to any person to abide by the results of any game or other uncertain even on which any wager is made. (Section 30).

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Wager means a bet. A wager may be defined as an agreement to pay money or money's worth on the happening of a specified uncertain event. It is a game of chance in which the change of either winning or losing is wholly dependent on an certain event. The parties to a wagering contract must agree that upon the determination of the said uncertain even, one should win from the other. Each party stands equally to win or lose the bet. The chance of gain or the risk of loss is not one sided. If either of the parties may win but not lose, or may lose but cannot win, it is not a wagering contract. The essence of a wagering contract is that neither of the parties should have any interest in the contract other than the sum which he will win or lose.

Essentials The following are the essentials of wagering agreement :

1. There must be a promise to pay money or money's worth.
2. Promise must be conditional on an event happening or not happening.
3. There must be uncertainty of even. The certain event may be past, present or future.
4. There must be two parties. Each party must stand to win or lose. In other words loss of one must be the gain of other.
5. There must be a common intention to bet at the time of making such agreement.
6. Neither party should have control over the happening of the event. If one of the parties has the event in his own hands, the transaction lacks an essential ingredient of a wager.
7. Parties should have no interest in the event except for stake. If either of the parties has any proprietary interest in the subject matter of the agreement, the same ceases to be a wagering agreement. It is on this basis that a wagering agreement is distinguished from a contract of insurance.

**Effect of Wagering Transactions :** Agreement by way of wager are void. Hence, such agreements cannot be enforced in any court of law. Any amount won on a wager cannot be recovered. For example, two persons entered into wagering transactions in shares and one became indebted to another. A promissory note was executed for the payment of debt. The note was held to be unenforceable.

**Effect of transactions collateral to wager :** All agreements by way of wager are void. A wagering contract being only void and not illegal, a collateral contract can well be enforced at law. Thus, it P lends money to D, to pay off a gambling debt, P can recover the money from D.

**Example :** A lost Rs. 8,500 to B on horse races. Subsequently A executed a hundi for same amount in favour of A to prevent B being declared as a defaulter in his club. B filed a suit on the Hundi. A pleaded that it was a wagering transaction and the consideration was unlawful. It was held that a wagering agreement is void but does not affect the collateral transactions.

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**Exceptions :** The following agreements are not held to be wagers :

**(i) Horse race :** Section 30 makes an exception in favour of certain prizes for horses races. It provides that an agreement to subscribe or contribute for or towards a plate, prize or a sum of money of the value of Rs.500 or above to be awarded to the winner of a horse race is valid.

**(ii) Commercial Transactions :** An agreement for actual purchase and sale of any commodity is not a wagering agreement. But sometimes it becomes difficult to determine whether a particular transaction was in fact a contract of purchase and sale or a wagering contract for the payment of differences. Thus, for example, if two traders A and B, contract for the sale and purchase of one hundred bags of sugar to be delivered three months after at rupees four hundred per bag, it may be difficult to say whether it is a perfectly good commercial contract entered into with the intention of delivering the goods or whether the two traders are really speculating and wagering upon the prices of sugar. To bring a case within the provisions of Section 30, a common intention to wager, e.g. to pay and receive differences in necessary. The intention to wager must be on the part of both the contracting parties. If only one of the parties to the agreement had the intention that the agreement should be for the mere payment of differences and the other party was not aware of the fact, the agreement is enforceable.

**(iii) Crossword Puzzles :** The literary competitions involving applications of skill are not wagers as here an effort is made to find out the best and skillful competitor.

**(iv) Chit funds :** A chit fund is not a wager. No doubt, some gain does come to some members, but none of them stands to lose his money.

**Wager and insurance contracts :** A contract of insurance, be it life, accident, fire, marine, etc. is not a wager though it is performable upon an uncertain event. It is so because therein the parties have an interest in the contract. A person has an insurable interest in his own life and he can make a valid contract to insure for the benefit of a third person. But an insurance on the life of a person in which the insurer has no interest whatever is void as being a wager. Thus, a person effecting insurance on his younger brother's life has no insurable interest and the contract is void.

**Agreements Contingent on Impossible Events**

"Contingent agreements to do or not do to 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." (Sec. 36)

**Illustrations (to Sec. 36) :** A agrees to pay B Rs.1,000 (as a loan) if two straight lines should enclose a space. The agreement is void.

**Agreements To Do Impossible Acts**

"An agreement to do an act impossible in itself is void." (Sec. 56 Para 1).

**Illustrations :**

(a) A agrees with B to discover treasure by magic. The agreement is void.

(b) A agrees with B to run with a speed of 100 Kilometres per hour. The agreement is void.

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### 1.2.9 Quasi Contracts

English Law identified quasi-contractual obligations first, the framers of the Indian Contract Act modified it and placed it in the Act as- "certain relations resembling those created by contracts". Therefore the elements that are present in the English Quasi-contract are also found in that of the Indian Contract Act.

Though the Indian Contract Act, 1872 does not define a quasi-contract, it calls them relation resembling those of contracts. However, a quasi-contract may be defined as, "a transaction in which there is no contract between the parties; the law creates certain rights and obligation between them which are similar to those created by a contract.

"An obligation created by law for the sake of justice; specif., an obligation imposed by law on parties because of a relationship between parties or because one of them would otherwise be unjustly enriched. It's not a contract, but instead is a remedy that allows the plaintiff to recover a benefit conferred on the defendant.These types of contracts are quasi-contract or restitution that fall in the third category of quasi-contracts or restitution.

The procedural term 'quantum meruit' has persisted and is sometimes used as a synonym for the more general term ' quasi-contract' which refers to any money claim for the redress of unjust enrichment. Basically, in other words, a contract made by law for reasons of equity with no statement of consent is a quasi-contract. Quasi-contracts bring a situation which imposes obligations or duties upon the parties by law rather than the assent given by them to the contract terms.

There are many situations in which law, as well as justice, requires that a certain person is required to confirm an obligation, although he has not broken any contract nor committed any tort. For example for Quasi Contract would be worthy of Quoting for the better understanding of Quasi Contract, if a person in whose home certain goods have been left by mistake is bound to restore them.

This shows that a person cannot entertain unjust benefits at the cost of some other person. Such kind of obligations is generally described, for the want of better or more appropriate name, as Quasi-Contractual Obligations. This would be better to explain it up that Quasi-contract consists of the Contractual Obligation which is entered upon not because the parties have consented to it but because the law does not allow a person to have an unjustified benefit at the cost of another party.

These are not contracts but these fictional agreements arise to ensure equity as it would be unfair if a party gets an undue advantage at the cost of others. The liability exists in quasi-contracts on the basis of the doctrine of

unjust enrichment. Take for an example a person in whose house certain goods have been left incidentally, so that person is bound to restore them. There will be an obligation on the house owner to restore the goods safely that is imposed by law rather than any agreement between the parties. Such type of contractual obligations is termed as quasi-contractual obligations. Basic elements of quasi-contracts are :

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**Liability**

In general, the quasi-contract doctrine is applied in disputes regarding payment of goods delivered or services rendered. If there is no valid contract between the parties, the main question that arises in such situations is the liability of the defendant. As the aim of this doctrine is to prevent unjust enrichment of one party, at the expense of the other, the damages are usually restricted to the value of the services rendered or the cost of the materials delivered. In short, the liability of the party who has enjoyed unjust benefits is limited to the value of that benefit only.

**Quasi Contract And Implied-In-Fact Contract**

The characteristic feature of a quasi-contract is the absence of a contract or a mutual consent between the parties. Quasi-contracts are often confused with implied-in-fact contracts. Implied-in-fact contracts are also not contracts in the true sense, as they lack a written agreement. In case of the latter, even though there is no contract between the parties as per the facts, the actions and words of the parties amount to mutual consent over the disputed matter. The difference between the two can be illustrated with an example.

A approaches a doctor for treatment. Here, there is mutual consent between A and the doctor. As A expects treatment from the doctor, the doctor expects payment from A for his services. This is an example of an implied-in-fact contract, wherein the conduct of the parties suggested a mutual consent. But, in a quasi-contract (as per the example given above), the parties to the dispute did not even know each other. So, there is no question of consent between them.

**Theories Behind Quasi Contracts :** So far as there was not an established rule of Quasi Contractual obligation the English Lawyers were content to enumerate the cases of the Quasi Contract for which they are provided a remedy as to many species of "Indebitatus Assumpsit (A form of action in which the plaintiff alleges that the defendant has undertaken a debt and has failed to satisfy it.), but they evaded the odious task of rationalization. But as soon as the urge was felt to explore their juristic basis, the controversy was born."

The "quasi-contract" is covered in Chapter V of the Indian Contract Act, 1872, under the heading of 'of certain relations and resembling those created by contract'. I feel that the Indian contract act, 1872 favors the term 'quasi-contract' but partially as it is not a real contract because if they would have been in support of this term, then they would have included this term in Chapter V of the act rather than giving the heading 'Certain Relations resembling those created by Contract' but they mean by this title that they are referring to quasi-contracts.

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The term 'quasi-contract' is avoided in the chapter but this chapter is about the doctrine of quasi-contracts.Nothing is precisely clear about the quasi-contracts. The founder of quasi-contract based on the theory of unjust enrichment was Lord MANSFIELD who explained such obligations based upon the law as well as justice to prevent undue advantage to one person at the cost of another.

The concept was first taken up in the case **Moses v. Macferlan**. The facts of the case are as such: Jacob issued four promissory notes to Moses and Moses indorsed them to Macferlan, excluding by a written agreement, his personal liability on the endorsement. Even so, Macferlan sued Moses on the endorsement and he was held liable despite which he had excluded and, therefore, sued to recover back his money from Macferlan.

He was allowed to do so. After stating that such money cannot be recovered where the person to whom it is given can "retain it with a safe conscience", LORD MANSFIELD continued:

"Liability of this kind is hard to classify. Since it partly resembles liabilities under the law of tort and partly it resembles contract since it owed to only a party and not a person or individual generally. Therefore, it comes within the ambit of an implied contract or even natural justice and equity for the prevention of unjust enrichment."

Then came the theory of implied contracts which became very popular amongst the courts and the theory of Lord MANSFIELD were discarded quite often. In the case of Sinclair v. Broughamliabilities under the name of quasi-contract were taken which were against the law and not within its ambit.

So later on, it was decided that the doctrine was going against the law and hence the doctrine of unjust enrichment prevailed over this theory after the case of ***Fibrosa SpolkaAkeyjna v. Fairbairn Lawson combe Barbour Ltd.*** In this case remedies arising from such obligations neither constitute contract nor torts. They fall into category different form these two and that is 'quasi contract or restitution'. It was also observed that the precious theory was against public policy and ultra vires to the law.

The principle of unjust enrichment requires: first, that the defendant has been 'enriched' by the receipt of a "benefit"; secondly, that this enrichment is "at the expense of the plaintiff"; and thirdly, that the retention of the enrichment be unjust.

**Position In Indian Law**

**Chapter I of the Indian contract Act, 1872** deals with the "certain relations resembling to those created by contract". It incorporates those obligations which are known as "Quasi Contracts" under English law. 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 the unjust benefit at the cost of the other. If A gets unjust enrichment at the cost of B, A has an obligation to compensate B for the same. For instance, A and B jointly

owe 100 rupees to C. A alone pays the amount to C and B, not knowing this fact, pays 100 rupees over again to C. C is bound to repay the amount to B.

In an action for unjust enrichment, the following essentials have to be proved:

- The defendant has been "enriched" by the receipt of a "benefit".
- The enrichment is "at the expense of the plaintiff".
- The retention of the enrichment is "unjust".

Notes

**Similarities Between Quasi Contracts and Contracts**

The result of the contract and quasi-contract are similar to that of contracts. So far as the claim for damages are concerned they are very similar to that of contracts because **Section 73 of the Indian Contract Act, 1872** provides remedies for the breach of quasi-contracts as provided for the breach of express contracts in various sections of the Indian Contract Act, 1872. Remedies are available under quasi-contract under the Indian contract act, 1872.

**Distinction Between Quasi Contracts and Contracts**

A "quasi" or constructive contract is an implication of law. An "implied" contract is an implication of fact. In the former, the contract is a mere fiction, imposed in order to adapt the case to a given remedy. In the latter, the contract is a fact legitimately inferred. In one the intention is disregarded; in the other, it is ascertained and enforced. In one, the duty defines the contract; in the other, the contract defines the duty.

Any contract has two essential features i.e. agreement and obligation. Agreement arises when a party puts forwards a proposal and when that proposal is accepted by the other party. Obligation comes into the picture as law imposes it over the parties but is linked to the agreement between the parties. Therefore, a contract is a legally enforceable agreement.

Basically, contracts are express or implied by law. The former comes into the picture by the conduct or words or negotiations between the parties. The contract that implied by law is not a real contract. It would be unfair to term it a contract. It arises when law irrespective of agreement aims at meeting the ends of justice. A distinction is set forth in Keener on these types of contracts. The learned author says that :

He says that the quasi contracts basically contracts implied by law denote the nature of evidence established through which the plaintiff can claim but the obligation arises out by the law. Though the defendant would not intend to assume any obligation but the law will impose an obligation because to avoid undue advantage to him at the cost of the plaintiff.

It has been observed that these contracts and quasi contracts are the matter of practical importance. The concept revolves around the agreement and obligations between parties. The quasi-contracts differ from contracts that are generally expressed as they contain each term in words while in the latter, the terms come into existence by the conduct of the parties.

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In one case it appears to be a fiction and in the other appears to be a fact that is legitimately inferred. In one intention is discarded and in the other intention is ascertained and enforced. In one duty defines the contract while on the other hand contract defines the duty.

Quasi contracts are not entered by implied words but are operated on the basis of the conduct of the parties. It seems to be unfair that the law implying a promise on someone whose declarations disprove any intention but still this practice is in functioning.

The express contracts are approved by parties as a matter of law both sharing equal interests with equal consequences though the conditions are stated expressly while in the case of quasi contracts the law imposes obligations taking into view the conduct of the parties in order to prevent undue advantage to one party at the cost of another.

These types of contracts are those which are referred to distinguish in practice form obligation quasi ex contractu and to pay for benefits conferred. If the situation arises where a mistake is not to the doer when the benefit is incurred, the obligation is quasi contractual. The concept of such types of contracts has been in existence upon the principles of honesty, justice and fairness.

Basically, the most fundamental principle to make quasi contract come in existence is upon the principle of justice to ensure no one ought to have unjustly enrich himself at the expense of another. In **Mahabir Kishore v. State Of Madhya Pradesh**, the requirements of the principle of unjust enrichment were laid down by the Hon'ble Supreme Court as follows :

- The defendant has been 'enriched' by the receipt of a benefit.
- This enrichment is at the expense of the plaintiff
- And the retention of unjust of the enrichment is unjust.

| Contracts | Quasi Contracts |
|---|---|
| • A contract is a contract between two parties. In contract, always there is an agreement between the parties. | • A quasi-contract is not a real contract. Quasi contracts are also known as "constructive contracts" or "certain relations resembling those created by contracts". |
| • In contract, always there is an agreement between the parties. | • Where as in quasi-contract, there is no agreement between the parties. |
| • In contract, the parties must give their consent to it. | • In quasi-contract, the parties do not consent. |
| • In contract, the liability exists between the parties by the terms of the parties. | • In quasi-contract, the liability exists independent of the agreement and rests upon equity, justice and good conscience. |
| • It is created by the operation of the contract. | • It is imposed by law. It is not created by the operation of the contract. |

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| • It is right in rem, and also right in personam. | • It is right in personam. i.e. strictly available against a person and is not available against the entire world. |
| • Section 2(h) of the Indian contract act, 1872, defines contract: "an agreement enforceable by law is a contract". | • Salmond defines quasi contracts: "there are certain obligations which are not in truth contractual in the sense of resting on an agreement, but which the law treats as if they were". |
| • The word "contract" is divided from the Latin "contractum" which gives meaning "drawn together" or "consensus ad idem (identity of minds). Thus the meaning of "contract" is a drawing together of two or more minds to form a common intention giving rise to an agreement". | • Lord Mansfield explained that law as well as justice should try to prevent "unjust enrichment". I.e. enrichment of one person at the cost of another. He explains: "it is clear that any civilized system of law is bound to provide remedies for cases of what has been called unjust enrichment or unjust benefit, i.e. to prevent a man from retaining the money of, or some benefit derived from, another which it is against conscience that he should keep. Such remedies in contract or tort, and are now recognized to fall within a third category of the common law which has been termed as quasi-contract or restitution". |
| • Essentials :<br>• Free consent;<br>• The parties must be competent;<br>• There must be lawful consideration and lawful object;<br>• The agreement must not expressly be declared to be void; and<br>• If the law in force requires, it must be registered. | • Essentials :<br>• It is imposed by law. It is not created by contract;<br>• It is a right in personam;<br>• The person who incurs expenses is entitled to receive money (unjust enrichment); and<br>• It is raised by a legal fiction. |

## 1.3 CONTRACT OF INDEMNITY AND GUARANTEE

**"Contract of indemnity" defined :** A contract by which one party promises to save the other from loss caused to him by the contract of the

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promisor himself, or by the conduct of any other person, is called a "contract of indemnity". Illustration A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of 200 rupees. This is a contract of indemnity.

**Rights of indemnity-holder when sued :** The promise in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor :

1. all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
2. all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorized him to bring or defend the suit;
3. all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorized him to compromise the suit.

**"Contract of guarantee", "surety", "principal debtor" and "creditor" :** A "contract of guarantee" is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the "surety"; the person in respect of whose default the guarantee is given is called the "principal debtor", and the person to whom the guarantee is given is called the "creditor". A guarantee may be either oral or written.

**Consideration for guarantee :** Anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

**Illustrations :**

(a) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A"s promise to deliver the goods. This is a sufficient consideration for C"s promise.

(b) A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that, if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C"s promise.

(c) A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

**Surety's liability :** The liability of the surety is co- extensive with that of the principal debtor, unless it is otherwise provided by the contract.

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

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

**Illustrations :**

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

(b) A guarantees payment to B, a tea-dealer, to the amount of £ 100, for any tea he may from time to time supply to C. B supplies C with tea to above the value of £ 100, and C pays B for it. Afterwards, B supplies C with tea to the value of £ 200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of £ 100.

(c) A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does riot pay for. The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks.

**Revocation of continuing guarantee :** A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

**Illustrations :**

(a) A, in consideration of B"s discounting, at A"s request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 5,000 rupees. B discounts bills for C to the extent of 2,000 rupees. Afterwards, at the end of three months, A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 2,000 rupees, on default of C.

(b) A guarantees to B, to the extent of 10,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee.

**Revocation of continuing guarantee by surety's death :** The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.

**Liability of two persons, primarily liable, not affected by arrangement between them that one shall be surety on other's default :** Where two persons contract with a third person to undertake a certain liability, and also contract

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with each other that one of them shall be liable only on the default of the other, the third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence.

**Illustration :** A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

**Discharge of surety by variance in terms of contract :** Any variance, made without the surety"s consent, in the terms of the contract between the principal 1 [debtor] and the creditor, discharges the surety as to transactions subsequent to the variance.

**Illustrations :**

(a) A becomes surety to C for B"s conduct as a manager in C"s bank. Afterwards, B and C contract, without A"s consent, that B"s salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent, and

(b) A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the later Act.

(c) C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A"s becoming surety to C for B"s duly accounting for moneys received by him as such clerk. Afterwards, without A"s knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. A is not liable for subsequent misconduct of B.

(d) A gives to C a continuing guarantee to the extent of 3,000 rupees for any oil supplied by C to B on credit. Afterwards B becomes embarrassed, and, without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payments shall be applied to the then, existing debts between B and C. A is not liable on his guarantee for any goods supplied after this new arrangement.

(e) C contracts to lend B 5,000 rupees on the 1st March. A guarantees repayment. C pays the 5,000 rupees to B on the 1st January. A is discharged from his liability, as the contract has been varied, inasmuch as C might sue B for the money before the 1st of March.

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**Discharge of surety by release or discharge of principal debtor :** The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

**Illustrations :**

(a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.

(b) A contracts with B to grow a crop of indigo on A"s land and to deliver it to B at a fixed rate, and C guarantees A"s performance of this contract. B diverts a stream of water which is necessary for the irrigation of A"s land and thereby prevents him from raising the indigo. C is no longer liable on his guarantee.

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

**Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor :** A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract.

**Surety not discharged when agreement made with third person to give time to principal debtor :** Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged. Illustration C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B. A is not discharged.

**Creditor's forbearance to sue does not discharge surety :** Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provision in the guarantee to the contrary, discharge the surety. Illustration B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.

**Release of one co-surety does not discharge others :** Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other sureties.

**Discharge of surety by creditor's act or omission impairing surety's eventual remedy :** If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires

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him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

**Illustrations :**

(a) B contracts to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages. A becomes surety to C for B"s due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments. A is discharged by this prepayment.

(b) C lends money to B on the security of a joint and several promissory note made in C"s favour by B, and by A as surety for B, together with a bill of sale of B"s furniture, which gives power to C to sell the furniture, and apply the proceeds in discharge of the note. Subsequently, C sells the furniture, but, owing to his misconduct and wilful negligence, only a small price is realized. A is discharged from liability on the note.

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

**Rights of surety on payment or performance :** Where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.

**Surety's right to benefit of creditor's securities :** A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

**Illustrations :**

(a) C, advances to B, his tenant, 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 rupees by a mortgage of B"s furniture. C cancels the mortgage. B becomes insolvent and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

(b) C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B"s goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.

(c) A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

**Guarantee obtained by misrepresentation invalid :** Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.

**Guarantee obtained by concealment invalid :** Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid.

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**Illustrations :**

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

(b) A guarantees to C payment for iron to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

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

**Implied promise to indemnify surety :** In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety, and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully.

**Illustrations :**

(a) B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.

(b) C lends B a sum of money, and A, at the request of B, accepts a bill of exchange drawn by B upon A to secure the amount. C, the holder of the bill, demands payment of it from A, and, on A"s refusal to pay, sues him upon the bill. A, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from B the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.

(c) A guarantees to C, to the extent of 2,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,000 rupees, but obtains from A payment of the sum of 2,000 rupees in

respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

**Co-sureties liable to contribute equally :** Where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.

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**Illustrations :**

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

(b) A, B and C are sureties to D for the sum of 1,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one- quarter, and C to the extent of one-half. E makes default in payment. As between the sureties, A is liable to pay 250 rupees, B 250 rupees, and C 500 rupees.

**Liability of co-sureties bound in different sums :** Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

**Illustrations :**

(a) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of each 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 30,000 rupees. A, B and C are each liable to pay 10,000 rupees.

(b) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 40,000 rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees each.

(c) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond.

### 1.3.1 Laws of Agency

**Appointment and authority of agents**

**"Agent" and "principal" defined :** An "agent" is a person employed to do any act for another, or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the "principal".

**Who may employ agent :** Any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent.

**Who may be an agent :** As between the principal and third persons, any person may become an agent, but no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal according to the provisions in that behalf herein contained.

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**Consideration not necessary :** No consideration is necessary to create an agency.

**Agent's authority may be expressed or implied :** The authority of an agent may be expressed or implied .

**Definitions of express and implied authority :** An authority is said to be express when it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted circumstances of the case.

**Illustration :** A owns a shop in Seram pore, living himself in Calcutta, and visiting the shop occasionally. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A"s funds with A"s knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

**Extent of agent's authority :** An agent, having an authority to do an act, has authority to do every lawful thing which is necessary in order to do such act. An agent having an authority to carry on a business, has authority to do every lawful thing necessary for the purpose, or usually done in the course, of conducting such business..

**Illustrations :**

(a) A is employed by B, residing in London, to recover at Bombay a debt due to B. A may adopt any legal process necessary for the purpose of recovering the debt, and may give a valid discharge for the same.

(b) A constitutes B his agent to carry on his business of a shipbuilder. B may purchase timber and other materials, and hire workmen, for the purpose of carrying on the business.

**Agent's authority in an emergency :** An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

**Illustrations :**

(a) An agent for sale may have goods repaired if it be necessary.

(b) A consigns provisions to B at Calcutta, with directions to send them immediately to C, at Cuttack. B may sell the provisions at Calcutta, if they will not bear the journey to Cuttack without spoiling.

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## Sub-agents

**When agent cannot delegate :** An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally, unless by the ordinary custom of trade a sub-agent may, or, from the nature of the agency, a sub-agent must, be employed.

**"Sub-agent" defined :** A "sub-agent" is a person employed by, and acting under the control of, the original agent in the business of the agency.

**Representation of principal by sub-agent properly appointed :** Where a sub-agent is properly appointed, the principal is, so far as regards third persons, represented by the sub-agent, and is bound by and responsible for his acts, as if he were an agent originally appointed by the principal.

**Agent's responsibility for sub-agent :** The agent is responsible to the principal for the acts of the

**Sub-agent. Sub-agent's responsibility :** The sub-agent is responsible for his acts to the agent, but not to the principal, except in cases of fraud or wilful wrong.

**Agent's responsibility for sub-agent appointed without authority :** Where an agent, without having authority to do so, has appointed a person to act as a sub-agent, the agent stands towards such person in the relation of a principal to an agent, and is responsible for his acts both to the principal and to third persons; the principal is not represented, by or responsible for the acts of the person so employed, nor is that person responsible to the principal.

**Relation between principal and person duly appointed by agent to act in business of agency :** Where an agent, holding an express or implied authority to name another person to act for the principal in the business of the agency, has named another person accordingly, such person is not a sub-agent, but an agent of the principal for such part of the business of the agency as is entrusted to him.

**Illustrations :**

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

(b) A authorizes B, a merchant in Calcutta, to recover the moneys due to A from C & Co. B instructs D, a solicitor, to take legal proceedings against C & Co. for the recovery of the money. D is not a sub-agent, but is solicitor for A.

**Agent's duty in naming such person :** In selecting such agent for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and, if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected.

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**Illustrations :**

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

(b) A consigns goods to B, a merchant, for sale. B, in due course, employs an auctioneer in good credit to sell the goods of A, and allows the auctioneer to receive the proceeds of the sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds. Ratification

**Right of person as to acts done for him without his authority. Effect of ratification :** Where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratify them, the same effects will follow as if they had been performed by his authority.

**Ratification may be expressed or implied :** Ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done.

**Illustrations :**

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

(b) A, without B"s authority, lends B"s money to C. Afterwards B accepts interest on the money from C. B"s conduct implies a ratification of the loan.

**Knowledge requisite for valid ratification :** No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective.

**Effect of ratifying unauthorized act forming part of a transaction :** A person ratifying any unauthorized act done on his behalf ratifies the whole of the transaction of which such act formed a part.

**Ratification of unauthorized act cannot injure third person :** An act done by one person on behalf of another, without such other person"s authority, which, if done with authority, would have the effect of subjecting a third person to damages, or of terminating any right or interest of a third person, cannot, by ratification, be made to have such effect.

**Illustrations :**

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

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

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## Revocation of Authority

**Termination of agency :** An agency is terminated by the principal revoking his authority; or by the agent renouncing the business of the agency; or by the business of the agency being completed; or by either the principal or agent dying or becoming of unsound mind; or by the principal being adjudicated an insolvent under the provisions of any Act for the time being in force for the relief of insolvent debtors.

**Termination of agency where agent has an interest in subject-matter :** Where the agent has himself an interest in the property which forms the subject-matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

**Illustrations :**

(a) A gives authority to B to sell A"s land, and to pay himself, out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

(b) A consigns 1,000 bales of cotton to B, who has made advances to him on such cotton, and desires B to sell the cotton, and to repay himself out of the price, the amount of his own advances. A cannot revoke this authority, nor is it terminated by his insanity or death.

**When principal may revoke agent's authority :** The principal may, save as is otherwise provided by the last preceding section, revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal.

**Revocation where authority has been partly exercised :** The principal cannot revoke the authority given to his agent after the authority has been partly exercised, so far as regards such acts and obligations as arise from acts already done in the agency.

**Illustrations :**

(a) A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A"s moneys remaining in B"s hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B"s authority so far as regards payment for the cotton.

(b) A authorizes B to buy 1,000 bales of cotton on account of A, and to pay for it out of A"s moneys remaining in B"s hands. B buys 1,000 bales of cotton in A"s name, and so as not to render himself personally liable for the price. A can revoke B"s authority to pay for the cotton.

**Compensation for revocation by principal, or renunciation by agent :** Where there is an express or implied contract that the agency should be continued for any period of time, the principal must make compensation to the agent; or the agent to the principal, as the case may be, for any previous revocation or renunciation of the agency without sufficient cause.

**Notice of revocation or renunciation :** Reasonable notice must be given of such revocation or renunciation, otherwise the damage thereby resulting to the principal or the agent, as the case may be, must be made good to the one by the other.

**Revocation and renunciation may be expressed or implied :** Revocation and renunciation may be expressed or may be implied in the conduct of the principal or agent respectively. Illustration A empowers B to let A"s house. Afterwards A lets it himself. This is an implied revocation of B"s authority.

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**When termination of agent's authority takes effect as to agent, and as to third persons :** The termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them.

**Illustrations :**

(a) A directs B to sell goods for him, and agrees to give B five per cent. commission on the price fetched by the goods. A afterwards, by letter, revoke B"s authority. B, after the letter is sent, but before he receives it, sells the goods for 100 rupees. The sale is binding on A, and B is entitled to five rupees as his commission.

(b) A, at Madras, by letter, directs B to sell for him some cotton lying in a warehouse in Bombay, and afterwards, by letter, revokes his authority to sell, and directs B to send the cotton to Madras. B, after receiving the second letter, enters into a contract with C, who knows of the first letter, but not of the second, for the sale to him of the cotton. C pays B the money, with which B absconds. C"s payment is good as against A.

(c) A directs B, his agent, to pay certain money to C. A dies, and D takes out probate to his will. B, after A"s death, but before hearing of it, pays the money to C. The payment is good as against D, the executor.

**Agent's duty on termination of agency by principal's death or insanity :** When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him.

**Termination of sub-agent's authority :** The termination of the authority of an agent causes the termination (subject to the rules herein contained regarding the termination of an agent"s authority) of the authority of all sub-agents appointed by him.

**Agent's duty to principal**

**Agent's duty in conducting principal's business :** An agent is bound to conduct the business of his principal according to the directions given by the principal, or, in the absence of any such directions, according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, if any loss be sustained, he must make it good to his principal, and if any profit accrues, he must account for it.

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**Illustrations :**

(a) A, an agent engaged in carrying on for B a business, in which it is the custom to invest from time to time, at interest, the moneys which may be in hand, omits to make such investment. A must make good to B the interest usually obtained by such investments.

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

**Skill and diligence required from agent :** An agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business unless the principal has notice of his want of skill. The agent is always bound to act with reasonable diligence, and to use such skill as he possesses; and to make compensation to his principal in respect of the direct consequences of his own neglect, want of skill or misconduct, but not in respect of loss or damage which are indirectly or remotely caused by such neglect, want of skill, or misconduct.

**Illustrations :**

(a) A, a merchant in Calcutta, has an agent, B, in London, to whom a sum of money is paid on A"s account, with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money, becomes insolvent. B is liable for the money and interest from the day on which it ought to have been paid, according to the usual rate, and for any further direct loss-as, e.g., by variation of rate of exchange-but not further.

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

(c) A, an insurance-broker employed by B to effect an insurance on a ship, omits to see that the usual clauses are inserted in the policy. The ship is after wards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. A is bound to make good the loss to B.

(d) A, a merchant in England, directs B, his agent at Bombay, who accepts the agency, to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in England. Soon after her arrival the price of cotton rises. B is bound to make good to A the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

**Agent's accounts :** An agent is bound to render proper accounts to his principal on demand.

**Agent's duty to communicate with principal :** It is the duty of an agent, in cases of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions.

Notes

**Right of principal when agent deals, on his own account, in business of agency without principal's consent :** If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows, either that any material fact has been dishonestly concealed from him by the agent, or that the dealings of the agent have been disadvantageous to him.

**Illustrations :**

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

(b) A directs B to sell A's estate B, on looking over the estate before selling it, finds a mine on the estate which is unknown to A. B informs A that he wishes to buy the estate for himself, but conceals the discovery of the mine. A allows B to buy, in ignorance of the existence of the mine. A, on discovering that B knew of the mine at the time he bought the estate, may either repudiate or adopt the sale at his option.

**Principal's right to benefit gained by agent dealing on his own account in business of agency :** If an agent, without the knowledge of his principal, deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction.

**Illustration :** A directs B, his agent, to buy a certain house for him. B tells A it cannot be bought, and buys the house for himself. A may, on discovering that B has bought the house, compel him to sell it to A at the price he gave for it.

**Agent's right of retainer out of sums received on principal's account :** An agent may retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business, and also such remuneration as may be payable to him for acting as agent.

**Agent's duty to pay sums received for principal :** Subject to such deductions, the agent is bound to pay to his principal all sums received on his account.

**When agent's remuneration becomes due :** In the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act; but an agent may detain moneys received by him on account of goods sold, although the whole of the goods consigned to him for sale may not have been sold, or although the sale may not be actually complete.

Notes

**Agent not entitled to remuneration for business misconducted :** An agent who is guilty of misconduct in the business of the agency, is not entitled to any remuneration in respect of that part of the business which he has misconducted.

**Illustrations :**

(a) A employs B to recover, 1,00,000 rupees from C, and to lay it out on good security. B recovers the 1,00,000 rupees; and lays out 90,000 rupees on good security, but lays out 10,000 rupees on security which he ought to have known to be bad, whereby A loses 2,000 rupees. B is entitled to remuneration for recovering the 1,00,000 rupees and for investing the 90,000 rupees. He is not entitled to any remuneration for investing the 10,000 rupees, and he must make good the 2,000 rupees to B.

(b) A employs B to recover 1,000 rupees from C. Through B's misconduct the money is not recovered. B is entitled to no remuneration for his services, and must make good the loss.

**Agent's lien on principal's property :** In the absence of any contract to the contrary, an agent is entitled to retain goods, papers and other property, whether movable or immovable of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or accounted for to him.

**Principal's duty to agent**

**Agent to be indemnified against consequences of lawful acts :** The employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him.

**Illustrations :**

(a) B, at Singapur, under instructions from A of Calcutta, contracts with C to deliver certain goods to him. A does not send the goods to B, and C sues B for breach of contract. B informs A of the suit, and A authorizes him to defend the suit. B defends the suit, and is compelled to pay damages and costs, and incurs expenses. A is liable to B for such damages, costs and expenses.

(b) B, a broker at Calcutta, by the orders of A, a merchant there, contracts with C for the purchase of 10 casks of oil for A. Afterwards A refuses to receive the oil, and C sues B. B informs A, who repudiates the contract altogether. B defends, but unsuccessfully, and has to pay damages and costs and incurs expenses. A is liable to B for such damages, costs and expenses.

**Agent to be indemnified against consequences of acts done in good faith :** Where one person employs another to do an act, and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it cause an injury to the rights of third persons.

**Illustrations :**

(a) A, a decree-holder and entitled to execution of B"s goods, requires the officer of the Court to seize certain goods, representing them to be the goods of B. The officer seizes the goods, and is sued by C, the true owner of the goods. A is liable to indemnify the officer for the sum which he is compelled to pay to C, in consequence of obeying A"s directions.

(b) B, at the request of A, sells goods in the possession of A, but which A had no right to dispose of, B does not know this, and hands over the proceeds of the sale to A. Afterwards C, the true owner of the goods, sues B and recovers the value of the goods and costs. A is liable to indemnify B for what he has been compelled to pay to C, and for B"s own expenses.

**Non-liability of employer of agent to do a criminal act :** Where one person employs another to do an act which is criminal, the employer is not liable to the agent, either upon an express or an implied promise, to indemnify him against the consequences of that Act.

**Illustrations :**

(a) A employs B to beat C, and agrees to indemnify him against all consequences of the act. B thereupon beats C, and has to pay damages to C for so doing. A is not liable to indemnify B for those damages.

(b) B, the proprietor of a newspaper, publishes, at A"s request, a libel upon C in the paper, and A agrees to indemnify B against the consequences of the publication, and all costs and damages of any action in respect thereof. B is sued by C and has to pay damages, and also incurs expenses. A is not liable to B upon the indemnity.

**Compensation to agent for injury caused by principal's neglect :** The principal must make compensation to his agent in respect of injury2 caused to such agent by the principal"s neglect or want of skill.

**Illustration :** A employs B as a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskilfully put up, and B is in consequence hurt. A must make compensation to B. Effect of agency on contracts with third persons.

**Enforcement and consequences of agent's contracts :** Contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner, and will have the same legal consequences, as if the contracts had been entered into and the acts done by the principal in person.

**Illustrations :**

(a) A buys goods from B, knowing that he is an agent for their sale, but not knowing who is the principal. B"s principal is the person entitled to claim from A the price of the goods, and A cannot, in a suit by the principal, set-off against that claim a debt due to himself from B.

Notes

(b) A, being B"s agent with authority to receive money on his behalf, receives from C a sum of money due to B. C is discharged of his obligation to pay the sum in question to B.

**Principal how far bound, when agent exceeds authority :** When an agent does more than he is authorized to do, and when the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority is binding as between him and his principal.

**Illustration :** A, being owner of a ship and cargo, authorizes B to procure an insurance for 4,000 rupees on the ship. B procures a policy for 4,000 rupees on the ship, and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

**Principal not bound when excess of agent's authority is not separable :** Where an agent does more than he is authorized to do, and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound to recognize the transaction.

**Illustration :** A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for one sum of 6,000 rupees. A may repudiate the whole transaction.

**Consequences of notice given to agent :** Any notice given to or information obtained by the agent, provided it be given or obtained in the course of the business transacted by him for the principal, shall, as between the principal and third parties, have the same legal consequences as if it had been given to or obtained by the principal.

**Illustrations :**

(a) A is employed by B to buy from C certain goods, of which C is the apparent owner, and buys them accordingly. In the course of the treaty for the sale, A learns that the goods really belonged to D, but B is ignorant of that fact. B is not entitled to set-off a debt owing to him from C against the price of the goods.

(b) A is employed by B to buy from C goods of which C is the apparent owner. A was, before he was so employed, a servant of C, and then learnt that the goods really belonged to D, but B is ignorant of that fact. In spite of the knowledge of his agent, B may set-off against the price of the goods a debt owing to him from C.

**Agent cannot personally enforce, nor be bound by, contracts on behalf of principal :** In the absence of any contract to that effect, an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them.

**Presumption of contract to contrary : Such a contract shall be presumed to exist in the following cases :**

1. where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad;
2. where the agent does not disclose the name of his principal;
3. where the principal, though disclosed, cannot be sued.

Notes

**Rights of parties to a contract made by agent not disclosed :** If an agent makes a contract with a person who neither knows, nor has reason to suspect, that he is an agent, his principal may require the performance of the contract; but the other contracting party has, as against the principal, the same rights as he would have had as against the agent if the agent had been principal.

If the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract, if he can show that; if he had known who was the principal in the contract, or if he had known that the agent was not a principal, he would not have entered into the contract.

**Performance of contract with agent supposed to be principal :** Where one man makes a contract with another, neither knowing nor having reasonable ground to suspect that the other is an agent, the principal, if he requires the performance of the contract, can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

**Illustration :** A, who owes 500 rupees to B, sells 1,000 rupees worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set-off A"s debt.

**Right of person dealing with agent personally liable :** In cases where the agent is personally liable, a person dealing with him may hold either him or his principal, or both of them, liable. Illustration A enters into a contract with B to sell him 100 bales of cotton, and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both, for the price of the cotton.

**Consequence of inducing agent or principal to act on belief that principal or agent will be held exclusively liable :** When a person who has made a contract with an agent induces the agent to act upon the belief that the principal only will be held liable, or induces the principal to act upon the belief that the agent only will be held liable, he cannot afterwards hold liable the agent or principal respectively.

**Liability of pretended agent :** A person untruly representing himself to be the authorized agent of another, and thereby inducing a third person to deal with him as such agent, is liable, if his alleged employer does not ratify his acts, to make compensation to the other in respect of any loss or damage which he has incurred by so dealing.

**Person falsely contracting as agent not entitled to performance :** A person with whom a contract has been entered into in the character of agent, is not entitled to require the performance of it, if he was in reality acting, not as agent, but on his own account.

Notes

**Liability of principal inducing belief that agent's unauthorized acts were authorized :** When an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority.

**Illustrations :**

(a) A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price. A is bound by the contract.

(b) A entrusts B with negotiable instruments endorsed in blank. B sells them to C in violation of private orders from A.

**The sale is good**

**Effect, on agreement, of misrepresentation of fraud, by agent :** Misrepresentation made, or frauds committed, by agents acting in the course of their business for their principals, have the same effect on agreements made by such agents as if such misrepresentations or frauds had been made or committed by the principals; but misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals.

**Illustrations :**

(a) A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.

(b) A, the captain of B's ship, signs bills of lading without having received on board the goods mentioned therein. The bills of lading are void as between B and the pretended cosignor.

### 1.3.2 Bailment

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

**Explanation :** If a person already in possession of the goods of another contracts to hold them as a bailee, he thereby becomes the bailee, and the owner becomes the bailor of such goods, although they may not have been delivered by way of bailment.

**Delivery to bailee how made :** The delivery to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorized to hold them on his behalf.

Notes

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

**Illustrations :**

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

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

**Care to be taken by bailee :** In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

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

**Termination of bailment by bailee's act inconsistent with conditions :** A contract of bailment is avoidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment.

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

**Liability of bailee making unauthorized use of goods bailed :** If the bailee makes any use of the goods bailed which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them.

**Illustrations :**

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

(b) A hires a horse in Calcutta from B expressly to march to Benares. A rides with clue care, but marches to Cuttack instead. The horse accidentally falls and is injured. A is liable to make compensation to B for the injury to the horse.

**Effect of mixture, with bailor's consent, of his goods with bailee's :** If the bailee, with the consent of the bailor, mixes the goods of the bailor with his

Notes

own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced.

**Effect of mixture, without bailor's consent, when the goods can be separated :** If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expense of separation or division, and any damage arising from the mixture.

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

**Effect of mixture, without bailor's consent, when the goods cannot be separated :** If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods, and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

**Illustration :** A bails a barrel of Cape flour worth Rs. 45 to B. B, without A"s consent, mixes the flour with country flour of his own, worth only Rs. 25 a barrel. B must compensate A for the loss of his flour. 158. Repayment, by bailor, of necessary expenses. Where, by the conditions of the bailment, the goods are to be kept or to be carried, or to have work done upon them by the bailee for the bailor, and the bailee is to receive no remuneration, the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of the bailment.

**Restoration of goods lent gratuitously :** The lender of a thing for use may at any time require its return, if the loan was gratuitous, even though he lent it for a specified time or purpose. But if, on the faith of such loan made for a specified time or purpose, the borrower has acted in such a manner that the return of the thing lent before the time agreed upon would cause him loss exceeding the benefit actually derived by him from the loan, the lender must, if he compels the return, indemnify the borrower for the amount in which the loss so occasioned exceeds the benefit so derived. 160. Return of goods bailed, on expiration of time or accomplishment of purpose. It is the duty of the bailee to return, or deliver according to the bailor"s directions, the goods bailed, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished.

**Bailee's responsibility when goods are not duly returned :** If, by the default of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time.

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

**Bailor entitled to increase or profit from goods bailed :** In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

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

Notes

**Bailor's responsibility to bailee :** The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods, or to give directions respecting them.

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

**Bailee not responsible on re-delivery to bailor without title :** If the bailor has no title to the goods, and the bailee, in good faith, delivers them back to, or according to the directions of, the bailor, the bailee is not responsible to the owner in respect of such delivery.

**Right of third person claiming goods bailed :** If a person, other than the bailor, claims goods bailed he may apply to the Court to stop the delivery of the goods to the bailor, and to decide the title to the goods.

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

**When finder of thing commonly on sale may sell it :** When a thing which is commonly the subject of sale is lost, if the owner cannot with reasonable diligence be found, or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it : (1) when the thing is in danger of perishing or of losing the greater part of its value, or, (2) when the lawful charges of the finder, in respect of the thing found, amount to two-thirds of its value.

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

**Illustrations :**

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

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

Notes

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

**Bailments of Pledges. "Pledge" "pawnor", and "pawnee" defined :** The bailment of goods as security for payment of a debt or performance of a promise is called "pledge". The bailor is in this case called the "pawnor". The bailee is called the "pawnee".

**Pawnee's right of retainer :** The pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest of the debt, and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged.

**Pawnee not to retain for debt or promise other than that for which goods pledged. Presumption in case of subsequent advances :** The pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged; but such contract, in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the pawnee.

**Pawnee's right as to extraordinary expenses incurred :** The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged.

**Pawnee's right where pawnor makes default :** If the pawnor makes default in payment of the debt, or performance, at the stipulated time of the promise, in respect of which the goods were pledged; the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledge as a collateral security; or he may sell the thing pledged, on giving the pawnor reasonable notice of the sale. If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor.

**Defaulting pawner's right to redeem :** If a time is stipulated for the payment of the debt, of performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them ; but he must, in that case, pay, in addition, any expenses which have arisen from his default.

**Pledge by mercantile agent :** Where a mercantile agent is, with the consent of the owner, in possession of goods or the document of title to goods,

any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has not authority to pledge.

Notes

**Explanation :** In this section, the expressions "mercantile agent" and "documents of title" shall have the meanings assigned to them in the Indian Sale of Goods Act, 1930 (3 of 1930).

**Pledge by person in possession under voidable contract :** When the pawnor has obtained possession of the goods pledged by him under a contract voidable under section 19 or section 19A, but the contract has not been rescinded at the time of the pledge, the pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pawnor's defect of title.

**Pledge where pawnor has only a limited interest :** Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest. Suits by bailees or bailors against wrong-doers.

**Suit by bailor or bailee against wrong-doer :** If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.

**Apportionment of relief or compensation obtained by such suits :** Whatever is obtained by way of relief or compensation in any such suit shall, as between the bailor and the bailee, be dealt with according to their respective interests.

## 1.4 SUMMARY

They are various forms of contracts such as contract of indemnity, contract of guarantee, agency etc. The contract act illustrateselements that need to be fulfilled for a valid contract along with exception and after wards it deals with the sections that illustrates the remedies for both parties in case the contract has been breached or has been considered to be void in case of any of the elements not being fulfilled. It is very important for a normal day to day trading and regular dealing to have a valid and effective contract and it need to be made affective under the Contract act.

The Indian Contract act doesn't specifically mention the different types of offers, but as ours is a common law country, we develop law from the decisions held by Indian and British courts. As an offer is the first step in the formulation of a contract, it is essential to distinguish what type of offer has been made by the offeror, as different types of offers have different types of legal rules being applied to them. It is also imperative to distinguish an offer and an invitation to offer, to avoid unwanted transactions.

Notes

Contracts have become an indispensable part of everyday life of the people so much so that most of the people enter into a contract without even realizing it. There are many essentials which are required for making a valid contract. After the formation of a valid contract, the ultimate object which is stipulated by both the parties in terms of consideration are sought after. Once the object for which the contract was entered into is achieved the parties to the contract as no longer bound by their respective contractual liability.

## 1.5 EXERCISE

1. What is Contract ? State the essential elements a valid contract ?
2. State the type of contract ?
3. Define an acceptance state the theory of Anson. Also explain the essential of a valid acceptance.
4. How can an offer lapse ? State the ways of lapse of an offer ?
5. What is Quasi contract and Bailment ?

# UNIT 2: THE SALE OF GOODS ACT 1930

**Structure:**



Notes

## 2.0 OBJECTIVES

After reading this Unit. you will be able to:

- explain the sale of goods act 1930;
- discuss the sale and agreement to sell;
- understand the conditions and warranties;
- analysis the transfer of property in goods;
- describe the unpaid seller and his rights.

## 2.1 INTRODUCTION

The law relating to the sale of goods or movables in India is contained in the Sale of Goods Act, 1930. Before the passing of the present act, the law relating to the sale of goods was contained in Chapter VII of the Indian Contract Act, 1872. The provisions of Chapter VII were found to be unsatisfactory and the present Act was passed with the main object of making the provisions more clear. The act came into force on 1st July, 1930. It contains 66 Sections and extends to the whole of India except the State of Jammu and Kashmir.

The Sale of Goods Act, 1930, is based mainly on the English Act and incorporates many of its provisions excepting those which were not suited to the needs of this country. Though the law relating to the sale of goods is contained in this separate enactment many of the general principles embodied in the Indian Contract Act still continue to be applicable to contracts of sale of goods.

Like any other contract, the contract of sale is the result of offer and acceptance by two different parties. The parties to the contract enjoy unfettered discretion to agree to any terms they like relating to delivery and payment of price. The Sale of Goods Act does not restrict or limit this discretion of the parties to the contract. It lays down certain positive rules and principles which may be applied in those cases where the parties have failed to contemplate expressly for

a contingency which may interrupt the performance of the contract of sale such as insolvency of the buyer or the destruction of the subject matter of the contract of sale.

## 2.2 THE SALE OF GOODS ACT 1930

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### 2.2.1 Meaning of Contract of Sale

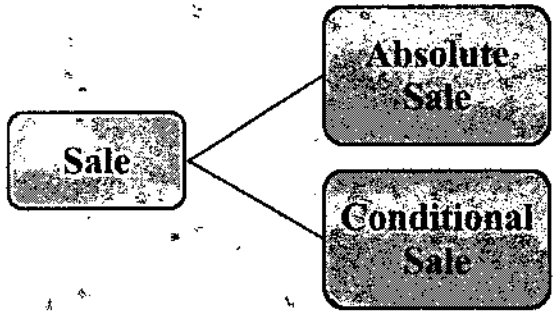
According to Section 4(1), a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. A contract of sale may be absolute or conditional. In an absolute sale, the property in the goods passes from the seller to the buyer immediately and nothing remains to be done by the seller. Sale on a counter in a shop is an absolute sale. In a conditional contract of sale, the property in the goods does not pass to the buyer absolutely until a certain condition is fulfilled. The term 'contract of sale' is a general term and comprises of :

1. Sale; and
2. Agreement to sell

Where the seller transfer the property in the goods immediately to the buyer there is a sale. But where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.

### 2.2.2 Sale and Agreement to Sell

**Definition of Sale :** A sale is a type of contract in which the seller transfers the ownership of goods to the buyer for a money consideration. Here the relationship amidst the seller and buyer is of creditor and debtor. It is the result of an agreement to sell when the conditions are fulfilled and the specified time is over.




**Types of Sale**

The following are the essential conditions regarding Sale :

1. There must be at least two parties; one is the buyer, and other is the seller.
2. The subject matter of the sale is the goods.
3. Payment should be made in the country's legal currency.
4. The goods should pass from seller to buyer.

5. All the necessary conditions of a valid contract should be present like free consent, consideration, a lawful object, capacity of parties, etc.

If the goods are being sold and the property is transferred to the buyer, but the seller is not paid. Then, the seller can go to the court and file a suit against the buyer for the damages and the price too. On the other hand, if the goods are not delivered to the buyer then he can also sue the seller for damages.

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**Definition of Agreement to Sell :** An agreement to sell is also a contract of sale of goods, in which the seller agrees to transfer goods to the buyer for a price at a later date or after the fulfilment of a condition.

When there is a willingness of the both the parties to constitute a sale i.e. the buyer agrees to buy, and the seller is ready to sell the goods for monetary value. In an agreement to sell the performance of the contract is done at a future date, i.e. when the time elapses or when the necessary conditions are satisfied. After the contract is executed, it becomes a valid sale. All the necessary conditions required at the time of sale should exist in the case of an agreement to sell too.

If the seller rescinds the contract, then the buyer can claim damages for the breach of contract. On the other hand, the unpaid seller can also sue the buyer for damages.

**When agreement to sell becomes sale ?**

An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred. Every sale originates in an agreement to sell. It is an agreement of sale which gives birth to a sale. On a sale, the agreement of sale is completely exhausted and ceases to exist.

**Essentials of A Contract of Sale**

To constitute a valid contract of sale, the following essentials must be present. A brief explanation of the various essentials is as follows :

**1. Contract :** The word contract means an agreement enforceable by law. It resumes free consent on the part of the parties who should be competent to contract. Thus, a compulsory transfer of goods under a Nationalisation Act is not a sale. The agreement must be made for a lawful consideration and with a lawful object. In other words all the essential elements of a valid contract must also be present in a contract of sale.

**2. Two parties :** To constitute a contract of sale, there must be a transfer or agreement to transfer the property in goods by the seller to the buyer. It means that there must be two persons, one the seller and the other the buyer. The seller and the buyer must be two different persons, for a man cannot purchase his own goods. The parties must be competent to contract.

**Examples :**

(a) A partnership firm was dissolved and the surplus assets including some goods were divided among the partners in specie. Tax officer wanted to tax this as a sale. The Court held that it was not a sale as the partners

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were themselves joint owners of the goods and they could not be both sellers and buyers. Moreover no money consideration was passed.

(b) A club supplies food and drinks to its members at fixed price. This was held not to be a sale as a member of the club pays to the members jointly (i.e. the club) Members of a club are undivided joint owners and not part owners.

There are certain exceptions to the rule that the same person cannot be both a purchaser and a seller. These are :

(a) Where a person's goods are sold in execution of a decree, he may himself buy them.

(b) A part owner can sell his share to the other part-owner so as to make the other part-owner the sole owner of the goods.

(c) Where a pawnee sells the goods pledged with him on non-payment of bill money, the pawnor may himself buy such goods.

(d) A partner may also buy the goods from the firm in which he is a partner and vice versa.

(e) In case there is sale by auction the seller may reserve right of making a bid at the auction and may thus purchase his own goods.

**3. Transfer the property :** In a contract of sale, there should be a transfer or agreement to transfer the absolute or general property in the goods sold or agreed to be sold. It contemplates the transfer of the ownership in the goods. Though passing of the title in the goods is an essential ingredient of sale, physical delivery of goods is not essential. The Sale of Goods Act contemplates the transfer of general property in goods from the seller to the buyer.

**4. Goods :** The subject-matter of the contract of sale must be the goods, the property in which is to be transferred from the seller to the buyer. Goods of any kind except immovable goods may be transferred. It does not include money and other actionable claims. The seller must be the owner of the goods the ownership of which is sought to be transferred. A debt is not goods because it can only be assigned as per Transfer of Property Act but cannot be sold.

**Example :** According to a contract between the hotel and resident customers the hotel made a consolidated charge for residents, services and supply of food. No rebate was allowed if food was not taken. On a question being raised whether the supply of food amounted to sale it was held that it was simply a provision of service as the transaction was an indivisible contract of multiple services and did not involve any sale of food.

**5. Price :** To constitute a valid contract of sale, consideration for transfer must be money paid or promised. Where there is no money consideration the transaction is not a contract of sale, as for instance goods given in exchange for goods or as remuneration for work or labour. However, an existing debt due from the seller to the buyer is sufficient. Further, there is nothing to prevent the consideration from being partly in money and partly in goods or some other articles of value. For example, when an old car is returned to the dealer for a new one and the difference is paid in cash, that would also be a sale.

It may be noted that no particular form is necessary to constitute a contract of sale. A contract of sale may be made in writing or by word of mouth or may be implied from the conduct of the parties.

**Distinction Between Sale and Agreement To Sell**

The distinction between sale and an agreement to sell is very necessary to determine the rights and the liabilities of the contract. The main points of distinction are :

**1. Nature of contract :** An agreement to sell is an executory contract, is a contract pure and simple and no property passes; where as a sale is an executed contract plus a conveyance.

**2. Transfer of property :** In a sale the property in the goods passes from the seller to the buyer at the time the contract is made. But in an agreement to sell, the transfer of property takes place at some future time or until some condition is fulfilled. In other words in a sale the buyer becomes the owner of the goods immediately at the time of making the contract. In an agreement to sell the seller continues to be the owner until the agreement to sell becomes a sale.

**3. Risk of loss :** In a sale, the buyer immediately becomes the owner of the goods and the risk as a rule passes to the buyer; under an agreement to sell, the seller remains the owner and the risk is with him. Thus under a sale, if the goods are destroyed the loss falls on the buyer, even though the goods are in the possession of the seller. But, under an agreement to sell, the loss will fall on the seller in the case of destruction of goods even though they are in the possession of the buyer.

**4. Consequences of the breach :** On breach of an agreement to sell by the seller, the buyer has only a personal remedy against the seller. But if after a sale the seller breaks the contract (e.g., resell the goods) the buyer may sue for delivery of the goods or for damages.

In an agreement to sell, if the buyer fails to accept the goods the seller may sue for damages only and not for the price. On a sale, if the buyer does not pay the price, the seller may sue him for the price.

**5. Insolvency of the buyer :** In a sale, if the buyer is adjudged an insolvent, the seller in the absence of a lien over the goods is bound to deliver the goods to the Official Receiver of assignee. The seller will, however, be entitled to a rateable dividend for the price of the goods. In an agreement to sell, when the buyer becomes insolvent before he pays for the goods, the seller may not part with the goods.

**6. Insolvency of the seller :** In a sale, if the seller becomes insolvent, the buyer is entitled to recover the goods from the Official Receiver or assignee as the property of the goods is with the buyer. In an agreement to sell, if the buyer has already paid the price and the seller becomes insolvent, the buyer can claim only a rateable dividend and not the goods.

**7. General and particular property :** An agreement to sell creates a right in personam while a sale creates a right in rem. In case of an agreement

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to sell the buyer and seller get remedy against each other in case of breach of an agreement. The agreement of sale creates a right with which only the contracting parties are concerned and not the whole world, whereas in case of sale, the buyer gets an absolute right of ownership and this right of the buyer is recognized by the whole world.

**8. Right of re-sale :** In an agreement to sell, the property in the goods remains with the seller and he can dispose of the goods as he likes, although he may thereby commit a breach of his contract. In a sale, the property is with the buyer and as such the seller cannot resell the goods. If he does so, the buyer can recover the goods sometimes even from third party.

**Sale Distinguished From Other Transactions**

**1.** Sale and bailment Bailment is the delivery of goods by one person to another for some purpose upon a condition that they shall, when the purpose is accomplished, be returned to the person delivering them where of the essence of sale is that the property in goods is transferred from the seller to the buyer for a price. The following are the main points of difference between the two :

| Sale | Bailment |
|---|---|
| In a sale, the property in the goods is transferred from the seller to the buyer and the buyer can therefore deal with the goods in any way he likes. | In a bailment, there is only transfer of possession of goods from the bailor to the bailee for any of the reasons like safe custody, carriage, use etc. and the bailee can only deal with the goods according to the directions of the bailor. |
| Goods once sold normally cannot be returned unless there is a breach of some condition. | In bailment the baliee must return the goods to the bailor on the accomplishment of the purpose for which the bailment was made. |
| In a sale the consideration is the price in terms of money. | In a bailment the consideration is an undertaking to return the goods after the accomplishment of purpose. |

**2. Sale and gift :** Where goods are transferred by one person to another person without any price or consideration, the transaction is called a gift and not a sale. Sale is always for a consideration.

**3. Sale and barter or exchange :** Where the consideration for transfer of property in goods from one person to another consists of delivery of other goods, the contract is not a contract of sale but is a contract of exchange or barter. The exchange of one form of money into another, as of currency notes into rupees is not a sale. But where property in the goods is transferred from the seller to the buyer against a price it is called a sale. Where, however, the consideration for a transfer consists partly of the delivery of the goods and partly of the payment of money, the contract may be held to be one of sale.

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**4. Sale distinguished from :** Hire Purchase Contracts of sale resemble contracts of hire purchase very closely, and indeed the real object of a contract of hire purchase is the sale of the goods ultimately. Nonetheless a sale has to be distinguished from a hire purchase as their legal incidents are quite different. Under hire purchase agreement the goods are delivered to the hire purchaser for his use at the time of the agreement but the owner of the goods agrees to transfer the property in the goods to the hire purchaser only when a certain fixed number of instalments of price are paid by the hirer. Till that time, the hirer remains the bailee and the instalments paid by him are regarded as the hire-charges for the use of the goods. If there is a default by the hire purchaser in paying an instalment, the owner has a right to resume the possession of the goods immediately without refunding the amount received till then, because the ownership still rests with him. Thus, the essence of hire-purchase agreement is that there is no agreement to buy, but there is only a bailment of the goods coupled with an option to purchase them which may or may not be exercised.

It may be noted that mere payment of price by instalments under an agreement does not necessarily make it a hire-purchase, but it may be a sale. For example, in the case of "Instalment Purchase Method," there is a 'sale,' because in this case the buyer is bound to buy with no option to return and the property in goods passes to the buyer at once. The main points of distinction between the 'sale and 'hire-purchase' are as follows :

1. In a sale, property in the goods is transferred to the buyer immediately at the time of contract, whereas in hire-purchase the property in the goods passes to the hirer upon payment of the last instalment.
2. In a sale the position of the buyer is that of the owner of the goods but in hire purchase the position of the hirer is that of a bailee till he pays the last instalment.
3. In the case of a sale, the buyer cannot terminate the contract and is bound to pay the price of the goods. On the other hand, in the case of hire-purchase the hirer may, if he so likes, terminate the contract by returning the goods to its owner without any liability to pay the remaining instalments.
4. In the case of a sale, the seller takes the risk of any loss resulting from the insolvency of the buyer. In the case of hire-purchase, the owner takes no such risk, for if the hirer fails to pay an instalment the owner has the right to take back the goods.
5. In the case of a sale, the buyer can pass a good title to a bonafide purchaser from him but in a hire-purchase, the hirer cannot pass any title even to a bonafide purchaser.
6. In a sale, sales tax is levied at the time of the contract whereas in a hire-purchase sales tax is not leviable until it eventually ripens into a sale.

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**5. Hire-purchase and an agreement to sell :** A contract of hire purchase may also be distinguished from "an agreement to sell" (or "an agreement to buy" from buyer's point of view). As already observed, a hirepurchase agreement initially is merely an irrevocable offer for sale, that is, under it the owner is bound to sell the goods later if the hirer pays all the instalments as agreed, but on the part of the hire purchaser there is an option to buy or to return the goods and hirer cannot be compelled to buy. 'An agreement to buy', on the other hand, imports a legal obligation to buy and therefore there is no option available to the buyer to buy or to terminate the contract in this case. Again, in a hire-purchase agreement, delivery of goods to the hire-purchaser is necessary whereas it is not so in an 'agreement to sell.'

**6. Sale distinguished from contract for work and labour :** A distinction has to be make between a contract of sale and a contract for work and labour mainly because of taxation purpose. Sales tax is levied only in the case of a contract of sale. When property in the goods is intended to be transferred and goods are ultimately to be delivered to the buyer, it is a contract of sale even though some labour on the part of the seller of the goods may be necessary. Where, however, the essence of the contract is rendering of service and exercise of skill and no goods are delivered as such, it is a contract of work and labour and not of sale. In fact, the difference between the two is very minute.

**Examples :**

(a) A dentist agreed to make a set of false teeth for a lady and fit it into her mouth. Held it is a contract for the sale of goods.

(b) An order for making and fixing curtains in a house is a contract of sale of goods, though it involves some work and labour in fixing the same.

(c) G engaged an artist to paint a portrait and supplied the necessary canvas and paint. Held, it is a contract for work and labour as the substance of the contract is the application of the skill and labour in the production of the portrait. If the canvas and paint are also to be supplied by the painter, it will become a contract of sale of goods.

(d) A contract to take and supply photographs has been held to be a contract of sale of goods

**7. Sale and mortgage :** A mortgage differs from a contract of sale in the following respects :

(a) In a sale, there is a transfer of the whole interest of the seller in the goods, but in the case of a mortgage there is a transfer of a limited interest.

(b) In a sale the buyer becomes the absolute owner of the goods sold, but in a mortgage the ownership of the goods remains vested in the mortgagor.

(c) The consideration in the case of sale is the price while the consideration in a mortgage is the advance of the loan and the securing of the debt.

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**Goods :** The subject matter of the contract of sale must be 'goods'. According to Section 2(7), "goods means every kind of movable property other than actionable 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 served before sale or under the contract of sale."

Thus every kind of movable property except actionable claim and money is regarded as 'goods'. Goodwill, trade marks, copyrights, patents right, water, gas, electricity, decree of a court of law, are all regarded as goods. Shares and stock are also included in goods. With regard to growing crops, grass and things attached to or forming part of the land, such things are regarded as goods as soon as they are agreed to be separated from the land. Thus where trees were sold so that they could be cut out and separated from the land and then taken away by the buyer, it was held that there was a contract for sale of movable property or goods . But contracts for sale of things 'forming part of the land itself' are not contracts for sale of goods. For example, a contract for the sale of coal mine or building stone quarry is not a contract of sale goods.

'Actionable claims' means claims which can be enforced by a legal action or a suit, e.g., a book debt. A book debt is to goods because it can only be assigned as per the Transfer of Property Act but cannot be sold. Similarly, a bill of exchange or a promissory not represents a debt, i.e., an actionable claim and implies the right of the creditor to recover its amount from the debtor. But since these can be transferred under Negotiable Instruments Act by mere delivery or indorsement and delivery, such instruments cannot be sold. 'Money' means current money. It is not regarded goods because it is the medium of exchange through which goods can be bought. Old and rare coins, however, may be treated as goods and sold as such.

It may be mentioned that sale of immovable property is governed by the Transfer of Property Act, 1882. Kinds of Goods 'Goods' form the subject mater of a contract of sale. We have already seen the meaning of the term 'goods' as per Section 2(7).

Goods may be classified into the following types :

1. Existing goods;
2. Future goods; and
3. Contingent goods.

**1. Existing goods :** Goods which are physically in existence and which are in seller's ownership and/or possession, at the time of entering the contract of sale are called 'existing goods' Where seller is the owner, he has the general property in them. Where seller is in possession, say, as an agent or a pledgee, he has a right to sell them. Existing goods may again be either 'specific' or 'unascertained.'

**(a) Specific goods :** Goods identified and agreed upon at the time of the making of the contract of sale are called 'specific goods' [Sec. 2(14)]. It may be noted that in actual practice the term 'ascertained goods' is used in the same

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sense as 'specific goods.' For example, where A agrees to sell to B a particular radio bearing a distinctive number, there is a contract of sale of specific or ascertained goods.

**(b) Unascertained goods :** The goods which are not separately identified or ascertained at the time of the making of the contract are known as 'unascertained goods.' They are indicated or defined only by description. For example, if A agrees to sell to B one bag of sugar out of the lot of one hundred bags lying in his godown, it is a sale of unascertained goods because it is not known which bag is to be delivered. As soon as a particular bag is separated from the lot for delivery, it becomes ascertained or specific goods. The distinction between 'specific' or 'ascertained' and 'unascertained' goods is important in connection with the rules regarding 'transfer of property' from the seller to the buyer.

**2. Future goods :** Goods to be manufactured, produced or acquired by the seller after the making of the contract of sale are called 'future goods' [Sec. 2(6)]. These goods may be either not yet in existence or be in existence but not yet acquired by the seller. It is worth noting that there can be no present sale of future goods because property cannot pass in what is not owned by the seller at the time of the contract. So even if the parties purport to effect a present sale of future goods, in law it operates only as an 'agreement to sell' [Sec. 6(3)]

**Examples :**

(a) A agrees to sell to B all the milk that his cow may yield during the coming year. This is a contract for the sale of future goods.

(b) X agrees to sell to Y all the mangoes which will be produced in his garden next year. It is contract of sale of future goods, amounting to 'an agreement to sell.'

**3. Contingent goods :** Goods, the acquisition of which by the seller depends upon an uncertain contingency are called 'contingent goods' [Sec. 6(2)].

Obviously they are a type of future goods and therefore a contract for the sale of contingent goods also operates as 'an agreement to sell' and not a 'sale' so far as the question of passing of property to the buyer is concerned. In other words, like the future goods, in the case of contingent goods also the property does not pass to the buyer at the time of making the contract. It is important to note that a contract of sale of contingent goods is enforceable only if the event on the happening of which the performance of the contract is dependent happens, otherwise the contract becomes void.

**Examples :**

(a) A agrees to sell to B a specific rare painting provided he is able to purchase it from its present owner. This is a contract for the sale of contingent goods.

(b) X agrees to sell to Y 25 bales of Egyptian cotton, provided the ship which is bringing them reaches the port safely. It is a contract for the sale of contingent goods. If the ship is sunk, the contract becomes void and the seller is not liable.

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**Effect of Perishing of Goods :** Section 7 and 8 deal with the effect of perishing of goods on the rights and obligations of the parties to a contract of sale. Under these Sections the word 'perishing' means not only physical destruction of the goods but it also covers :

(a) damage to goods so that the goods have ceased to exist in the commercial sense, i.e., their merchantable character as such has been lost (although they are not physically destroyed), e.g., where cement is spoiled by water and becomes almost stone or where sugar becomes sharbat and thus are unsaleable as cement or sugar;

(b) loss of goods by theft (Barrow Ltd. vs. Phillips Ltd.);

(c) where the goods have been lawfully requisitioned by the government.

It may also be mentioned that it is only the perishing of specific and ascertained goods that affects a contract of sale. Where, therefore, unascertained goods form the subject-matter of a contract of sale, their perishing does not affect the contract and the seller is bound to supply the goods from wherever he likes, otherwise be liable for breach of contract.

Thus where A agrees to sell to B ten bales of Egyptian cotton out of 100 bales lying in his godown and the bales in the godown are completely destroyed by fire, the contract does not become void. A must supply ten bales of cotton after purchasing them from the market or pay damages for the breach. The effect of perishing of goods maybe discussed under the following heads :

1. Perishing of goods at or before making of the contract (Sec. 7). This may again be divided into the following sub-heads :

**(i)** In case of perishing of the 'whole' of the goods. Where specific goods from the subject-matter of a contract of sale (both actual sale and agreement to sell), and they, without the knowledge of the seller, perish, at or before the time of the contract, the contract is void. This provision is based either on the ground of mutual mistake as to a matter of fact essential to the agreement, or on the ground of impossibility of performance, both of which render an agreement void ab-initio.

**Examples :**

(a) A sold to B a specific cargo of goods supposed to on its way from England to Bombay. It turned out, however, that before the day of the bargain, the ship conveying the cargo had been cast away and the goods were lost. Neither party was aware of the fact. The agreement was held to be void.

(b) A agrees to sell to 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.

**(ii) In case of perishing of only 'a part' of the goods.** Where in a contract for the sale of specific goods, only part of the goods are destroyed or damaged, the effect of perishing will depend upon whether the contract is entire or divisible. If

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it is entire (i.e., indivisible) and part only of the goods has perished, the contract is void. If the contract is divisible, it will not be void and the part available in good condition must be accepted by the buyer.

**Example :** There was a contract for the sale of a parcel containing 700 bags of Chinese groundnuts of different qualities. Unknown to the seller 109 bags had been stolen at the time of the contract. The seller delivered the remaining 591 bags and, on the buyer's refusal to take them, brought an action for the price. It was held that the contract, being indivisible, had become void by reason of the loss of the goods and the buyer was not bound to take delivery of 591 bags or pay for the goods (Barrow Ltd. vs. Philips Ltd.). (Note that had there been all bags of the same weight and quality for certain price per bag, the contract would have been divisible and the buyer could only have avoided the contract as to those goods which had actually perished).

**2. Perishing of goods before sale but after agreement to sell (Sec. 8) :** Where there is an agreement to sell specific goods, and subsequently the goods, without any fault on the part of the seller or buyer, perish before the risk passes to the buyer, the agreement is thereby avoided, i.e., the contract of sale becomes void and both parties are excused from performance of the contract. This provision is based on the ground of supervening impossibility of performance which makes a contract void. Notice that under Section 7 the agreement is void ab-initio while under this Section the contract becomes void later.

If only part of the goods agreed to be sold perish, the contract becomes void if it is indivisible. But if it is divisible then the parties are absolved from their obligations only to the extent of the perishing of the goods (i.e., the contract remains valid as regards the part available in good condition)

It must further be noted that if fault of either party causes the destruction of the good, then the party in default is liable for non-delivery or to pay for the goods, as the case may be (Sec. 26). Again, if the risk has passed to the buyer, he must pay for the goods though undelivered (unless otherwise agreed... risk prima facie passes with the property (Sec. 26).

**Examples :**

(a) A buyer took a horse on a trial for 8 days on condition that if found suitable for his purpose the bargain would become absolute. The horse died on the 3rd day without any fault of either party. Held, the contract, which was in the form of an agreement to sell, becomes void and the seller should bear the loss (Elphick vs. Barnes).

(b) A, had contracted to erect machinery on M's premises, the price was to be paid on completion. During the course of the work, there was a fire which completely destroyed the premises and the machinery. It was held that both parties were excused from further performance and A was not entitled to any payment as the price was payable on the completion of entire work (Appleby vs. Myers).

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**Effect of perishing of future goods :** As observed earlier, a present sale of future goods always operates as an agreement to sell [Sec. 6(3)].

As such there arises a question as to whether Section 8 applies to a contract of sale of future goods (amounting to an agreement to sell) as well? The answer is found in the leading case of Howell vs. Coupland, where it has been held that future goods, if sufficiently identified, are to be treated as specific goods, the destruction of which makes the contract void. The facts of the cases are as follows :

**Example :** C agreed to sell to H 200 tons of potatoes to be grown on C's land. C sowed sufficient land to grow the required quantity of potatoes, but without any fault on his part, a disease attacked the crop and he could deliver only about ten tons. The contract was held to have become void.

**The Price :** The money consideration for a sale of goods is known as 'price' [Sec. 2(10)]. We have already seen that the price is an essential element in every contract of sale of goods, that is, no valid sale can take place without a price. The price should be paid or promised to be paid in legal tender money, unless otherwise agreed. It may be paid in the form of a cheque, hundi, bank deposit etc. For, it is not the mode of payment of a price but the agreement to pay a price in money that is requisite to constitute a valid contract of sale.

**Modes of fixing the price :** According to Section 9 the price may be fixed by one or the other of the following modes :

**1. It may be expressly fixed by the contract itself :** This is the most usual mode of fixing the price. The parties are free to fix any price they like and the court will not question as to the adequacy of price. But the sum should be definite. Where an alternative price is fixed, the agreement is void ab-initio as it involves an element of wager (Bourke vs. Short).

**2. It may be fixed in accordance with an agreed manner provided by the contract :** For example, it may be agreed that the buyer would pay the market price prevailing on a particular date, or that the price is to be fixed by a third party (i.e., valuer) appointed by the consent of the parties.

But in the following cases where the agreement of the parties as to price is uncertain, price is deemed as 'not capable of being fixed' and hence the agreement is void ab-initio for uncertainty :

(a) if the price is agreed to be whatever sum the seller be offered by any third party or

(b) if the price is left to be fixed by one of the contracting parties, expressly. Remember that if no price is fixed then the contract is not void for uncertainty because in that case law usually allows market price prevailing on the date of supply of goods as the price bargained for.

**3. It may be determined by the course of dealings between the parties :** For example, if the buyer has been previously paying to a particular seller the

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price prevailing on the date of placing the order, the course of dealings suggest that in subsequent transactions also the price as on the date of order will be paid.

**4. If the price is not capable of being determined in accordance with any of the above modes, the buyer is bound to pay to the seller a 'reasonable price':** What is a reasonable price is a question of fact dependent on the circumstances of each particular case. Ordinarily, the market price of the goods prevailing on the date of supply is taken as reasonable price.

**Agreement to sell at valuation (Sec. 10) :** Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party and such third party fails to fix the price (either because he cannot value or because he does not want to value), the contract becomes void, except as to part of goods delivered and accepted, if any, under the contract, as regards which the buyer is bound to pay a reasonable price. If, however, any one of the two parties, namely, the seller or the buyer, prevents the third party from making the valuation, the innocent party may maintain a suit for damages against the party in fault. Notice that although in this case also the contract becomes void, yet the party at fault is bound to compensate the other party for the actual loss suffered by him because of the act of prevention.

It is to be remembered that unless otherwise agreed, payment of the price and delivery of the goods are concurrent conditions (Sec.32). Again, Section 64-A, which provides for "Escalation Clause," is important. As per Section 64-A, unless otherwise agreed, where, after making of the contract and fixing the price but before the delivery of the goods a new or increased custom or excise duty or sale or purchase tax is imposed and the seller has to pay it, the seller is entitled to add the same to the price. Conversely, if the rate of duty or tax is lowered, the buyer would be entitled to a reduction in price.

**Earnest or Deposit :** Money deposited with seller by the buyer as security for due fulfillment of the contract is called 'earnest' or 'deposit'. Where the contract is carried through, earnest money counts as part payment and only the balance of the price is required to be paid. But if the contract goes off because of the fault of the buyer, the seller is entitled to forfeit it and where it falls through because of the default of the seller, the buyer is entitled to recover the earnest money in addition to damages for breach. If on the breach of the agreement by the buyer, the seller sues him for the breach, the earnest, although forfeited, is to be taken into account as diminishing the amount of damages.

**Stipulations as to Time :** Stipulations as to time in a contract of sale fall under the following two heads :

1. Stipulation relating to time of delivery of goods.
2. Stipulation relating to time of payment of the price.

As regards the time fixed for the delivery of goods, time is usually held 'to be of the essence of the contract.' Thus if time is fixed for the delivery of goods and the seller makes a delay, the contract is voidable at the option of the buyer. In case of late delivery, therefore, the buyer may refuse to accept the delivery and may put an end to the contract.

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As regards the time fixed for the payment of the price, the general rule is that 'time is not deemed to be of the essence of the contract,' unless a different intention appears from the terms of the contract (Sec. 11). Thus even if the price is not paid as agreed, the seller cannot avoid the contract on that account. He has to deliver the good if the buyer tenders the price within reasonable time before resale of the goods. The seller may, however, claim compensation for the loss occasioned to him by the buyer's failure to pay on the appointed day.

Document of Title to Goods Any document which is used in the ordinary course of business as proof of the possession or control of goods, or authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented is a document of title to goods [Sec.2(4).

Thus a document of title is a proof of the ownership of the goods. It authorizes its holder to receive goods mentioned therein or to further transfer such right to another person by proper endorsement or delivery. A document of title to goods contains an undertaking on the part of the issuing authority to deliver the goods to the holder thereof unconditionally.

Although such a document can be transferred by mere delivery o by endorsement, yet it is regarded as 'quasi negotiable instrument' because the title of the transferee will not be superior to that of the transferor in the case of transfer of such document. Bill of lading, dock-warrant, warehouse keeper's certificate, wharfinger's certificate, railway receipt, delivery order, etc. are popular examples of the documents of title to goods.

### 2.2.3 Conditions and Warranties

The contract of sale of goods is a special type of contract and has a huge application in the business world. These contracts are governed by the Sale of Goods Act 1930, which was earlier part of the Indian Contract Act, 1872. Because of the wide use of the contract of sale of goods, a special enactment was necessary but despite the separate legislation, the law has its root in the Indian Contract Act, 1872. Both the laws are complementary to each other thus, the basic provisions of the Indian Contract Act are applicable to the contracts of sale.

Whenever we buy any goods like electronic gadgets etc, we are concerned about the warranty periods. We ask the seller about the warranty to make sure that even if the product is found to be faulty after purchase, we can easily get the product replaced or repaired. The terms "Condition" and "Warranty" are set out in the contract of sale in order to determine remedies the parties can claim in case of the breach by either of the parties. Here in this article, we will see the manner how these terms are defined, their differences and their legality in the light of Sale of Goods Act, 1930.

- **Definition :** Certain provisions need to be fulfilled as demanded in the contract of sale or any other contract. The condition is a fundamental precondition on the basis of which the whole contract is based upon, on the other hand,

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warranty is the written guarantee wherein the seller commits to repair or replace the product in case of any fault in the product. Section 11 to 17 of the Sale of Goods Act enlightens the provisions relating to Conditions and Warranties.

Section 12 of the Act draws a demarcation between a condition and a warranty. The determination of condition or warranty depends upon the interpretation of the stipulation. The interpretation should be based on its function rather than the form of the word used.

• **Condition :** In the context of the Sale of Goods Act, 1930, a condition is a foundation of the entire contract and integral part for performing the contract. The breach of the conditions gives the right to the aggrieved party to treat the contract as repudiated. In other words, if the seller fails to fulfil a condition, the buyer has the option to repudiate the contract or refuse to accept the goods. If the buyer has already paid, he can recover the prices and also claim the damages for the breach of the contract.

For example, Sohan wants to purchase a horse from Ravi, which can run at a speed of 50 km per hour. Ravi shows a horse and says that this horse is well suited for you. Sohan buys the horse. Later on, he finds that the horse can run only at a speed of 30 km/hour. This is the breach of condition as the requirement of the buyer is not fulfilled. The conditions can be further classified as follows.

• **Kinds of conditions :**

**1. Expressed Condition :** The dictionary meaning of the term is defined as a statement in a legal agreement that says something must be done or exist in the contract. The conditions which are imperative to the functioning of the contract and are inserted into the contract at the will of both the parties are said to be expressed conditions.

**2. Implied Condition :** There are several implied conditions which are assumed by the parties in different kinds of contracts of sale. Say for example the assumption during sale by description or sale by sample. Implied conditions are described in Section 14 to 17 of the Sale of Goods Act, 1930. Unless otherwise agreed, these implied conditions are assumed by the parties as if it is incorporated in the contract itself. Let's study these conditions briefly :

**Implied condition as to title :** In every contract of sale, the basic yet essential implied conditions on the part of the seller are that

1. Firstly, he has the title to sell the goods.
2. Secondly, in case of an agreement to sell, he will have the right to sell the goods at the time of performing the contract.

Consequently, if the seller has no title to sell the given goods, the buyer may refuse or reject those goods. He is also entitled to recover the full price paid by him.

In Rowland v. Divall (1923), the party bought a second-hand motor car from the former and paid for the same. After six months, he was deprived of it as the seller had no title to sell the car. It was held that the aggrieved party is entitled to recover the money.

**Implied condition as to the description Moving to Section 15 of the Act :** In the contract of sale, there is an implied condition that the goods should be in conformity with the description. The buyer has the option to either accept or reject the goods which do not conform with the description of the good. Say for example: Where Ram buys a new car which he thinks to be new from "B" and the car is not new. Ram' can reject the car.

Referring to Section 16(2) of the given Act, goods must be of merchantable quality. In other words, the goods are of such quality that would be accepted by a reasonable person. For eg: A purchased sugar sack from B which was damaged by ants. The condition of merchantability is broken here and it is unfit for use. It must be noted from this section that the buyer has the right to examine the goods before accepting it. But a mere opportunity without an actual examination would not suffice to deprive the buyer of his rights. If, however, the examination does not reveal the defect but within a reasonable time period the goods are found to be defective, He may repudiate the contract even if he approves the goods.

The implied conditions especially in case of eatables must be wholesome and sound and reasonably fit for the purpose for which they are purchased. For eg: Amit purchases milk that contains typhoid germs and because of its consumption he dies. His wife can claim damages.

**Implied condition as to sale by sample :** In the light of Section 17 of the Act, in a contract of sale by sample, there may be following implied conditions :

1. That the actual products would correspond with the sample with respect to the quality, size, colour etc.
2. That the buyer gets a reasonable opportunity to compare the goods with the sample.
3. Further, the goods are free from any defect rendering them unmerchantable.

For example, A company sold certain shoes made of a special kind of sole by sample sale for the French Army. Later when the bulk was delivered it was found that they were not made from the same sole. The buyer was entitled to the refund of the price and damages.

**Implied condition as to Sale by sample as well as a description :** Referring to Section 15 of the Sale of Goods Act, 1930, in a sale by sample as well as description, the goods supplied must be in accordance with both the sample as well as the description. In Nichol v. Godis (1854), there was a sale of foreign refined rape-oil. The delivered oil was the same as the sample but it was having a mixture of other oil too. It was held in this case that the seller was liable to refund the amount paid.

• **Warranty :** Warranty is the additional stipulation and a written guarantee that is collateral to the main purpose of the contract. The effect of a breach of a warranty is that the aggrieved party cannot repudiate the whole contract however, can claim for the damages. Unlike in the case of breach of condition, in the breach of warranty, the buyer cannot treat the goods as repudiated.

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• **Kinds of Warranty :** Expressed Warranty The warranties which are generally agreed by both the parties and are inserted in the contract, it is said to be expressed warranties. 1. Implied Warranty Implied warranties are those warranties which the parties assumed to have been incorporated in the contract of sale despite the fact that the parties have not specifically included them in the contract. Subject to the contract, the following are the implied warranties in the contract of sale :

• **Warranty as to undisturbed possession :** Section 14(2) of the given Act provides that there is an implied warranty that the buyer shall enjoy the uninterrupted possession of goods. As a matter of fact, if the buyer having got possession of the goods, is later disturbed at any point, he can sue the seller for the breach of warranty.

For e.g. 'X' purchased a second-hand bike from 'Y'. Unknown to the fact that the bike was a stolen one, he used the bike. Later, he was compelled to return the same. X is entitled to sue Y for the breach of warranty.

• **Warranty as to freedom from Encumbrances :** In Section 14(3), there is an implied warranty that the goods shall be free from any charge or encumbrances that are in favour of any third party not known to the buyer. But if it is proved that the buyer is known to the fact at the time of entering into the contract, he will not be entitled to any claim. For e.g. A pledges his goods with C for a loan of Rs. 20000 and promises him to give the possession. Later on, A sells those goods to B. B is entitled to claim the damages if he suffers any.

• Implied warranty to disclose Dangerous nature of the goods sold If the goods sold are inherently dangerous or likely to be dangerous and the buyer is not aware of the fact, it is the duty of the seller to warn the buyer for the probable danger. If there would be a breach of this warranty, the seller will be liable. For eg: A purchases a horse from B if the horse is violent and then It is the duty of the seller to inform A about the probable danger. While riding the horse, A was inflicted with serious injuries. A is entitled to claim damages from B.

• **Difference between Condition and Warranty**

| **Basis for Comparison** | **Condition** | **Warranty** |
|---|---|---|
| **Meaning** | It is a stipulation which forms the very basis of the contract. | It is additional stipulation complementary to the main purpose of the contract. |
| **Provision** | Section 12(2) of the Sale of Goods Act, 1930 defines Condition. | Section 12(3) of the Sale of Goods Act, 1930 defines Condition. |
| **Purpose** | Condition is basic for the formulation of the contract. | It is a written guarantee for assuring the party. |

| | | |
|---|---|---|
| **Result of Breach of Contract** | The whole contract may be treated as repudiated. | Only damages can be claimed in case of a breach. |
| **Remedies available to the aggrieved party** | Repudiation, as well as damages, can be claimed. | Only damages can be claimed. |

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**• When does Condition sink to the level of Warranty ?**

Section 13 of the Act specifies the cases wherein a breach of Condition sink to the level of breach of Warranty. In the first two following points, it depends upon the will of the buyer, but the last one is compulsory and acts as estoppel against him :

1. When the buyer waives the condition, the condition is considered a warranty.
2. A condition would sink to the level of warranty where the buyer on his own will treat the breach of condition as a breach of warranty.
3. Wherein the contract is indivisible and the buyer has accepted the whole or part of goods; the condition is treated as a warranty.

Consequently, the contract cannot be repudiated. However, the damages can be claimed.

**Rule of Caveat Emptor (S.16-17) :** The rule of caveat emptor which means "let the buyer beware" has been overridden by the rule of caveat venditor. Such change was required because of changing conditions of modern trade and commerce. The phrase caveat emptor is not used by the judges very often nowadays. This doctrine is based on the principle that when a buyer is satisfied as to the product's suitability, then he is left with no subsequent right to reject such product. The caveat emptor rule originated many years ago in common law and over the times has undergone major changes. The exceptions of the doctrine started expanding with time as it was being given a concrete shape.

**Statement of Caveat emptor :** The principle of Caveat emptor is explained in Section 16 of the Sale of Goods Act 1930 which states that there is no implied condition or warranty as to quality or fitness for any particular purpose of goods supplied."

**The History of Caveat emptor :** In the 19th century, the attitude of common law towards the buyer can be understood by the maxim Caveat emptor which means let the buyer beware. This maxim explains that a purchaser must carefully examine and judge what is best for him. The purchaser should not take the risk of the condition and quality of the object which he needs to buy, he must protect himself by a warranty. The philosophy behind the rule of Caveat emptor basically was that buyer shall apply his own skill and judgment before buying. It is based on the fundamental principle that when a buyer is satisfied with the suitability of the product for his use, no subsequent right will be left with him to reject the same. When the rule of caveat emptor originated, it was quite rigid and there was no scope for any subsequent change in the rule.

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In English Sale of Goods Act, 1893, it is highly noticeable and evident that the seller's duties as to requirements of disclosure when a product is sold was minimal. There was no duty upon the seller to provide information and proper examination of the goods by the buyer was considered over and above any other duty. The Concepts which could be used to shift the burden as to quality and fitness on the seller such as 'fitness of goods' and 'merchantability', were not encouraged. Another strong statement which was present in Section 11(1)(c) in the said Act, which mandated that the buyer could not reject the goods on any ground in cases where there was sale of 'specific' goods. Thus, it is highly noticeable that the law was bent towards the seller and in those times, one could not even find a corresponding rule which would put the burden on the seller.

**The Fallacy & The Need for Change :** At the time of its origin the rule of Caveat emptor prevailed in its absolute form but it was later categorised as detrimental to the development of commerce and trade. Rule of Caveat emptor in its absolute form was highly detrimental to the buyer because of the absence of the element of reasonable examination. Therefore, a buyer would have no recourse against the seller who is aware of the latent defect but did not aware the buyer about the same and the buyer cannot detect that defect (as it cannot be detected by reasonable examination).

Another strong reason for the fallacy of the rule of Caveat emptor, is the need for providing protection to the buyer who purchases the goods in good faith, that is, where the buyer purchases goods from the seller by relying on his skill and judgment. Thus, the rule was subsequently diluted so as to give proper recognition to the relationship between the seller and the buyer and in order to give rise to a scenario wherein commercial transactions are encouraged.

**How it changed to Caveat venditor ?**

For the aforementioned reasons, the rule of Caveat emptor for the first time suffered backlash in the case of Priest v. Last, wherein reliance was placed on the buyer relying on seller's skill and judgment and the buyer was allowed to reject the goods for the first time. In this case the buyer purchased a hot water bottle relying on the seller's skill and judgment. It was observed that if a buyer purchases an object relying on the seller's skill and judgment then the buyer will be allowed to reject the same on the occurrence of any defect. This was the first ever decision in common law in which importance was given to the buyer's reliance on the seller's judgment and skill.

Gradually this rule gained prominence and the seller's obligations have been given a proper shape along various case laws and statutes limiting the rule of Caveat emptor to 'reasonable examination'. In cases like milk containing typhoid germs, contaminated beer, the Courts have been generous enough to establish that where the defects would not have been traced by reasonable examination in ordinary circumstances, the buyer will be exempted from this duty.

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Further, in Harlingdon& Leinster Enterprises Ltd v. Christopher Hull Fine Art Ltd, the buyer claimed that he had the right to reject the painting as it was not of the original painter. So, it was observed that where the buyer has more expertise in a given field and is more reasonable than the seller then it would be completely wrong to suggest that the buyer would have the right to reject the purchased object. Therefore, the seller is bound by the duty to make known to the buyer all the defects in the goods and the information relating to the usage of goods. This obligation of the seller is irrespective of his own judgment and skill because what matters is what he is expected to have and not what he has.

**Judicial Trends :** In Ward v. Hobbes (1878) 4 AC 13, the House of Lords held that if a seller uses artifice or disguise to conceal the defects in the product which is to be sold, it would amount to fraud on the buyer; still no duty to disclose the defects in the product is imposed on the seller by the doctrine of caveat emptor. An obligation to use care and skill while purchasing goods is imposed on the buyer by the doctrine of Caveat emptor.

The Court of Appeal Wallis v. Russel (1902) 2 IR 585, explained the scope of caveat emptor and laid down that the rule of Caveat emptor implies that "the buyer must take care". It applies to the purchase of those things upon which buyer can exercise his own skill and judgment, e.g. a picture, book, etc (also known as specific goods); it also applies in the cases where by usage or by a term of contract it is implied that the buyer shall not rely on the skill and judgment of the seller.

**Exceptions to The Rule of Caveat emptor (Section 16 of The Sale of Goods Act, 1930)**

- **Fitness for buyers' purpose [Section 16(1)] :** Section 16(1) of the said Act provides that in situations where the seller is aware either expressly or by necessary implication of the purpose for which a buyer needs to purchase a specific product, further, the goods are of such description which the seller supply in his ordinary course of business and by relying upon the judgment and skill of the seller, the buyer purchases that product, then the goods should be in accordance with the purpose. In other words, this section explains the circumstances where the seller has an obligation to supply the goods to the buyer as per the purpose for which he intends to buy the goods. Requirements of Section 16(1) are as follows :
  - The buyer should explain the particular purpose for which he is making the purchase to the seller.
  - The buyer should rely on the seller's skill and judgment while making a purchase.
  - The goods must be of a description which the seller in his ordinary course of business supply.

In Shital Kumar Saini v. Satvir Singh, a compressor was purchased by the petitioner with oneyear warranty. The defect in the product appeared within three months. The petitioner sought a replacement. The seller replaced it but did

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not provide any further warranty. The State Commission stated that an implied warranty was guaranteed under section 16 of the Sale of Goods Act, 1930 and allowed it to be rejected.

• **Sale under Trade Name [Proviso to S. 16(1)]:** In some cases, a buyer purchases goods not by relying on the skill and judgment of the seller but by relying on the product's trade name. In such cases, it would be unfair that the seller is burdened with the responsibility of quality. The proviso to Section 16 deals with such cases. It provides that :

"Provided that, there is no implied condition as to fitness for any particular purpose in the case of a contract for the sale of a specified product under its patent or other trade names.

• **Merchantable quality [Section 16(2)] :** The second most important exception to the rule of Caveat emptor is incorporated by Section 16(2) of the Act. The Section imposes a duty upon the dealer to deliver the goods of merchantable quality.

Section 16(2) states that there is an implied condition that when goods are purchased by description from a seller who deals in the goods of that description, the goods shall be of merchantable quality.

**Meaning of Merchantable Quality :** It implies that when the goods are purchased for resale, the goods must be capable enough of passing in the market under the name by which they are sold.

**Merchantable quality depends on the following two factors :** Marketability- Merchantability does not mean that the goods are saleable just because the goods look all right, but they shall be marketable at their full value. "Merchantability does not mean that the goods are saleable even if it has defects which makes it unfit for its proper use but is not noticeable on ordinary examination.

**Reasonable fitness for general purposes :** "Merchantable quality" means, that if goods are purchased for self-use, they must be fit for the purpose for which they are generally used.

**Example :** A person bought a hot-water bottle which is generally used for the application of heat. The bottle burst to scald the person's wife. The seller was held to be liable.

• **Examination by buyer [Proviso to S. 16(2)] :** The proviso to S. 16(2) provides that "if upon examination of the goods to be purchased, the defects ought to have been revealed, then no implied condition as regards to the defect will exist." The requirement provided in the proviso would be considered as satisfied fully when the buyer was given full opportunity to examine the goods and the argument that the buyer did not use that opportunity will not make any difference, an existence of opportunity is sufficient in such cases.

• **Conditions implied by trade usage [Sec. 16(3)] :** Section 16(3) gives statutory force to the conditions implied by the usage of a particular trade. It states :

"An implied condition or warranty as to the quality or fitness for any particular purpose may be annexed by the usage of trade."

In the case of Peter Darlington Partners Ltd v Gosho Co Ltd, a contract for the sale of canary seeds was subjected to the custom of trade and held that if there exist any impurities in the seeds the buyer will get a rebate on the price but he would not reject the goods. However, a custom which is unreasonable will not affect the parties' contract. Thus, it can be concluded from the aforementioned analysis that the rule of Caveat emptor is being taken over by the rule of Caveat venditor and is dying a slow death.

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The change is taking place in order to create a more consumer-oriented market wherein transactions of commercial nature will be encouraged. Such change will help to create a more consumer-friendly market and an appropriate balance can be maintained between the rights and obligations of the buyer and the seller. But it should be noted that if this approach is taken too far, it might end up in becoming extremely pro buyer and then some people might end up misusing the protection under the law.

### 2.2.4 Transfer of Property in Goods

The term passing of goods or property means that there is a transfer of ownership which is governed by the principles of the Sale of Goods Act, 1930. In order to understand the rights, duties and liabilities of both the seller and the buyer it is very important to understand the concept of passing of property. It is a settled principle of law that along with the ownership of the goods or property, the risk is also transferred from the seller to the buyer. This article will be dealing with the various principles and provisions pertaining to Passing of property in the light of the Sale of Goods Act, 1930.

**Types of Goods under the Act :** There are three types of goods under the umbrella of the Sale of Goods Act, 1930 and they are as follows :

1. Existing Goods
2. Future Goods
3. Contingent Goods

**Existing Goods :** As per Section 6 of the Sale of Goods Act, 1930, those goods which are present (in existence) at the time of formation of a contract are known as existing goods. The existing goods can be further classified as :

**Specific Goods :** As per Section 2(14) of the Sale of Goods Act, 1930, specific goods are those goods which are specifically identified and ascertained by the buyer which he intends to buy at the time when the contract of sale is formulated.

For example, Deepak wants to sell his old guitar. He put an advertisement in the local newspaper with its picture, make and other details. Rahul agrees to buy the guitar and thereby formed a contract with Deepak. The guitar is a 'Specific Good' in this case.

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**Ascertained Good :** Ascertained goods are not defined under the Sale of Goods Act, 1930 and many jurists have considered specific Goods and ascertained Goods as alike. However, ascertained goods can be called those goods which are specifically selected from a large set of goods.

For example, Deepak went to buy oranges in a wholesale market. He specifically selected 300 oranges from a larger set of unspecified oranges. These 300 oranges will be ascertained goods.

**Unascertained Good :** Unascertained goods are those goods which are not specifically identified by the buyer at the time when the contract for sale is formulated.

For example, Deepak from his 300 oranges wants to sell 100 oranges; however, he doesn't specify which oranges he wants to sell. This is called a sale of unascertained goods.

**Future Goods :** As per Section 2(6) of the Sale of Goods Act, 1930, future goods have been characterised as those goods which at the time of formation of the contract will either be "manufactured, produced or acquired by the buyer". There will not be an actual sale in the sale of future goods, it will always be an "agreement to sell".

For example, Deepak has an orange grove with oranges in it. He agrees to sell 500 oranges to a buyer once the oranges are ready for market. This is a sale which will happen in the future. However, the goods have already been identified along with the agreement to sell. Such goods are known as future goods.

**Contingent Goods :** Contingent goods are a subtype of future goods. In contingent goods, the sale happens in the future. The sale will always come with some contingency clause in it. For example, if Deepak sells his oranges from his orange grove when the trees are yet to produce oranges, then the oranges are contingent good. This sale of contingent goods will be dependent on a condition that the trees will produce oranges, which may or may not happen.

• **Legal Principles regarding Transfer of Goods :** There are four principles regarding the transfer of goods under the umbrella of The Sale of Goods Act, 1930, which the article will be talking about and they're as follows:

**Transfer of property in sale of Specific or Ascertained Goods :** Section 19 to section 22 of The Sale of Goods Act, 1930 are a few sections which govern the transfer of goods in a case where the goods are specific and ascertained in nature :

**Property when intended to pass (Section 19) :** Section 19 of The Sale of Goods Act, 1930, is divided into further subsections and they're as follows :

1. Where a contract for sale of ascertained or specific goods exists, a specified time is fixed as per the convenience and consensus of both the parties at which the property is intended to be transferred from the seller to the buyer.

2. One has to pay attention to the circumstances and conduct of both the parties to the contract in order to understand the true intention of the contracting parties. Also, the terms of the contract should be given equal importance in the existing case.
3. Except if an alternate intention shows up, the principles laid under the Section 20 to 24 of the Act will help in finding out the intention of the contracting parties in respect with the time at which the goods are about to get transferred from the seller to the buyer.

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**Specific goods in a Deliverable state (Section 20) :** Section 20 of The Sale of Goods Act, 1930 relates to specific goods in a deliverable state, and it states :

In a contract for the sale of specific goods, which is unconditional in nature, the goods are transferred from the seller to the buyer at the time of formation of the contract. However, the only precondition required for the transfer of property is the fact that the goods must be existing in a deliverable state. The delay in the payment or delivery of goods or both is not something which holds importance.

**Example :** A goes to a big electronic shop in order to buy a television set. He selects a big plasma Television set and asks the shopkeeper to deliver the television at his house which is at the other end of the town. The shopkeeper agrees to it. With this, "A" will become the owner of the television, and the Television set will become his property.

**Specific goods to be put into a deliverable state (Section 21) :** Section 21 of The Sale of Goods Act, 1930: certain goods to be put in a deliverable state :

Where there is an existence of a contract for the sale of specific goods, the property concerned in the transaction will only be passed to the buyer, if the seller performs the necessary acts and omissions in order to put the goods in a deliverable state. Also, it is mandatory for the seller to notify the buyer regarding the alterations.

**Example :** A goes to a mall to buy a smart television from an electronics store. He selects a big fancy smart TV from the electronic section and asks for its home delivery. The manager agrees to deliver it to A's home. However, at the time where he selects the smart TV, it doesn't have an operating system installed. The manager promises to install the operating system and on the next day, he informs "A" that his smart TV is now installed with the operating system and is ready for its delivery. Further, he asked for his permission to make the delivery.

In order to summarize the example, the goods will only be transferred to "A" if the manager has installed the operating system making the smart TV ready for its use.

Specific goods are in a deliverable state but the seller has to do something to ascertain the price (Section 22)

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**Section 22 of The Sale of Goods Act, 1930: Specific goods are in a deliverable state but the seller has to do something to ascertain the price :**

Where there is a contract for the sale of specific goods in a deliverable state, the seller is undoubtedly bound to weigh, measure, test or do the necessary demonstration or anything which is required in reference with the sale of those particular goods. He'll be doing this to ascertain the appropriate value of the goods. The property in the goods will not pass until such demonstration or particulars are done and the buyer has acknowledged it thereof.

**Example :** Rishabh sells a wooden bed to Deepak and agrees to assemble it in Deepak's bedroom as it was a part of the agreement. Rishabh delivers the wooden bed and makes a call to him informing Deepak that he will assemble the wooden bed the next day. That night the wooden bed gets stolen from Deepak's premises. In this case, Deepak will not be liable for the loss since the wooden bed was not passed to him. According to the terms of the contract, the wooden bed would be in a deliverable state only after it is assembled.

**Transfer of property in sale of Unascertained Goods :** Section 23 of The Sale of Goods Act, 1930 govern the transfer of goods in a case where the goods are unascertained in nature :

- **Sale of unascertained goods and appropriation (Section 23) :** Section 23 of The Sale of Goods Act, 1930, is divided into further subsections and they're as follows: Section 23(1) Sale of unascertained goods by description: In a contract, for the sale of unascertained goods by description, if goods of a specific description are appropriated either by the seller with the consent of buyer or by the buyer with the consent of the seller, then the goods are passed to the buyer. The consent can be expressed or implied and can be given before or after the appropriation is made.

**Section 23(2) Delivery to the carrier :** The seller has unconditionally appropriated the property if he delivers the property to the buyer/ carrier/ bailee for the reason of transmission to the buyer, however, he doesn't reserve the disposal rights to the property, then it can be said that he has appropriated the contract.

**Goods sent on"sale or return" :** When goods are disposed on the basis of "sale or return" by the seller, the ownership of the goods aren't transferred to the buyer unless the buyer gives assent to the goods. However, if these goods are held by its buyer without giving an approval then they're taken as goods whose ownership is yet to be transferred. In that case, they're treated as goods which belong to the seller and not the buyer.

**Goods sent on approval or "on sale or return" (Section 24) Section 24 :** In a case where the goods are delivered to the buyer either on approval or on "sale or return" or on other comparable terms then :

(a) The goods therein will only pass to the buyer if the buyer either portrays his consent or acknowledges to the seller or does any act by which the transaction would be adopted.

(b) The goods therein will only pass to the buyer if the buyer doesn't express his consent or acknowledgement to the seller that he intends to reject the goods, however, holds the goods without giving a notice to the buyer then on the expiration of time frame for the return of the goods or if time hasn't been fixed, then on the completion of a reasonable time, the property will be passed to the buyer.

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**Example :** "A" the seller of a precious necklace gives it to "B" the buyer on "Sale or return" basis. B after observing the necklace finds it very beautiful and put forth his consent on buying the necklace. In this case, the goods will be transferred to the buyer. However, if the buyer doesn't wish to give the acknowledgement for the product then the goods shall be duly returned back to B.

**In case of right to disposal :** The intention behind reserving the right of disposal of the goods is to make sure that the value of the product is paid before the property is transferred to the buyer. However, under the prepared value system, the ownership follows the possession. That is to say, the seller transfers the possession of the goods but retains the ownership until the buyer pays the appropriate amount.

**Reservation of Right to Disposal (Section 25) :** Section 25 of Sale of Goods Act, 1930 deals with the conditional appropriation of goods and is bifurcated into the following subsections :

Section 25(1) : As per the terms and conditions of the contract the seller of goods reserves the right of disposal of the goods in a situation where the sale of specific goods is concerned. Despite the delivery of the goods, the goods will not get transferred from the seller to the buyer unless the subsequent terms of the contract aren't appropriated or fulfilled.

For example, A sends certain goods by rickshaw to B and instructs the rickshaw driver not to deliver the goods until B pays him the price which was set between them as per the agreement. The rickshaw reaches the destination in time. However, the buyer "B" refuses to pay the amount as he had no money with him at the moment. Here the rickshaw driver can refuse to deliver the goods and the seller can rightly exercise his right to disposal.

Section 25(3) : A few perspectives pertaining to the transfer of property during a sale of goods or property are encapsulated in Sales of Goods Act, 1930. The liabilities of the buyer and seller are determined in consonance with the provisions enshrined from section 18 to 25 of The Sale of Goods Act. The concept of possession of goods differs from passing of the goods as the latter in essence means transfer of ownership from the seller to the buyer while the former is confined to the custody of goods.

**Cases pertaining to Transfer of Property :** Badri Prasad Vs. State of Madhya Pradesh In the case of Badri Prasad Vs. State of Madhya Pradesh, the appellant entered into a contract in respect of certain forests in Madhya Pradesh. He was entitled to chop teak trees with girth over 12-inch. After the passing of

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the Abolition of Proprietary Rights (Estates, Mahals. Alienated Lands) Act, the appellant was prohibited from cutting trees in the exercise of his rights under the contract.

He filed a suit claiming specific performance of the contract on the grounds :

1. The forest and trees did not vest in the State under the Act;
2. Even if they vested, the standing timber, having been sold to the appellant, did not vest in the State;
3. In any event, a new contract was completed on 5 February 1955, and the appellant was entitled to its specific performance.

**The court held :** The forest and trees vested in the State under the Act. The plaintiff was entitled to cut teak trees of more than 12-inch girth. However, it had to be ascertained which trees would be falling in that Description. Till this was ascertained, they will not be ascertained goods as per Section 9 of the Sale of Goods Act.

**MultanuakChempalal Vs. C.P Shah & Co. :** In the case of MultanuakChempalal Vs. C.P Shah & Co., Section 26 of the Sale of Goods Act 1930 was discussed and it was held that the risk passes only after the property in the agreement has been passed. Thus, the parties can enter into a contract which provides for the passing of risk before the passing of property.

**HooglyChinsurah Municipality vs Spence Ltd :** In the case of HooglyChinsurah Municipality vs Spence Ltd, the HooglyChinsurah Municipality contracted with Spence Ltd to buy a tractor on the condition that if the municipality is not satisfied then it will reject the tractor. The municipality took possession of the tractor, used it for a month and a half and then rejected it. The suit was filed upon the unwillingness of Spence Ltd to accept it. The Court while dismissing the appeal held that, the municipality had not only used the tractor but also extinguished a reasonable time. Hence the property in the tractor had passed to the municipality and they could not reject it now.

The Sale of Goods Act, 1930 tells us about a few views regarding the transfer of property during a contract pertaining to the sale of goods. Section 18 to 25 of the Sale of Goods Act, 1930 provides the contracting parties several principles, through which rights and liabilities of the buyer and seller are determined. Passing of the goods from the seller to the buyer portrays the transfer of ownership from one party to another, which is without an exception a different concept from that of the possession of goods as possession only involves custody of goods.

**Distance selling and e-commerce :** E-Commerce, also known as electronic commerce or internet commerce, is an activity of buying and selling goods or services over the internet or open networks. So, any kind of transaction (whether money, funds, or data) is considered as E-commerce. So, E-commerce can be defined in many ways, some define E-Commerce as buying and selling goods and services over the Internet, others define E-Commerce as retail sales to

consumers for which the transaction takes place on open networks. The buying and selling of products, services, and digital products through the Internet all fall under the umbrella of e-commerce.

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**Organisation for Economic Cooperation and Development (OECD) defines e-commerce as :** "All forms of transactions relating to commercial activities, including both organizations and individuals, which are based on the processing and transmission of digitized data including text, sound, and visual images." According to this view, E-commerce does not necessarily require the use of the Internet. E-commerce includes all forms of transactions that process and transmit digitized data which includes text, sound and visual images.

E-commerce is the application of information technology and communication technology to three basic activities related to commercial business; the three basic activities are as follows :

1. Production and support- which includes assisting production, distribution, and maintenance of goods and services.
2. Transaction preparation- which includes getting product information into the marketplace and bringing buyers and sellers into contract with each other; and
3. Transaction completion- which includes concluding transactions, transferring payments, and securing financial services.

**Types of E-Commerce**

E-commerce can be categorised into six categories :

**1. Business-to-Business (B2B) :** B2B e-commerce consists of all kinds of electronic transactions, dealings and business related to the goods and services that are conducted between two companies. This type of e-commerce exists between the producers of a product and the conventional wholesalers who advertise the product to consumers for purchase. So, in this kind of e-commerce the final consumer is not involved and the online transactions only involve the manufacturers, wholesalers, retailers etc.

**2. Business-to-Consumer (B2C) :** It is the most common form of e-commerce, and it deals with electronic business relationships between businesses and consumers. This kind of e-commerce allows consumers to shop around for the best prices, read customer reviews and find different products that they would not find otherwise in the retail world. This kind of e-commerce is related to the transactions and relationships between businesses and the end customers. Today, we find various online shopping sites and virtual stores on the internet, that sell thousands of products, ranging from computers, fashion items to medicines and other necessities.

**3. Consumer-to-Consumer (C2C) :** This level of e-commerce consists of all electronic transactions that take place between consumers. This consists of electronic transactions of goods and services between two customers and is mainly conducted through a third party that provides an online platform for these transactions. C2C e-commerce consists of sites where old items are bought

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and sold, such as OLX, Quicker etc. Generally, these payment transactions are provided by online platforms (such as Paytm, Google Pay etc), and are conducted through social media networks (such as Facebook, Instagram etc) and websites.

**4. Consumer-to-Business (C2B) :** In C2B e-commerce, a consumer or an individual makes their goods or services available online for companies to purchase, so, in this kind of e-commerce a complete reversal of the selling and buying process takes place. For example, a graphic designer making a company site or logo or a photographer taking photos for an e-commerce website. This is very relevant for crowdsourcing projects.

**5. Business-to-Administration (B2A) :** This e-commerce consists of electronic transactions that takes place companies and bodies of public administration such as government. Therefore, the B2A model is sometimes also referred to as B2G (Businessto-Government). Many processes are becoming optimized through digitalization because of that many administrations and governing bodies are implementing thirdparty technologies to assist in the process. This involves many services in various areas such as social security, fiscal measures, employment and legal documents.

**6. Consumer-to-Administration (C2A) :** This e-commerce consists of electronic transactions that takes place between people and bodies of public administration. This relationship allows access for consumers to receive information, make payments, and establish direct communication between the government or administrations and theconsumers.

Many common C2A transactions may include paying taxes, fines, or paying tuition to a University. The main objective of both the B2A and C2A types of eCommerce is to increase flexibility, efficiency, and transparency in public administration.

**Important Issues in Global E-commerce**

**1. Issue relating to Privacy :** The increase of electronic transactions over the internet raises various concerns on the collection, storing and manipulation of personal information without the consent or knowledge of consumers. The functioning of E-Commerce is highly connected and dependent upon the collection and storing of personal information of consumers to provide them with the products and services and maintain their data. Therefore, there is a chance that without the consent or knowledge of consumers, personal information may be shared with or sold to others. Because of these concerns the protection of privacy has become one of the most important policy issues among policy-makers, businesses and consumers.

**2. Issue relating to Security :** E-Commerce security can be defined as "a protection of an information resource from the threats and risks in the confidentiality, authenticity and integrity of the electronic transactions transmitted via a network". The e-commerce can only grow if the system is capable of providing the same level of trust and security which is found in traditional methods of business. This can be achieved only if consumers of e-commerce are confident of the security provided by the concerned ecommerce.

**3. Issue relating to Consumer Protection :** The consumers must be sure that they are as protected in the electronic marketplace as they are in the real marketplace. There are many consumer protection issues related to electronic transactions such as card information, bank information, etc. Therefore, it becomes important that confidential information such as credit/ debit card information, bank account number etc. are kept protected. Earlier, it used to be difficult for a consumer to verify the authentication and security information in an online atmosphere, but with the introduction of digital signature it has become easy and safe.

**4. Issue relating to Content Regulation :** There is certain types of online transmissions that are deemed inappropriate, offensive or harmful to certain segments of consumers and users of E-Commerce. Adult materials, bullying, terrorism, hate speech against minors and sedition are some examples of those activities that raise public concerns. And those who are concerned about these harmful or inappropriate Internet contents advocate for regulatory intervention and content regulation by government and concerned organizations. This is an issue for policy makers and concerned companies. However, the counter argument for such content regulation and intervention is on the ground of right to speech and expression. This problem should be solved without affecting the functioning and growth of e-commerce.

**5. Issues relating to Access :** The following are the main issues related to access to ecommerce:Access to infrastructure- In order to conduct commercial transactions over the Internet, consumers need to have access to telecommunications networks and services.

**Access to content :** In e-commerce, the kind and amount of content transmitted over this infrastructure is also one of the critical elements for the growth of e-commerce. The contents have to be competitive, respecting the cultural values of others, and not inappropriate or harmful to others.

**Universal access :** With the increasing importance and involvement of Information and Communication Technologies in our everyday lives, universal availability of various communication services, has become a necessity for both consumers and companies of ecommerce.

A large number of people are still living without the basic telephone services. This gap related to technology and digitization in the world population is called as digital divide. The digital divide affects the people's capacity to access modern Information and Communication Technologies, which in turn impedes their capacity to access the Internet and e-commerce, which ultimately daunts the growth of e-commerce.

**Language and localization :** With e-commerce extending to other boundaries, language and localization becomes an issue because it becomes difficult to communicate with a native speaker of any particular country.

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**Pros of E-Commerce**

E-commerce is an advanced way of conducting businesses online and across the borders and because of that it has various advantages to it :

1. Its reach is across the global market and with minimum investments.
2. It enables sellers to sell their products on a global level and allows customers to make a broader choice. Now sellers and buyers can meet in the virtual world, without the barrier of borders.
3. E-commerce process reduces the product distribution chain to a considerable extent.
4. It helps in making a direct and transparent business and transaction channel between the producers, wholesalers and final customers.
5. It provides quick delivery of goods and customer complaints are also addressed quickly. It also saves time, energy and effort for both the consumers and the company.
6. E-commerce leads to increased productivity and better service as it brings sellers and customers closer.
7. The customer can choose between different sellers.
8. Customers now have access to virtual stores all the time.
9. E-Commerce leads to considerable cost reduction of goods and services. Transaction costs are also reduced in E-commerce and due to that customers get to buy products at a comparatively lower rate.

**Cons of E-Commerce**

However, along with advantages, E-commerce has certain disadvantages too, such as :

1. Its dependence on network connectivity and information technology.
2. There aren't definite legislations both domestically and internationally to regulate ecommerce transactions.
3. There can be a loss of the privacy of the customer.
4. Security is another issue. Issues like credit card theft, identity theft, etc. are some of the security related concerns.
5. There can be fraudulent financial transactions on online platform.
6. The costs of opening the e-commerce portal and maintaining it are very high. The setup of the hardware and the software, the training cost of employees and the constant maintenance are all expensive.

E-commerce is an ever-developing area. With the advancement in technology and communication, e-commerce has also gained popularity among the people of India and worldwide. It has made e-business easy and accessible to people sitting at home. E-commerce has a huge impact on costs, access to goods and services and increased productivity of businesses. It also plays an important role in the economic growth and development of a nation. Though it is a relatively new area belonging to the era of the internet, it has the potential to change and replace the traditional form of business and trade activities.

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However, Indian e-commerce still faces many difficulties in web marketing because of infrastructural difficulties, limited access and computer illiteracy. Majority of the Indian population lives in rural areas and they do not have sufficient knowledge about computers and the internet. Some customers even in urban areas do not have sufficient facilities and knowledge of online transactions and payments, therefore, this activity of buying and selling of goods online is limited to certain people who are equipped with the knowledge of computer and internet. However, with the government initiatives like Digital India, this scenario has changed a lot in the last decade and India is becoming a huge platform for e-commerce.

### 2.2.5 Unpaid Seller and his Rights

The Sale of Goods Act has expressly given two kinds of rights to an unpaid seller of goods, namely.

**1. Against the goods :**

(a) When the property in the goods has passed

(i) right of lien

(ii) Right of stoppage of goods in transit

(iii) Right of re-sale.

These rights of an unpaid seller do not depend upon any agreement, express or implied between the parties. They arise by the implication of law.

(b) When property in the goods has not passed.

(i) Right of withholding delivery. Where the property in goods has not passed to the buyer, the unpaid seller has an addition to other remedies a right of withholding delivery, similar to and co-extensive with his right of lien and stoppage in transit, where the property has passed to the buyer.

**2. Against the buyer personally :**

(i) Right to sue for price

(ii) Right to sue for damages

(iii) Right to sue for interest

**Rights of unpaid seller against the goods**

**(i) Right of lien (Section 47-49) :** 'Lien' is the right to retain possession of goods until payment in respect of them is paid. Section 47(1) describes the circumstances in which an unpaid seller may exercise his right of lien. The unpaid seller of goods, who is in possession of them, can retain possession until payment or tender of the price in the following case :

(a) Where the goods have been sold without any stipulation as to credit;

(b) Where the goods have been sold on credit, but the term of credit has expired.

(c) where the buyer becomes insolvent.

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The right of lien is linked with possession and not with title. It is essentially a right over the property of another person. The unpaid seller's lien can be exercised only so long as the goods are in the actual possession of the seller or his agent. Once the possession is lost, the lien is also lost. The right of lien cannot be exercised during the currency of credit term. When the term expires, the unpaid seller may exercise the right of lien. The lien of the unpaid seller the is for the price only; so when the price has been paid or tendered, he cannot retain possession of the goods any longer. Again the right of lien does not extend to other charges which the seller may have to incur for storing the goods during the exercise of the lien.

**Conditions for the Exercise of Right of Lien :** The following are conditions precedent to the exercise of the right of lien :

(a) the ownership must have passed to the buyer.

(b) The goods must be in possession of the seller or under his control as bailee, etc.

(c) The possession of the goods by the seller must not expressly exclude the right of lien.

(d) The whole or part of the price must remain unpid. It may be noted that the lien can be exercised only for price.

Thus the seller cannot claim lien for godown charges, for storing of goods in exercise of his lien for price. The lien of an unpaid seller is a particular one. It is the personal right which can be exercised only by him and not by his assignee or his creditors.

**Part Delivery :** Where an unpaid seller has made party-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.

Thus in case of part-delivery of the goods, the unpaid seller may exercise his right of lien on the remainder, but where part delivery has been made under circumstances as to show an agreement to waive the lien, the seller cannot exercise his lien.

**Example :** A sold certain shares to B. The relative share certificates and transfer forms duly signed were handed over by the seller to the buyer against payment of price by cheque. The buyer became insolvent. It was held by the Privy Council that the seller had no lien on shares because his lien ceased when he parted with the possession.

The right of lien is indivisible in nature, and so the buyer is not entitled to claim delivery of a portion of the goods on payment of a proportionate price. Further this right is available even after part delivery of the goods has been made, unless such part delivery is made under such circumstances as to show an agreement to waive the lien. (Section 48).

**Example :** A sells to B a certain quantity of sugar. It is agreed that three months credit shall be given. B allows the sugar to remain in A's warehouse till

the expiry of the three months, and then does not pay for them. A may retain the goods for price. Termination of lien Section 49 provides that an unpaid seller loses his lien on the goods in the following cases :

(a) When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal.

Where the seller regains possession of the goods from the carrier by exercising his right of stoppage in transit, his lien revives. But if he takes back the goods from the carrier for any other purpose, the lien does not revive.

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**Example :** The goods sold were delivered to the buyer's shipping agents, who had put them on board a ship. But the goods were returned to the seller for repacking. While they were still with the seller on this mission, the buyer became insolvent, and the seller being unpaid, claimed to retain the goods in the exercise of his lien. It was held that, having lost his lien by delivery to the shipping agents, his refusal to deliver was wrongful.

(b) When the buyer or his agent lawfully obtains possession of the goods. For example in a case in which the goods were delivered to a forwarding agent who was to receive instructions from the buyer as to the ultimate destination of the goods. In the mean time the buyer became insolvent it was held that the right of lien was lost with the delivery of goods to such a forwarding agent.

(c) By waiver thereof When the unpaid seller waives his right of lien expressly or impliedly. Express waiver is there when the contract of sale provides that the seller shall not retain possession of goods even if the price remains unpaid.

On the contrary, implied waiver means that the seller by his conduct waives the right of lien. It may be done in the manner as stated below :

(i) When the goods are sold on credit or the seller, on the expiry of the original term of credit, grants a fresh term of credit, the lien in these cases revives on the expiry of the term of credit.

(ii) When seller takes a bill for the price to be paid at a future date, lien revives on the dishonour of the bill.

(iii) When the seller agrees to a sub-sale, the lien is waived.

(vi) An unpaid seller's lien is also lost by payment or tender of price. Further, it may be noted that the right of the lien of an unpaid seller is not lost because he has obtained a decree for the price of the goods against the buyer.

**(ii) Right of stoppage in transit (Sections 50-52) :** The second important right which is available to an unpaid seller is the right of stoppage in transit. The right to stoppage means the right to stop further transit of the goods, to resume possession thereof and to retain the same till the price is paid. The right can be exercised under the following circumstances :

(i) The seller must be unpaid.

(ii) The seller must have parted with the possession of the goods and the buyer must not have acquired it.

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(iii) The buyer must be insolvent.

(iv) The property must have passed from the seller to the buyer. Example : When the goods reach their destination and after taking delivery the buyer puts them on his cart, though the cart has not left the station, the railway company cannot stop the goods at this stage if the seller asks. The transit has already ended.

The right of stoppage in transit arises only after the seller has parted with possession of the goods and the buyer has become insolvent. This right is only available when the goods are neither in the possession of the seller nor that of the buyer, but are in the possession of a middleman for the purpose of transmission to the buyer.

**Example :** B, who had bought goods from M/s Clark & Co. of Glasgow, instructed the sellers to send the goods by a certain named ship to Melbourne. Goods were first railed to London and then shipped to Melbourne, a mate's receipt being sent to buyers. On B becoming insolvent, the sellers gave notice to the Rail Co. to stop delivery to buyers, but it was too late. They then gave fresh notice to the shipowners claiming back the goods before the ship arrived at Melbourne. On arrival there, the receiver in bankruptcy of B demanded the bills of lading from the master. Held, the goods having been effectively stopped in transit, the trustee could not claim them.

**Duration of transit :** Since the right of stoppage in transit can be validly exercised only during transit, the question of duration of transit is of great importance. Goods are deemed to be in transit from the time they are delivered to a carrier or other bailee for the purpose of transmission to the buyer until the buyer or his agent takes delivery thereof. Much depends upon the capacity in which the carrier holds the goods. The carrier may hold the goods :

1. as seller's agent. In this case, there is no transit because the goods are under the seller's lien.
2. as buyer's agent. In this case the seller cannot exercise his right of stoppage in transit because the buyer has acquired possession.
3. as an independent contractor. In this case the seller has and can exercise the right of stoppage in transit. It is not necessary that the goods should be actually moving. The transit comes to an end in the following cases :
   (a) If the buyer or his agent obtains delivery of the goods before their arrival at the appointed destination.
   (b) 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 them on his behalf.
   (c) In case the carrier or other baliee wrongfully refuses to deliver the goods to the buyer or his agent.

**Example :** In a case the buyer was insolvent when the goods (timber) arrived at the destination. However, his agent went on board the ship and

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demanded possession of the goods. The captain refused to deliver the goods until freight was paid. In the mean time, the seller exercised his right of stoppage in transit by giving a notice to the captain who delivered the goods to the agent of the seller. It was held that the carrier was supposed to return the goods to the seller as the transit had not ended.

**When the buyer rejects the Goods**

The buyer may reject the goods wholly or partly :

(i) When He Rejects Wholly : When the buyer rejects the goods and the carrier or any other bailee continues to posses them, the transit is not said to have ended. This will be so even if the seller refuses to take back the goods.

**Example :** The buyer accepted a part of the goods and rejected the rest. The seller refused to take back the goods and ordered them back to the buyer who again refused to take their delivery. In the mean-time the buyer was declared insolvent and the seller exercised his right of stoppage in transit. It was held that the transit continued.

(ii) Part Delivery Where the goods have been delivered in part, the seller may stop the remainder of goods, unless the part delivery shows an intention to give up the possession of the whole. Example A sells to B 100 bales of cotton; 60 bales having come into B's possession and 40 being still in transit, B becomes insolvent; and A, being still unpaid, stops the 40 bales in transit. A is entitled to hold the 40 bales until the price of the 100 bales is paid.

When Delivery is made to a Ship Chartered by the Buyer (Sec.51(5)) : If the goods are delivered to a ship chartered by the buyer and the goods are held by him as an agent of the buyer, the transit comes to an end. Where goods are delivered to a ship chartered by the seller, it is a question depending on the circumstances of the particular case, whether they are in the possession of the master as a carrier or as agent of the buyer.

When the carrier of Bailee Wrongfully Refuses to Delivers the Goods to the Buyer : Where the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent in that behalf, the transit will not come to an end.

It is obvious that the goods should have arrived at their destination because otherwise the carrier cannot refuse to deliver the goods. How right of stoppage in transit is exercised The unpaid seller may exercise the right of stoppage in transit :

1. by actually taking possession of the goods, or
2. by giving notice of his claim to the carrier or other bailee in whose possession the goods are.

Such notice may be given either to the person in actual possession of the goods or to his principal. In the latter case, notice must be given in sufficient time to enable the principal to communicate the same to his agent, so as to prevent delivery to the buyer.

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When notice of stoppage in transit is given by the seller to carrier or other bailee in possession of the goods, he shall re-deliver the goods to or according to the directions of the seller. The expenses of such re-delivery shall be borne by the seller.

**Wrongful Refusal by the Carrier :** If, even after a proper notice by the seller to the carrier for stopping the goods in transit, the carrier delivers them to the buyer, he shall be liable to the seller for conversion, i.e., wrongful appropriation of the goods to another. If after the transit has ended and the carrier wrongfully returns the goods to the seller, he is liable to the buyer for conversion.

**Distinction between right of lien and right of stoppage in transit :** Both the rights are designed for the protection of the unpaid seller. The effect of their exercise is also the same, because when the seller stops the goods in transit he resumes possession and the goods once again fall into the spell of his lien until the price is paid. Yet it is important to know their distinction.

The main points of distinction between the two are as follows :

1. Right of stoppage in transit arises when the buyer is insolvent and is unable to pay. But the right of lien can be exercised even when the buyer is able to pay but does not pay.
2. The right of stoppage in transit comes into operation only after the seller has parted with the possession of the goods but the seller's lien comes into existence and continues so long as the seller has got possession of the goods.
3. The right of stoppage in transit commences when the goods have left the possession of the seller and continues until the buyer has acquired possession thereof. But the right of lien comes to an end as soon as the goods go out of the possession of the seller.
4. The right of lien is right to retain possession of the goods. The right of stoppage on the other hand is the right to regain possession of the goods.
5. Possession is the test of a right of lien. The test for stoppage in transit is the nondelivery of the goods to the buyer.

**Effect of Sub-Sale or Pledge by Buyer (Sec. 53) :** The general rule is that the unpaid seller's right of lien or stoppage in transit is not affected by any sale or other disposition of the goods which the buyer may have made. However, there are two exceptions to this general rule. They are stated below :

1. When the seller has assented to the sale or other disposition which the buyer may have made.

**Example :** A sold to B 80 maunds of grain out of a granary. B then sold (out of these 80 maunds) 60 maunds to C. C after receiving from B the delivery order presented it to A. A told C that the grains would be delivered in due course, B then became insolvent. A's right against the 60 maunds is not lost since A recognized the title of C the sub-buyer.

2. When a document of title to goods (e.g., a bill of lading or railway receipt) has been issued or transferred to a buyer, and the buyer transfers the document to a person who takes the document in good faith and for consideration, then

(a) If such last mentioned transfer was by way of sale, the unpaid seller's right of lien or stoppage in transit is defeated, and

(b) If such last mentioned transfer was by way of pledgee, the unpaid seller's right of lien or stoppage in transit can only be exercised, subject to the rights of the pledgee. But in this case the unpaid seller may require the pledgee to satisfy his claim against the buyer first out of any other goods or securities of the buyer in the hands of the pledgee.

Notes

**(iii) Right of re-sale (Section 54) :** In addition to the rights of lien and stoppage in transit, the unpaid seller has got the valuable right of re-sale of the goods, which are the subject-matter of the contract. This limited right of resale is conferred by the section 54 which also enumerates the circumstances under which the right of re-sale may be exercised. The right may be exercised in the following cases :

(a) Where the goods are of a perishable nature. In this case the unpaid seller need not give a notice to the buyer of his intention to resell the goods.

(b) Where the unpaid seller has exercised his right of lien or stoppage in transit, he can give notice to the buyer of his intention to resell the goods. If after such notice the buyer does not within a reasonable time pay or tender the price, the seller can resell the goods within a reasonable time. He can recover from the original buyer any loss occasioned by the breach of the contract. The seller shall be entitled to the profits, if any on the resale. If the unpaid seller fails to give such notice he cannot recover damages from the buyer and is under an obligation to pay over the profits, if any, arising from the resale.

(c) Where the seller has expressly reserved a right of resale, in case the buyer makes default. In such a case, on re-sale though the original contract of sale is thereby rescinded, the unpaid seller does not lose his right to claim damages for breach of the contract. Where an unpaid seller who has exercised his right of lien or stoppage in transit, resells the goods, the buyer acquires a good title thereto as against the original buyer.

**Right of withholding delivery :** Where the property in the goods has not passed to the buyer, the unpaid seller has in addition to other remedies against the buyer personally, a right of withholding delivery of goods which are the subject-matter of the contract. This right is similar to and coextensive with his right of lien and stoppage in transit. This right can be exercised even if the sale was on credit or that the goods were specific or unascertained.

**Rights of Unpaid Seller against the Buyer Personally :** The unpaid seller, in addition to his rights against the goods as discussed above, has the following three rights of action against the buyer personally :

Notes

**1. Suit for price (Sec. 55) :** Where property in goods has passed to the buyer; or where the sale price is payable 'on a day certain', although the property in goods has not passed; and the buyer wrongfully neglects or refuses to pay the price according to the terms of the contract, the seller is entitled to sue the buyer for price, irrespective of the delivery of goods.

**2. Suit for damages for non-acceptance (Sec.56) :** Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance. The seller's remedy in this cases is a suit for damages rather than an action for the full price of the goods.

The damages are calculated in accordance with the rules contained in Section 73 of the Indian Contract Act, that is, the measure of damages is the estimated loss arising directly and naturally from the buyer's breach of contract. Where the goods have a ready market the principle applicable is that the seller may recover from the buyer damages equal to the difference between the contract price and the market price on the date of the breach of the contract. Thus, if the difference between the contract price and market price is nil, the seller can get only nominal damages (Charter Vs. Sullivan). But where the goods do not have any ready market, the measure of damages will depend upon the facts of each case. For example, in Thompson Ltd. Vs. Robinson the damages were assessed on the basis of profits lost. In that case, T Ltd. who were car dealers, contracted to supply a motorcar to R. R refused to accept delivery. It was found as a fact that the supply of cars exceeded the demand at the time of breach and hence in a sense there was no market price on the date of breach. Held, T Ltd., were entitled to damages for the loss of their bargain viz., the profit they would have made, as they had sold one car less than they otherwise would have sold. To take another illustration, if the goods have been manufactured to some special order and they are unsaleable and have no value at all for other buyers, then the seller may even be allowed the full price of the goods as damages.

**3. Suit for special damages and interest (Sec. 61) :** This Section entitles the seller to sue the buyer for 'special damages' also for such loss "which the parties knew, when they made the contract, to be likely to result from the breach of it." In fact the Section is only declaratory of the principle regarding 'special damages' laid down in Section 73 of the Indian Contract Act. The Section also recognises unpaid seller's right to get interest at a reasonable rate on the total unpaid price of the goods sold, from the time it was due until it is actually paid.

## 2.4 SUMMARY

A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. A contract of sale may be absolute or conditional. The essential elements of the contract are (a) contract (b) two parties (c) transfer of property (d) goods and (e) price. Goods are the subject-matter of a contract of sale. Goods are of three types namely existing goods, future goods and contingent goods.

After doing extensive research on the topic "transfer of property under the Sale of Goods Act, 1930, it is a wide concept and contains many aspects divided into smaller topics. I found SOGA, 1930, especially the concept of passing the ownership of property is something that needs a day and night research and analysis. The concept of transfer of property is very comprehensive and complicated. By analyzing the topic from different sources, I can conclude that section 18 to section 24 of SOGA, 1930 has done a fair job in protecting the interest of the parties. Almost everything required to know the legality of this subject has been included, but it was a complex and complicated one to grasp in this section of the act for an ordinary man.

Notes

## 2.5 EXERCISE

1. Define the term 'Sale' and 'agreement to sell' and distinguish between the two. Give example.
2. Define the term 'good'. What are different types of good ?
3. What is the effect of perishing of goods on a contract of a sale ?
4. Explain the various modes of modes of fixing the price in a contract of sale.
5. What is Transfer of property in goods.

Notes

# UNIT 3: THE LIMITED LIABILITY PARTNERSHIP ACT, 2008

**Structure:**



## 3.0 OBJECTIVES

After reading this Unit. you will be able to:

- discuss the salient features of LLP;
- explain the difference between LLP and partnership and difference between LLP and company;
- describe the LLP agreement and nature of limited liability partnership;
- analysis the incorporation of limited liability partnership and matters incidental thereto;
- understand the whistle blowing and winding up and dissolution of LLP.

## 3.1 INTRODUCTION

Notes

Seeing the market need of the country, the government of India has enacted the limited liability partnership act,2008. This was done in order to make provisions for the formation and regulation of limited liability partnerships and for matters connected therewith or incidental thereto.Unlike the other Acts,this Act is applicable to the whole of India Including the state of Jammu & Kashmir. Section 1 of the Act clearly states the jurisdiction of the Act.

These days the concept of limited liability partnership has become one of the most recognised ways of doing business in all countries of the world. India is also among those countries where the business is carried on in the form of limited liability partnership. India introduced its Limited Liability Partnership Act in 2008. A Limited Liability Partnership also called as an LLP combines features of both the Partnership and the Company into one single organisation. In other words, LLP is a way of doing business that provides the advantages of limited liability of a company and at the same time gives flexibility to its members as in the case of partnership firm.

Thus, a Limited Liability Partnership (LLP) is a type of partnership in which the liability of the partners is limited unlike the partnership governed by the Indian Partnership Act, 1932. In an LLP, a partner cannot be held liable for the wrongful conduct or negligence of his co-partner. This is an important point which distinguishes it from the unlimited partnership. In an LLP, the partner's liability is therefore limited like that of shareholders in a company. Thus, an LLP is a combination of both partnership and company and because of this very feature, it is appropriate for small and medium-sized enterprises.

**Origin of LLP**

The concept of Limited Liability Partnership emerged in the early 1990s in the United States in response to the sudden fall in real estate and early prices in Texas in the 1980s and the subsequent effect it had on the banks and other financial institutions. This collapse led to a large wave of bank and savings and loan failures. Because the amounts recoverable from the banks were small, efforts were made to recover assets from the lawyers and accountants who had advised the banks in the early 1980s. The reason was that partners in law and accounting firms were subject to the possibility of huge claims which would bankrupt them personally, and the first LLP laws were passed to shield innocent members of these partnerships from liability. Thus, the first ever law on LLP was enacted in Texas on 26th August 1991, which was then followed by other countries of the worlds. Many countries that have recognised the concept of LLPs include Canada, Germany, Japan, China, Greece, Singapore, etc., India being one of them.

**Limited Liability Partnership In India**

The recommendations of the J.J. Irani Committee and the Naresh Chandra Committee-II led the making of the draft bill for introducing LLP in India. The

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Cabinet approved the Bill on December 7, 2006, which was then tabled in the Rajya Sabha on December 15, 2006. Subsequently, the Department Related Parliamentary Standing Committee on Finance recommended certain changes in the draft Bill, 2006. The committee submitted its final report to the Ministry for Corporate Affairs.

Finally, the Limited Liability Partnership (LLP) Bill, 2008 received the approval of the Cabinet on 1st May 2008. Both Houses of Parliament passed the bill without any changes. The Bill then received the assent of President on 7th January 2009. In India, 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 31 March 2009. The LLP Act, 2008 thereby makes provision for the formation and regulation of limited liability partnerships and matters connected with it.

## 3.2 LLP (LIMITED LIABILITY PARTNERSHIP)

**Limited Liability Partnership :** The limited liabilities partnership (LLP) form of entity was introduced in India through the innovative Limited Liabilities Partnership Act of 2008. This form of entity integrates the features of both traditional partnership firms and limited liability corporations. A Limited Liabilities Partnership means a partnership formed and registered under the Limited Liabilities Partnership Act, 2008. An LLP is a body corporate which has separate legal entity and perpetual succession. Its existence, rights or liabilities are not affected by any change in the partners. It is thought that the LLP form of entity is suitable for small and medium size businesses and professional enterprises.

**Definitions :** 1. In this Act, unless the context otherwise requires,—

(a) "address", in relation to a partner of a limited liability partnership, means :

(i) if an individual, his usual residential address; and

(ii) if a body corporate, the address of its registered office;

(b) "advocate" means an advocate as defined in clause (a) of sub-section (1) of section 2 of the Advocates Act, 1961 (25 of 1961);

(c) "Appellate Tribunal" means the National Company Law Appellate Tribunal constituted under sub-section (1) of section 10FR of the Companies Act, 1956 (1 of 1956);

(d) "body corporate" means a company as defined in section 3 of the Companies Act, 1956 (1 of 1956) and includes :

(i) a limited liability partnership registered under this Act;

(ii) a limited liability partnership incorporated outside India; and

(iii) a company incorporated outside India,

but does not include :

(i) a corporation sole;

(ii) a co-operative society registered under any law for the time being in force; and

(iii) any other body corporate (not being a company as defined in section 3 of the Companies Act, 1956 (1 of 1956) or a limited liability partnership as defined in this Act), which the Central Government may, by notification in the Official Gazette, specify in this behalf;

Notes

(e) "business" includes every trade, profession, service and occupation;

(f) "chartered accountant" means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

(g) "company secretary" means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 (56 of 1980) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

(h) "cost accountant" means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;

(i) "Court", with respect to any offence under this Act, means the Court having jurisdiction as per the provisions of section 77;

(j) "designated partner" means any partner designated as such pursuant to section 7;

(k) "entity" means any body corporate and includes, for the purposes of sections 18, 46, 47, 48, 49, 50, 52 and 53, a firm setup under the Indian Partnership Act, 1932 (9 of 1932);

(l) "financial year", in relation to a limited liability partnership, means the period from the 1st day of April of a year to the 31st day of March of the following year: Provided that in the case of a limited liability partnership incorporated after the 30th day of September of a year, the financial year may end on the 31st day of March of the year next following that year;

(m) "foreign limited liability partnership" means a limited liability partnership formed, incorporated or registered outside India which establishes a place of business within India;

(n) "limited liability partnership" means a partnership formed and registered under this Act;

(o) "limited liability partnership agreement" means any written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership;

Notes

(p) "name", in relation to a partner of a limited liability partnership, means :

(i) if an individual, his forename, middle name and surname; and

(ii) if a body corporate, its registered name;

(q) "partner", in relation to a limited liability partnership, means any person who becomes a partner in the limited liability partnership in accordance with the limited liability partnership agreement;

(r) "prescribed" means prescribed by rules made under this Act;

(s) "Registrar" means a Registrar, or an Additional, a Joint, a Deputy or an Assistant Registrar, having the duty of registering companies under the Companies Act, 1956 (1 of 1956);

(t) "Schedule" means a Schedule to this Act;

(u) "Tribunal" means the National Company Law Tribunal constituted under sub-section

1. of section 10FB of the Companies Act, 1956 (1 of 1956).

2. Words and expressions used and not defined in this Act but defined in the Companies Act, 1956 (1 of 1956) shall have the meanings respectively assigned to them in that Act.

### 3.2.1 Salient Features of LLP

**Hybrid form of organisation :** An LLP is a hybrid form of organisation having features of a partnership firm under the Partnership Act, 1932 and a company under the Companies Act, 1956/2013. However, the Indian Partnership Act, 1932 shall not be applicable to LLPs.And The LLP's are administered by the Registrar of Companies.

**Separate legal entity :** The LLP shall be a body corporate and a legal entity separate from its partners. Hence, it would be liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP.

No partner would be liable on account of the independent or unauthorised actions of other partners or their misconduct. The liabilities of the LLP and its partners who are found to have acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP.

**Perpetual Succession :** Since, LLP is a body corporate and a legal entity separate from its partners, It has perpetual succession. Thus, an LLP is capable, in its own name, of acquiring, owning, holding, disposing of property, whether movable, immovable, tangible or intangible. It can sue and can be sued, and is capable of doing and suffering other acts as a body corporate may do or suffer.

**Number of partners :** LLP must have at least two individuals as Designated Partners. At least one of the Designated Partners must be resident in India. A body corporate partner of the LLP may nominate an individual as a Designated Partner. There is no limit on the maximum number of partners.

Notes

**Rights and duties of partners :** Rights and duties of partners of an LLP and mutual rights and duties between an LLP and its partners are governed by the LLP Agreement between the partners or between the LLP and its partners.

**Books of Account of an LLP :** The LLP shall be under an obligation to maintain annual accounts reflecting true and fair view of its state of affairs. A statement of accounts and solvency shall be filed by every LLP with the Registrar every year. The accounts of LLPs shall also be audited, subject to any class of LLPs being exempted from this requirement by the Central Government.

All filings under the LLP Act to be done electronically. Similarly, the Registrar may furnish information or provide copies and extracts certifying the same by affixing digital signature.

**Conversion in to LLP :** A partnership under the Partnership Act, 1932 may be converted into an LLP. A private company or an unlisted public company may also be converted into an LLP provided there is no 'security interest' subsisting on the date of application for conversion.

**Winding up of LLP :** winding up of the LLP may be either voluntary or by the Tribunal to be established under the **Companies Act, 1956**. Till the Tribunal is established, the power in this regard has been given to the High Court;

**Changes in LLP :** the compromise or arrangement including merger and amalgamation of LLPs shall be in accordance with the provisions of the act

Heavy penalties have been provided in case of non-compliance of provisions of the LLP Act.

**The LLP has the following important features :**

(i) LLP forms of organizations are governed by the Limited Liabilities Partnership Act, 2008 and The Indian Partnership Act, 1932 is not applicable to LLPs.

(ii) LLP is a body corporate and as a result has legal entity separate from that of its partners.

(iii) LLP has perpetual succession. In other words, LLP's existence is not affected by death, bankruptcy, insanity and change in membership.

(iv) Unlike shareholders of company, partners of LLP can directly manage the affairs of business. In other words, in case of LLP there is no separation between management and ownership.

(v) The liability of LLP is to the extent of its assets. The partners are liable to the extent of the amount they have agreed to contribute to the LLP.

(vi) A partner cannot be held responsible for the misconduct or negligence of other partners.

(vii) The minimum number of partners is 2 and there is no maximum limit.

(viii) There shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

(ix) A private or unlisted public company and firm can be converted into LLP.

(x) The winding up of LLP is either voluntary or by the High Court. Advantages and Disadvantages of LL.

Notes

**Advantages and Disadvantages of LLP :** We have already learned that LLP has the features of both partnership and company. It has the advantages of both simplicity of doing business like partnership and separate legal entity and limited liability like company. The advantages as well as disadvantages of LLP are discussed below.

**Advantages :**

1. An LLP has legal entity separate from its partners. Thus, it can sue or be sued by third parties. Again a partner cannot be made responsible for the misconduct or negligence of other partner.
2. Active participation in the management of the LLP. Partners of LLP can actively participate in the management of the business of LLP. There is no separation of management from ownership.
3. The partners of LLP have the flexibility to draft the agreement of LLP defining the roles, responsibilities, rights and powers of the partners to LLP and to each other.
4. The liability of partners of LLP is limited to the extent of the amount they have agreed to contribute. A partner is held responsible only when it is proved that a fraud has happened on the part of the partner.
5. The LLP has to comply with just three annual requirements, namely, annual return filing, filing of statement of accounts and income tax return filing. Whereas, a private limited company has to follow more complex requirements.
6. Unlike private limited company, an LLP can be wound up very easily within two to three months.

**Disadvantages :**

1. LLP has separate legal status and as a result requires extensive legal paper works compared with partnership firm.
2. Venture capitalists are unwilling to make investment in LLP. Because, in order to make investment in LLP, venture capitalist has to become partners of the LLP and eventually, has to take some responsibility as partner.
3. Higher penalties compared with private limited company if an LLP fails to comply with the requirements.
4. At least two partners are required to form an LLP. If for any reason, number of partners is reduced to one, then the LLP has to be terminated.
5. LLP form of organization is limited to only certain types of profession, such as, lawyers, accountants and architects.

Notes

**Need of Limited Liability Partnership :** For a long time, a need has been felt to provide for a business format that would combine the flexibility of a Partnership firm firm and the advantages of Limited Liability of a Private Limited Company at a low compliance cost. The limitations of the partnership firms and the rigidity of the companies has led to the birth of what we call it as Limited Liability Partnership(LLP).

The Limited Liability Partnership format is an alternative corporate business vehicle that provides the benefits of limited liability of a company but allows its members the flexibility of organizing their internal management on the basis of a mutually arrived agreement, as is the case in a partnership firm. This format would be quite useful for small and medium enterprises in general and for the enterprises in the services sector in particular.

**Object of the Limited Liability Partnership Act, 2008 :** With the growth of the Indian economy, a need has been felt for a new corporate form that would provide an alternative to the traditional partnership, with unlimited personal liability on the one hand, and the statute based governance structure of the limited liability company on the other hand, in order to enable professional expertise and entrepreneurial initiative to combine, organize and operate in flexible, innovative and efficient manner.

The Limited Liability Partnership is viewed as an alternative corporate business vehicle that provides the benefits of limited liability but allows its members the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement. The LLP form would enable entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements.

### 3.2.2 Difference between LLP and Partnership

We know that partnership is an old concept whereas LLP is a new concept. In an LLP form of organization, partners have limited liabilities like company. Following are the essential differences between LLP and partnership form of organization :

1. LLP is governed by the Limited Liabilities Partnership Act, 2008 whereas; partnership is governed by the Indian Partnership Act of 1932.
2. LLP is a type of partnership formed and registered according to the Limited Liabilities Partnership Act, 2008 whereas; partnership is a type of business organization where partners have agreed to carry on a business and share profit and loss of the business in accordance with the terms of the partnership agreement.
3. Partnership does not have separate legal entity, whereas; LLP has separate legal entity.
4. Registration is optional for partnership form of business, whereas; LLP must be registered as per LLP Act, 2008.

Notes

5. Partnership does not have perpetual succession, whereas; LLP has perpetual succession.
6. Liabilities of partners in case of partnership firm are unlimited, whereas; in case of LLP liabilities of partners are limited to the extent of contribution of partners, except in case of fraud.
7. Audit of accounts is mandatory for LLP only if turnover and capital contribution exceed Rs.40 lakhs and 25 lakhs respectively, whereas; for partnership audit is not mandatory.
8. Annual return filing is necessary in case of LLP, but partnership does not require submitting annual return.
9. The existence and operation of LLP are not affected by any change in partnership, whereas; annual return filing is not necessary in case of partnership.

### 3.2.3 Difference between LLP and Company

Following are the essential differences between LLP and Company :

1. LLPs are registered under the Limited Liabilities Partnership Act, 2008, whereas; companies are registered as per Companies Act, 2013. It is mandatory to register for both types organization.
2. The name of LLP ends with "LLP", whereas; name of private limited company ends with "Pvt. Ltd." And Public limited company end with "Ltd.".
3. In case of LLP the amount of capital contribution is not specified in law but for private limited company minimum authorized capital is 1 lakh and for public limited company minimum authorized capital is Rs 5 lakh. However, there is no requirement of paid up capital.
4. The compliance requirements for LLP are minimum in comparison with company as per Companies Act.
5. In LLP related parties transactions are allowed but in case of companies there are restrictions related to related party transactions.
6. The liability of partner is limited to the extent of their capital contribution in case of LLP, whereas; liability of shareholders of company is limited to the extent of the unpaid capital.
7. There is no limit on the number of directors for LLP but for private company minimum number of director is 2 and for public limited company minimum number of director is 3.
8. In case of LLP audit of accounts is required only if the contribution exceeds Rs.25 lakhs or annual turnover exceeds Rs40 lakhs. In case of company compulsory audit is required whatever may the turnover or capital.

**Incorporation of LLP :** The LLP form of organization has the benefits of both partnership and company. As a result, it is the preferred form of organization

among the new entrepreneurs. The Limited Liability partnership (Second Amendment) Rules, 2018 prescribed new rules and procedure superseding LLP Rules, 2009 for the incorporation of LLP. Following are the steps for the incorporation of LLP

Notes

**Step 1 :** To register an LLP all designated partners of the proposed LLP first need to obtain Designated Partner Identification Number (DPIN). E-Form DIR-3 needs to be filed in order to obtain DPIN. However, if a director already has Director Identification Number (DIN) the same can be used as DPIN.

**Step 2 :** The second step is to obtain Digital Signature Certificate (DSC) of partners or designated partners of proposed LLP from any authorized certifying agency.

**Step 3 :** A new user needs to register by filling New User Registration form through the website of Ministry of Corporate Affairs, Government of India i.e. www.mca.gov.in. This will create User Name and Password. On successful registration the system will give a message that you have been registered successfully.

**Step 4 :** After successful registration the next step is to select a name of the LLP to be registered by filing Form 1 and appending digital signatures.

**Step 5 :** The next step is to file Form 2 "Incorporation Document and Subscriber's Statement".

**Step 6 :** Once the form has been approved by the concerned official of the Ministry of Corporate Affairs, Government of India and after incorporation of LLP, Form-3 needs to be filled within 30 days of incorporation of LLP. Form 3 contains information regarding LLP Agreement and changes, if any, made therein.

### 3.2.4 LLP Agreement

Over the years the business community has realized there is a need for a different form of business organization. One that is more freedom than a partnership and fewer formalities than a company. Hence the Limited Liability Partnership (LLP) came into existence. Let us learn a bit more about LLP Agreement.

**LLP Agreements :** An LLP agreement is a written document defining the agreement between the partners of a Limited Liability Partnership. It defines the rights and duties of all the partners towards each other and towards the firm.

Under the Limited Liability Partnership Act, the filing of an LLP agreement is mandatory while registering the firm within 30 days of the formation of the LLP. In the absence of the agreement all the rights and liabilities provided in Schedule, I of the act will apply to the partners and the LLP.

A well-defined LLP agreement sets the solid foundation for the business. A comprehensive, detailed LLP agreement defines the roles and responsibilities of a firm very clearly. This helps avoid any conflict in the future.

Notes

**Contents of LLP Agreement**

Let us take a look at the contents of a proper LLP agreement.

1. Firstly, it contains the name of the limited liability partnership firm. According to the Act, the name must always end with LLP.
2. It also contains the date of the agreement. The act states that the agreement must be registered within 30 days after incorporation.
3. Then we come to the partner's contribution. The agreement has the ratio of the capital invested by the partners, the profit sharing ratio and other provisions regarding the capital contribution if any.
4. The agreement has the provisions related to the recording, storage, and maintenance of the books of accounts and other important documents
5. It includes the particulars of the capital accounts and current accounts. For example, where the drawings of the partner will be recorded.
6. The agreement contains the terms of disassociation as well. If any partners want to withdraw from the LLP, then the procedure and process are listed out. Also, it contains the rights of the exciting partners, rights of the continuing partners, the division of firm assets etc.
7. Also contains the provisions for the admission of a new partner into the LLP.
8. The agreement must also contain the procedural information regarding the sale or transfer of partnership rights. If such transfer of rights is prohibited, then it must be mentioned.

**Provisions in absence on an LLP Agreement**

If there is no registered LLP agreement between the partners, the provisions of Schedule I of the LLP Act 2008 shall apply to all the partners. These provisions are as follows :

- All partners of LLP shall share profits and losses equally.
- Partners shall have indemnity for any personal payments made by him in the ordinary course of business or anything done for the preservation of assets of the business
- Partners shall indemnify the LLP if losses are caused due to a fraudulent act was done by him
- All partners can take part in the management of the firm
- No partner is entitled to any remuneration or salary for the management of the LLP
- Admission of any new partner will require the permission of all the partners
- Any other issue will be decided by a vote of all the partners, and a simple majority will be needed to pass a resolution. But if the firm wants to change the nature of the business, all the partners must consent.

- Majority of the partners cannot expel a partner unless there is an express agreement between partners.
- Any disputes between the partners of an LLP which are not resolved amongst themselves must be referred for arbitration as per the act.

Notes

### 3.2.5 Nature of Limited Liability Partnership

Limited Liability Partnership agreement is a written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to such partnership, and partner in relation to limited liability partnership, as any person who becomes a partner in the limited liability partnership in accordance with the limited liability partnership agreement.

**Limited liability partnership to be body corporate :**

1. A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
2. A limited liability partnership shall have perpetual succession.
3. Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

**Non-applicability of the Indian Partnership Act, 1932 :** Save as otherwise provided, the provisions of the Indian Partnership Act, 1932 (9 of 1932) shall not apply to a limited liability partnership.

### 3.2.6 Partners and Designated Partners

**Partners :** Any individual or body corporate may be a partner in a limited liability partnership: Provided that an individual shall not be capable of becoming a partner of a limited liability partnership, if :

(a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent; or

(c) he has applied to be adjudicated as an insolvent and his application is pending.

**Minimum number of partners :**

1. Every limited liability partnership shall have at least two partners.

2. If at any time the number of partners of a limited liability partnership is reduced below two and the limited liability partnership carries on business for more than six months while the number is so reduced, the person, who is the only partner of the limited liability partnership during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the limited liability partnership incurred during that period.

Notes

**Designated partners :**

1. Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India: Provided that in case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners.

**Explanation :** For the purposes of this section, the term "resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty-two days during the immediately preceding one year.

2. **Subject to the provisions of sub-section (1)**

(i) **if the incorporation document :**

(a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; or

(b) states that each of the partners from time to time of limited liability partnership is to be designated partner, every such partner shall be a designated partner;

(ii) any partner may become a designated partner by and in accordance with the limited liability partnership agreement and a partner may cease to be a designated partner in accordance with limited liability partnership agreement.

3. An individual shall not become a designated partner in any limited liability partnership unless he has given his prior consent to act as such to the limited liability partnership in such form and manner as may be prescribed.

4. Every limited liability partnership shall file with the registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.

5. An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed.

6. Every designated partner of a limited liability partnership shall 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 (1 of 1956) shall apply mutatis mutandis for the said purpose.

**Liabilities of designated partners :** Unless expressly provided otherwise in this Act, a designated partner shall be :

(a) responsible for the doing of all acts, matters and things as are required to be done by the limited liability partnership 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 limited liability partnership agreement; and

(b) liable to all penalties imposed on the limited liability partnership for any contravention of those provisions.

**Changes in designated partners :** A limited liability partnership may appoint a designated partner within thirty days of a vacancy arising for any reason and provisions of sub-section (4) and sub-section (5) of section 7 shall apply in respect of such new designated partner: Provided that 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.

Notes

**Punishment for contravention of sections 7, 8 and 9 :**

1. If the limited liability partnership contravenes the provisions of sub-section (1) of section 7, the limited liability partnership and its every partner shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees.
2. If the limited liability partnership contravenes the provisions of sub-section (4) and sub-section (5) of section 7, section 8 or section 9, the limited liability partnership and its every partner shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

## 3.4 INCORPORATION OF LIMITED LIABILITY PARTNERSHIP AND MATTERS INCIDENTAL THERETO

### 3.4.1 Incorporation Document

1. For a limited liability partnership to be incorporated, :

(a) two or more persons associated for carrying on a lawful business with a view to profit shall subscribe their names to an incorporation document;

(b) the incorporation document shall be filed in such manner and with such fees, as may be prescribed with the Registrar of the State in which the registered office of the limited liability partnership is to be situated; and

(c) there shall be filed along with the incorporation document, a statement in the prescribed form, made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the limited liability partnership 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.

2. The incorporation document shall :

(a) be in a form as may be prescribed;

(b) state the name of the limited liability partnership;

Notes

(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 limited liability partnership on incorporation;

(f) state the name and address of the persons who are to be designated partners of the limited liability partnership on incorporation;

(g) contain such other information concerning the proposed limited liability partnership as may be prescribed.

3. If a person makes a statement under clause (c) of sub-section (1) which he :

(a) knows to be false; or

(b) does not believe to be true,

shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees.

### 3.4.2 Incorporation by Registration

1. When the requirements imposed by clauses (b) and (c) of sub-section (1) of section 11 have been complied with, the Registrar shall retain the incorporation document and, unless the requirement imposed by clause (a) of that sub-section has not been complied with, he shall, within a period of fourteen days :

(a) register the incorporation document; and

(b) give a certificate that the limited liability partnership is incorporated by the name specified therein.

2. The Registrar may accept the statement delivered under clause

(c) of sub-section (1) of section 11 as sufficient evidence that the requirement imposed by clause (a) of that sub-section has been complied with.

3. The certificate issued under clause (b) of sub-section (1) shall be signed by the Registrar and authenticated by his official seal.

4. The certificate shall be conclusive evidence that the limited liability partnership is incorporated by the name specified therein.

### 3.4.3 Registered Office of Limited Liability Partnership and Change Therein

1. Every limited liability partnership shall have a registered office to which all communications and notices may be addressed and where they shall be received.

2. A document may be served on a limited liability partnership or a partner or designated partner thereof by sending it by post under a certificate of posting or by registered post or by any other manner,

as may be prescribed, at the registered office and any other address specifically declared by the limited liability partnership for the purpose in such form and manner as may be prescribed.

3. A limited liability partnership may change the place of its registered office and file the notice of such change with the Registrar in such form and manner and subject to such conditions as may be prescribed and any such change shall take effect only upon such filing.

4. If the limited liability partnership contravenes any provisions of this section, the limited liability partnership and its every partner shall be punishable with fine which shall not be less than two thousand rupees but which may extend to twenty-five thousand rupees.

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### 3.4.4 Change of Name of Limited Liability Partnership

1. Notwithstanding anything contained in sections 15 and 16, where the Central Government is satisfied that a limited liability partnership has been registered (whether through inadvertence or otherwise and whether originally or by a change of name) under a name which :

(a) is a name referred to in sub-section (2) of section 15; or

(b) is identical with or too nearly resembles the name of any other limited liability partnership or body corporate or other name as to be likely to be mistaken for it, the Central Government may direct such limited liability partnership to change its name, and the limited liability partnership shall comply with the said direction within three months after the date of the direction or such longer period as the Central Government may allow.

2. Any limited liability partnership which fails to comply with a direction given under sub-section (1) shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to five lakh rupees and the designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

### 3.4.5 Partners and Their Relations

Chapter 3 of the LLP Act. covers Section 22 to Section 25. Section 22, prescribes who would be considered as a partner of an LLP. Section 23 provides that the mutual rights and duties amongst the partners' inter-se and between partners and LLP shall be governed by the LLP agreement and in the absence of such agreement. shall be governed by the relevant provisions of the LLP Act. Section 24 prescribes the circumstances when a person may cease to be a partner of an LLP and governs the rights and duties of the person who is ceased to be a partner as well as of the LLP. Section 25 emphasizes on the requirement of public information regarding the fact of cessation of a partner from LLP and provides the mode in which such information has to be disseminated to the Registrar or third parties. The Section also prescribes penalties for default made in relation to its provisions.

Notes

**Eligibility to be partners (Section 22)**

Section 23 of LLP Act seeks to provide that the persons who subscribe their names to the incorporation document shall be partners of LLP and any other person may also become partner of the LLP in accordance with its agreement.

This seciton provides that there are two ways in which a person can become a partner in an LLP - one is by subscribing his name to the incorporation document and other is by following the procedures/norms prescribed in the partnership agreement for this purpose.

The first partners of an LLP are those who signed the incorporation document. Section 41 of the Companies Act. 1956 also contains a similar provision with respect to the members of a company. It provides that the subscribers of the memorandum of association shall be deemed to have agreed to become members of the company. and on its registration shall be entered as members in the register of members. In this regard, it was held in Official Liquidator v. Suleman Bhai (AIR 1955 MB 166). that the subscriber of the memorandum is to be treated as having become the member by the very fact of subscription. Neither application form. not allotment of shares is necessary. Even an absence of entry in the register of members cannot deprive him to his status. He acquires. asc soon as the company is registered, the full status of a member with all the rights and liabilities.

After incorporation, any person may become a partner of an LLP by agreement with the existing partners. The agreement may prescribe any mode for taking a person as a partner in the LLP. It could be an admission of partner with the consent of three fourths of the partners or a partner having 10 years of (specified) professional experience and consent of majority of partners of any other criteria specified in the agreement. In the absence of partnership agreement or in the absence of a clause to this effect in the agreement, a new partner can be admitted to an LLP with the consent of all the existing partners as per the default provisions under Schedule I of the LLP Act. 2008.

Thus, a person can become a partner in an LLP in either of the above two modes. Thus a person who may be holding beneficial interest of a partner or a nominee of a deceased partner would not be considered as partner in LLP despite having interest therein. In context of the Companies Act. 1956. In Balkrishan Gupt v. Swadeshi Polytex Ltd. (1985) 58 Comp. cas 563 SC, it was held that a pewnee of shares or a receiver appointed under Section 182A of the Land Revenue Act, or the person in whose favour, the order for attachment of shares has been passed by the court does not acquire any rights of a member.

**Relationship of Partners (Section 23)**

Section 23 of the LLP Act seeks to provide that the mutual rights and duties of the partners of the LLP inter se and that of the LLP and its partners shall be governed by the LLP agreement and in absence of any such agreement, such mutual rights and duties shall be determined as set out in the First Schedule of the Act. It also seeks to empower the Central Government to prescribe, by rules,

the form, manner and fees for filing the LLP agreement and informing changes therein. This clause further seeks to provide that any agreement, made before the incorporation of LLP, between the partners who subscribe their names to the incorporation document may impose obligation on LLP, if ratified by all the partners after its incorporation.

Notes

Section 23 of the LLP Act provides that the relationship of partners with LLP and as also between themselves is governed by the partnership agreement and in the absence there of is covered by the default provisions in this regard given under Schedule I of the ACt.

**Section 23(1) :** As regards the management of the internal affairs of the LLP there is a parallel with the system that operates for partnerships. As in case of partnersip. the mutual rights and duties of the partners of a limited liability partnership, and the mutual rights and duties of a limited liability partnership and its partners are governed by the limited liability partnership agreement.

Partners are not obliged to enter into a formal agreement among themselves and there is no obligation to publish any agreement which is entered into. As in the case of partnerships, however, there will in general, be clear advantages in having a formal written agreement between partners to regulate the affairs of the undertaking and to avoid disputes between them. The formal procedures needed to establish an LLP, including the need for an application to the registar of companies, are likely to encourage the partners to set up a formal arrangement before the LLP commences business.

As per Rule 21 of the LLP Rules, every limited liability partnership shall file information with regard to the limited liability partnership agreement in Form 4 with the registar within 30 days from the date of agreement.

Here, notable point is that under the LLP rules, the partnership agreement to be submitted to the Registar is supposed to be in a given formal (i.e. Form No. 4) rather than in the usual form of a legal agreementt.

In case, an LLP decides to make an LLP agreement, it would require determining parameters under above heads and Form 4 filled in with the above details is to be filed with the Registar within 30 days of the agreement. It may be noted that though the law has provided a time limit to submit partnership agreement to the Registar, however, forming and filling a partnership agreement as such is not a mandatory requirement.

**Section 23(2) :** This sub-section provides that limited liability partnership agreement and any changes, made there in shall be filled with the Registar in such form, manner and accompanied by such fees as may be prescribed.

**Annual Compliance of LLP :** Proper books of account are to be maintained by the LLP relating to its affairs for each year and for filing of an Annual Statement of Accounts and Solvency in form 8 with the Registrar in such form and manner as may be prescribed.

The accounts of the LLPs shall be audited as provided by the rules which are made by the Government.

Notes

Every LLP shall be required to file with the Registrar an annual return duly authenticated in Form 11 every year.

Incorporation document, names of partners and changes, if any.

Statement of Account and Solvency and Annual Return filed by each LLP with the Registrar shall be available for inspection in the office of the Registrar by the public.

**Assignment and transfer of partnership rights :** The rights of a partner to a share of the profits and losses of the LLP and to receive distributions in accordance with the LLP agreement are transferable either wholly or in part.

The transfer of any rights by any partner would not by itself cause the disassociation of the partner or a dissolution and winding of an LLP.

The transfer of rights would not entitle the transferee or assignee to participate in the management or conduct of the activities of the LLP or access information concerning the transactions of the LLP.

**Investigation of affairs of LLP :** The act provides for the circumstances under which investigation of the affairs of an LLP may be ordered by the Central Government.

The act also empowers the Central Government, if it feels it is necessary in public interest, to initiate proceedings against the LLP for recovery of property and damages.

**Conversion of existing firms into a LLP :** A partnership firm may convert itself into an LLP as per Section 55 and second schedule of the act.

A private Limited company may convert itself into an LLP as per section 56 and third schedule of the act.

An unlisted Public company may be converted into an LLP as per section 57 and the fourth schedule of the act.

Upon such conversion, on and from the date of certificate of registration issued by the Registrar in this regard, the effects of the conversion shall be such as are specified in the act.

On and from the date of LLP registration specified in the certificate of registration, all tangible (movable or immovable) and intangible property vested in the firm or the company, all assets, interests, rights, privileges, liabilities, obligations relating to the firm or the company, and the whole of the undertaking of the firm or the company, shall be transferred to and shall vest in the LLP without further assurance, act or deed and the firm or the company, shall be deemed to be dissolved and removed from the records of the Registrar of Firms or Registrar of Companies, as the case may be.

**Provisions for incorporation of Foreign LLP :** Foreign LLP can establish a place of business in India and its regulatory mechanism will be as per the rules prescribed by the Central Government.

**Compromise, arrangement or reconstruction of LLP :** The LLP act provides compromise or arrangement including mergers and amalgamations, winding up and dissolution of LLP. These should be agreed by majority of members and creditors of LLP representing three-fourths in value and confirmed by the National Company Law Tribunal.

## 3.5 EXTENT AND LIMITATION OF LIABILITY OF LIMITED LIABILITY PARTNERSHIP AND PARTNERS

Notes

**Partner as agent :** Every partner of a limited liability partnership is, for the purpose of the business of the limited liability partnership, the agent of the limited liability partnership, but not of other partners.

**Extent of liability of limited liability partnership :** 1. A limited liability partnership is not bound by anything done by a partner in dealing with a person if :

(a) the partner in fact has no authority to act for the limited liability partnership in doing a particular act; and

(b) the person knows that he has no authority or does not know or believe him to be a partner of the limited liability partnership.

2. The limited liability partnership is liable if a partner of a limited liability partnership is liable to any person as a result of a wrongful act or omission on his part in the course of the business of the limited liability partnership or with its authority.

3. An obligation of the limited liability partnership whether arising in contract or otherwise, shall be solely the obligation of the limited liability partnership.

4. The liabilities of the limited liability partnership shall be met out of the property of the limited liability partnership.

**Extent of liability of partner :** (1) A partner is not personally liable, directly or indirectly for an obligation referred to in sub-section (3) of section 27 solely by reason of being a partner of the limited liability partnership. (2) The provisions of sub-section (3) of section 27 and sub-section (1) of this section shall not affect the personal liability of a partner for his own wrongful act or omission, but a partner shall not be personally liable for the wrongful act or omission of any other partner of the limited liability partnership.

**Holding out :** 1. Any person, who by words spoken or written or by conduct, represents himself, or knowingly permits himself to be represented to be a partner in a limited liability partnership is liable to any person who has on the faith of any such representation given credit to the limited liability partnership, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit :

Provided that where any credit is received by the limited liability partnership as a result of such representation, the limited liability partnership

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shall, without prejudice to the liability of the person so representing himself or represented to be a partner, be liable to the extent of credit received by it or any financial benefit derived thereon.

2. Where after a partner's death the business is continued in the same limited liability partnership name, the continued use of that name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the limited liability partnership done after his death.

**Unlimited liability in case of fraud :** 1. In the event of an act carried out by a limited liability partnership, or any of its partners, with intent to defraud creditors of the limited liability partnership or any other person, or for any fraudulent purpose, the liability of the limited liability partnership and partners who acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the limited liability partnership: Provided that in case any such act is carried out by a partner, the limited liability partnership is liable to the same extent as the partner unless it is established by the limited liability partnership that such act was without the knowledge or the authority of the limited liability partnership.

2. Where any business is carried on with such intent or for such purpose as mentioned in sub-section (1), every person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

3. Where a limited liability partnership or any partner or designated partner or employee of such limited liability partnership has conducted the affairs of the limited liability partnership in a fraudulent manner, then without prejudice to any criminal proceedings which may arise under any law for the time being in force, the limited liability partnership and any such partner or designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct: Provided that such limited liability partnership shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of the limited liability partnership.

### 3.5.1 Whistle Blowing

1. The Court or Tribunal may reduce or waive any penalty leviable against any partner or employee of a limited liability partnership, if it is satisfied that :

(a) such partner or employee of a limited liability partnership has provided useful information during investigation of such limited liability partnership; or

(b) when any information given by any partner or employee (whether or not during investigation) leads to limited liability partnership or

any partner or employee of such limited liability partnership being convicted under this Act or any other Act.

2. No partner or employee of any limited liability partnership may be discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against the terms and conditions of his limited liability partnership or employment merely because of his providing information or causing information to be provided pursuant to sub-section (1).

Notes

### 3.5.2 Winding Up and Dissolution of LLP

**Winding up and dissolution :** The winding up of a limited liability partnership may be either voluntary or by the Tribunal and limited liability partnership, so wound up may be dissolved.

**Circumstances in which limited liability partnership may be wound up by Tribunal :** A limited liability partnership may be wound up by the Tribunal, :

(a) if the limited liability partnership decides that limited liability partnership be wound up by the Tribunal;

(b) if, for a period of more than six months, the number of partners of the limited liability partnership is reduced below two;

(c) if the limited liability partnership is unable to pay its debts;

(d) if the limited liability partnership has acted against the interests of the sovereignty and integrity of India, the security of the State or public order;

(e) if the limited liability partnership has made a default in filing with the Registrar the Statement of Account and Solvency or annual return for any five consecutive financial years; or

(f) if the Tribunal is of the opinion that it is just and equitable that the limited liability partnership be wound up.

**Rules for winding up and dissolution :** The Central Government may make rules for the provisions in relation to winding up and dissolution of limited liability partnerships.

## 3.6 SUMMARY

The first LLP was registered on 2nd April, 2009 and till the 25th of April, 2011, 4580 LLPs were registered. With the liberalisation and globalisation of Indian economy, the LLP, as an alternate mode of carrying business, will encourage joint ventures and would make Indian service sectors globally competitive. The hybrid structure of LLP will facilitate entrepreneurs, service providers and professionals to organize and operate in an innovative and efficient manner for effectively competing in the global market.

Limited liability concept plays a very great role under Indian business as people have a choice instead of choosing rigid functioning of partnership firms they can go for LLP. After the LLP ACT 2008, new birth to 2 parties functioning

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gives rise. Likewise other developing countries we have to try to make our country not legging behind in LLP concept. Measures must be effective and have regularity. Limited liability restricts partners to perform their liability in limited manner. The law must have to involve more and more people to give a new way to this new concept. Profit percentage is going higher and higher of the LLP companies as compared to partnership firm.

## 3.7 EXERCISE

1. Define limited liability partnership.
2. What are the advantages of LLP from of entity ?
3. Distinguish between LLP from of entity and partnership.
4. Write two differences between LLP and Company.
5. Write features of LLP.

# UNIT 4: CONSUMER PROTECTION ACT, 1986

Notes

**Structure:**



## 4.0 OBJECTIVES

After reading this Unit. you will be able to:

- discuss the aims and objects of the act;
- explain redressal machinery under the act;
- describe the procedure for complaint under the act, 1986;
- analysis the remedies and appeals;
- understand the enforcement of orders and penalties.

## 4.1 INTRODUCTION

A consumer is said to be a king in a free market economy. The earlier approach of caveat emptor, which means "Let the buyer beware", has now been changed to caveat venditor ("Let the seller beware"). However, with growing competition and in an attempt to increase their sales and market share, manufacturers and service providers may be tempted to engage in unscrupulous, exploitative and unfair trade practices like defective and unsafe products, adulteration, false and misleading advertising, hoarding, black-marketing, etc. This means that a consumer might be exposed to risks due to unsafe products, might suffer from bad health due to adulterated food products, might be cheated because of misleading advertisements or sale of spurious products, might have to pay a higher price when sellers engage in overpricing, hoarding or black-marketing, etc. Thus, there is a need for providing adequate protection to consumers against such practices of the sellers. Let us now discuss the importance of consumer protection.

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The industrial revolution and the development in the international trade and commerce has led to the vast expansion of business and trade, as a result of which a variety of consumer goods have appeared in the market to cater to the needs of the consumers and a host of services have been made available to the consumers like insurance, transport, electricity, housing, entertainment, finance and banking.

A well organized sector of manufacturers and traders with better knowledge of markets has come into existence, thereby affecting the relationship between the traders and the consumers making the principle of consumer sovereignty almost inapplicable. The advertisements of goods and services in television, newspapers and magazines influence the demand for the same by the consumers though there may be manufacturing defects or imperfections or short comings in the quality, quantity and the purity of the goods or there may be deficiency in the services rendered. In addition, the production of the same item by many firms has led the consumers, who have little time to make a selection, to think before they can purchase the best. For the welfare of the public, the glut of adulterated and sub-standard articles in the market have to be checked.

In spite of various provisions providing protection to the consumer and providing for stringent action against adulterated and sub-standard articles in the different enactments like Code of Civil Procedure, 1908, the Indian Contract Act, 1872, the Sale of Goods Act, 1930, the Indian Penal Code, 1860, the Standards of Weights and Measures Act, 1976 and the Motor Vehicles Act, 1988, very little could be achieved in the field of Consumer Protection. Though the Monopolies and Restrictive Trade Practices Act, 1969 and the Prevention of Food Adulteration Act, 1954 have provided relief to the consumers yet it became necessary to protect the consumers from the exploitation and to save them from adulterated and sub-standard goods and services and to safe guard the interests of the consumers. In order to provide for better protection of the interests of the consumer the Consumer Protection Bill, 1986 was introduced in the Lok Sabha on 5th December, 1986.

## 4.2 CONSUMER PROTECTION ACT, 1986

### 4.2.1 Aims and Objects of The Act

1. The Consumer Protection Bill, 1986 seeks to provide for better protection of the interests of consumers and for the purpose, to make provision for the establishment of Consumer councils and other authorities for the settlement of consumer disputes and for matter connected therewith.

2. It seeks, *inter alia*, to promote and protect the rights of consumers such as :

(a) the right to be protected against marketing of goods which are hazardous to life and property;

(b) the right to be informed about the quality, quantity, potency, purity, standard and price of goods to protect the consumer against unfair trade practices;

(c) the right to be assured, wherever possible, access to an authority of goods at competitive prices;

(d) the right to be heard and to be assured that consumers interests will receive due consideration at appropriate forums;

(e) the right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers; and

(f) right to consumer education.

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3. These objects are sought to be promoted and protected by the Consumer Protection Council to be established at the Central and State level.

4. To provide speedy and simple redressal to consumer disputes, a quasi-judicial machinery is sought to be setup at the district, State and Central levels. These quasi-judicial bodies will observe the principles of natural justice and have been empowered to give relief of a specific nature and to award, wherever appropriate, compensation to consumers. Penalties for noncompliance of the orders given by the quasi-judicial bodies have also been provided.

5. The Bill seeks to achieve the above objects.

### 4.2.2 Definitions

1. In this Act, unless the context otherwise requires, :

(a) "appropriate laboratory» means a laboratory or organisation :

(i) recognised by the Central Government;

(ii) recognised by a State Government, subject to such guidelines as may be prescribed by the Central Government in this behalf; or

(iii) any such laboratory or organisation established by or under any law for the time being in force, which is maintained, financed or aided by the Central Government or a State Government for carrying out analysis or test of any goods with a view to determining whether such goods suffer from any defect;

(aa) "branch office" means :

(i) any establishment described as a branch by the opposite party; or

(ii) any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the establishment;

(b) "complainant" means :

(i) a consumer; or

(ii) any voluntary consumer association registered under the Companies Act, 1956 (1of 1956)or under any other law for the time being in force; or

(iii) the Central Government or any State Government,

(iv) one or more consumers, where there are numerous consumers having the same interest;

(v) in case of death of a consumer, his legal heir or representative; who or which makes a complaint;

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(c) "complaint" means any allegation in writing made by a complainant that :

(i) an unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider;

(ii) the goods bought by him or agreed to be bought by him; suffer from one or more defects;

(iii) the services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;

(iv) a trader or service provider, as the case may be, has charged for the goods or for the service mentioned in the complaint a price in excess of the price :

(a) fixed by or under any law for the time being in force

(b) displayed on the goods or any package containing such goods;

(c) displayed on the price list exhibited by him by or under any law for the time being in force;

(d) agreed between the parties;

(v) goods which will be hazardous to life and safety when used or being offered for sale to the public, :

(a) in contravention of any standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force;

(b) if the trader could have known with due diligence that the goods so offered are unsafe to the public;

(vi) services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by the service provider which such person could have known with due diligence to be injurious to life and safety;";

(d) "consumer" means any person who :

(i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose; or

(ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who 'hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such

services are availed of with the approval of the first mentioned person ***but does not include a person who avails of such services for any commercial purposes***;

***Explanation :*** For the purposes of this clause, "commercial purpose" does not include use by a person of goods bought and used by him and services availed by him exclusively for the purposes of earning his livelihood by means of self-employment;

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(e) "consumer dispute» means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

(f) "defect" means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force under any contract, express or implied or as is claimed by the trader in any manner whatsoever in relation to any goods;

(g) "deficiency" means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service;

(h) "District Forum" means a Consumer Disputes Redressal Forum established under clause (a) of section 9;

(i) "goods" means goods as defined in the Sale of Goods Act, 1930 (3 of 1930);

(j) "manufacturer" means a person who—

(i) makes or manufactures any goods or part thereof; or

(ii) does not make or manufacture any goods but assembles parts thereof made or manufactured by others; or

(iii) puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer;

***Explanation :*** Where a manufacturer dispatches any goods or part thereof to any branch office maintained by him, such branch office shall not be deemed to be the manufacturer even though the parts so dispatched to it are assembled at such branch office and are sold or distributed from such branch office;

(k) "member" includes the President and a member of the National Commission or a State Commission or a District Forum, as the case may be;

(l) "National Commission" means the National Consumer Disputes Redressal Commission established under clause (c) of section 9;

(m) "notification" means a notification published in the Official Gazette;

(n) "person" includes, :

(i) a firm whether registered or not;

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(ii) a Hindu undivided family;

(iii) a co-operative society;

(iv) every other association of persons whether registered under the Societies Registration Act, 1860 (21 of 1860) or not;

(o) "prescribed" means prescribed by rules made by the State Government, or as the case may be, by the Central Government under this Act;

(oo) "regulation" means the regulations made by the National Commission under this Act;

(ooo) "restrictive trade practice" means a trade practice which tends to bring about manipulation of price or conditions of delivery or to affect flow of supplies in the market relating to goods or services in such a manner as to impose on the consumers unjustified costs or restrictions and shall include :

(a) delay beyond the period agreed to by a trader in supply of such goods or in providing the services which has led or is likely to lead to rise in the price;

(b) any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be; services as condition precedent to buying; hiring or availing of other goods or services;

(p) "service" means service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing insurance, transport, processing, supply of electrical or other energy, board or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service;

(pp) "spurious goods and services" mean such goods and services which are claimed to be genuine but they are actually not so;

(q) "State Commission" means a Consumer Disputes Redressal Commission established in a State under clause (b) of section 9;

(r) "trader" in relation to any goods means a person who sells or distributes any goods for sale and includes the manufacturer thereof, and where such goods are sold or distributed in package form, includes the packer thereof;

(s) "unfair trade practice" means a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice including any of the following practices, namely;—

1. the practice of making any statement, whether orally or in writing or by visible representation which, :

(i) falsely represents that the goods are of a particular standard, quality, quantity, grade, composition, style or model;

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(ii) falsely represents that the services are of a particular standard, quality or grade;

(iii) falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods;

(iv) represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have;

(v) represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;

(vi) makes a false or misleading representation concerning the need for, or the usefulness of, any goods or services;

(vii) gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that is not based on an adequate or proper test thereof;

Provided that where a defence is raised to the effect that such warranty or guarantee is based on adequate or proper test, the burden of proof of such defence shall lie on the person raising such defence;

(viii) makes to the public a representation in a form that purports to be :

(i) a warranty or guarantee of a product or of any goods or services; or

(ii) a promise to replace, maintain or repair an article or any part thereof or to repeat or continue a service until it has achieved a specified result, if such purported warranty or guarantee or promise is materially misleading or if there is no reasonable prospect that such warranty, guarantee or promise will be carried out;

(ix) materially misleads the public concerning the price at which a product or like products or goods or services, have been or are, ordinarily sold or provided, and, for this purpose, a representation as to price shall be deemed to refer to the price at which the product or goods or services has or have been sold by sellers or provided by suppliers generally in the relevant market unless it is clearly specified to be the price at which the product has been sold or services have been provided by the person by whom or on whose behalf the representation is made;

(x) gives false or misleading facts disparaging the goods, services or trade of another person.

***Explanation :*** For the purposes of clause (1), a statement that is :

(a) expressed on an article offered or displayed for sale, or on its wrapper or container; or

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(b) expressed on anything attached to, inserted in, or accompanying, an article offered or displayed for sale, or on anything on which the article is mounted for display or sale; or

(c) contained in or on anything that is sold, sent, delivered, transmitted or in any other manner whatsoever made available to a member of the public, shall be deemed to be a statement made to the public by, and only by, the person who had caused the statement to be so expressed, made or contained;

2. permits the publication of any advertisement whether in any newspaper or otherwise, for the sale or supply at a bargain price, of goods or services that are not intended to be offered for sale or supply at the bargain price, or for a period that is, and in quantities that are, reasonable, having regard to the nature of the market in which the business is carried on, the nature and size of business, and the nature of the advertisement.

**Explanation :** For the purpose of clause (2), "bargaining price" means—

(a) a price that is stated in any advertisement to be a bargain price, by reference to an ordinary price or otherwise, or

(b) a price that a person who reads, hears or sees the advertisement, would reasonably understand to be a bargain price having regard to the prices at which the product advertised or like products are ordinarily sold;

3. permits :

(a) the offering of gifts, prizes or other items with the intention of not providing them as offered or creating impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole;

(b) the conduct of any contest, lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest;

3A. withholding from the participants of any scheme offering gifts, prizes or other items free of charge, on its closure the information about final results of the scheme.

**Explanation :** For the purposes of this sub-clause, the participants of a scheme shall be deemed to have been informed of the final results of the scheme where such results are within a reasonable time, published, prominently in the same newspapers in which the scheme was originally advertised;

4. permits the sale or supply of goods intended to be used, or are of a kind likely to be used, by consumers, knowing or having reason to

believe that the goods do not comply with the standards prescribed by competent authority relating to performance, composition, contents, design, constructions, finishing or packaging as are necessary to prevent or reduce the risk of injury to the person using the goods;

5. permits the hoarding or destruction of goods, or refuses to sell the goods or to make them available for sale or to provide any service, if such hoarding or destruction or refusal raises or tends to raise or is intended to raise, the cost of those or other similar goods or services.

6. manufacture of spurious goods or offering such goods for sale or adopts deceptive practices in the provision of services.

2. Any reference in this Act to any other Act or provision thereof which is not in force in any area to which this Act applies shall be construed to have a reference to the corresponding Act or provision thereof in force in such area.

### 4.2.3 Redressal Machinery Under the Act

Consumers play a key role in maintaining the economy of India. Each and every person constitutes a consumer because each one of us is engaged in some form of exchange of goods or services through money as a medium. Gradually, there arise many kinds of disputes among the consumers as well as consumers and the sellers. In this context, it has to be stated that there lies a need for a statute which regulates the friction between the consumers and the sellers. For this purpose, Consumer Protection Act was enacted in the year 1986 to look after the various rights and duties of the consumers during the time of purchasing a product and even after that. The Act plays an important role in the fields where there arises an incidence of exchange of goods or services between two persons where money acts as a medium. The Act also provides certain guidelines as to what measures must be complied with during the time of such exchange, what are the various rights available to both the buyer and seller etc. It also provides certain provisions regarding the need and formulation of various "Consumer Redressal Centres' both at the central as well as states level.

The Act lays down certain provisions regarding the definition of consumer, various consumer protection councils, and provisions in connection with various consumer redressal agencies in India as well as other miscellaneous provisions. Among this, provisions relating to consumer redressal agencies demand a lot of attention in the present Indian scenario. Many people are still not aware that there are such agencies working in favor of consumers in every district. Due to this reason, many of them are not getting proper solutions for their problems as consumers. Chapter III of the Act provides for the implementation of redressal agencies. Section 9 of the Act provides for 'establishment of consumer dispute redressal agencies' which include :

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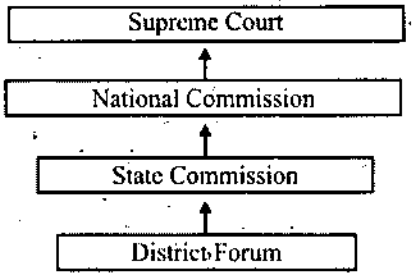
- A District forum established by the State Government in each district of the State by its notification.
- A State Commission established by the State Government in each state by its notification and
- A National Commission established by Central Government by notification

For the redressal of consumer grievances, the Consumer Protection Act provides for setting up of a three-tier enforcement machinery at the District, State, and the National levels, known as the District Consumer Dispute Redressal Forum, State Consumer Disputes Redressal Commission, and the National Consumer Disputes Redressal Commission. They are briefly referred to as the 'District Forum', 'State Commission', and the 'National Commission', respectively. While the National Commission is set up by the Central Government, the State Commissions and the District Forums are set up, in each State and District, respectively, by the State Government concerned. The Figure on redressal agencies shows the hierarchical structure of this three-tire machinery. Before studying the set-up and functioning of these redressal agencies let see how the Consumer Protection Act defines a consumer and who can file a complaint under the Consumer Protection Act.

**Consumer :** A 'consumer' is generally understood as a person who uses or consumes goods or avails of any service. Under the Consumer Protection Act, a consumer is defined as :

(a) Any person who buys any goods for a consideration, which has been paid or promised, or partly paid and partly promised, or under any scheme of deferred payment. It includes any user of such goods, when such use is made with the approval of the buyer, but does not include a person who obtains goods for re-sale or any commercial purpose.

(b) Any person who hires or avails of any service, for a consideration which has been paid or promised, or partly paid and partly promised, or under any system of deferred payment. It includes any beneficiary of services when such services are availed of with the approval of the person concerned, but does notinclude a person who avails of such services for any commercial purpose.




**Redressal Agencies under the Consumer Protection Act**

A complaint before the appropriate consumer forum can be made by :

(i) Any consumer can file a complaint on his/her own and does not need the services of advocate/ professionals;

(ii) Any registered consumers' association;

(iii) The Central Government or any State Government;

(iv) One or more consumers, on behalf of numerous consumers having the same interest; and

(v) A legal heir or representative of a deceased consumer.

(vi) A complaint under Section 2 (b) of the Consumer Protection Act 1986.

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Let us now see how the consumer grievances are redressed by the three tire machinery under the Consumer Protection Act.

**1. District Forum :** There are 644 district commissions in India. The District Forum consists of a President and two other members, one of whom should be a woman. They all are appointed by the State Government concerned. A complaint can to be made to the appropriate District Forum when the value of the goods or services in question, along with the compensation claimed, does not exceed Rs 20 lakhs. On receiving the complaint, the District Forum shall refer the complaint to the party against whom the complaint is filed. If required, the goods or a sample thereof, shall be sent for testing in a laboratory.

The District Forum shall pass an order after considering the test report from the laboratory and hearing to the party against whom the complaint is filed. In case the aggrieved party is not satisfied with the order of the District Forum, he can appeal before the State Commission within 30 days of the passing of the order.

**2. State Commission :** There are 365 State Commission of India. Each State Commission consists of a President and not less than two other members, one of whom should be a woman. They are appointed by the State Government concerned. A complaint can to be made to the appropriate State Commission when the value of the goods or services in question, along with the compensation claimed, exceeds Rs 20 lakhs but does not exceed Rs 1 crore. The appeals against the orders of a District Forum can also be filed before the State Commission. On receiving the complaint, the State Commission shall refer the complaint to the party against whom the complaint is filed. If required, the goods or a sample thereof, shall be sent for testing in a laboratory. The State Commission shall pass an order after considering the test report from the laboratory and hearing to the party against whom the complaint is filed. In case the aggrieved party is not satisfied with the order of the State Commission, he can appeal before the National Commission within 30 days of the passing of the order.

**3. National Commission:** The National Commission has territorial jurisdiction over the whole country. The National Commission consists of a President and at least four other members, one of whom should be a woman. They are appointed by the Central Government. A complaint can to be made to the National Commission when the value of the goods or services in question, along with the compensation claimed, exceeds Rs 1 crore. The appeals against the orders of a State Commission can also be filed before the National Commission. On receiving the complaint, the National Commission shall refer the complaint

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to the party against whom the complaint is filed. If required, the goods or a sample thereof, shall be sent for testing in a laboratory.

The National Commission shall pass an order after considering the test report from the laboratory and hearing to the party against whom the complaint is filed. An order passed by the National Commission in a matter of its original jurisdiction is appealable before the Supreme Court. This means that only those appeals where the value of goods and services in question, along with the compensation claimed, exceeded Rs 1 crore and where the aggrieved party was not satisfied with the order of the National Commission, can be taken to the Supreme Court of India. Moreover, in a case decided by the District Forum, the appeal can be filed before the State Commission and, thereafter, the order of the State Commission can be challenged before the National Commission and no further.

**Power of redressal forums :** There are various powers for all of the redressal forums with regards to its jurisdiction. Some of them include :

1. Examining, enforcing as well as summoning the witness on oath;
2. Discovering and producing any material evidence;
3. Receiving evidence on affidavit;
4. Requesting for report or test analysis from the concerned authorities and laboratories;
5. Issuing commission for examining the witness;
6. Enforcing any other powers prescribed by the Central or State Government.

**Limitation period :** The District, State or National Forum for consumer grievance redressal will not entertain a case which is filed two years after the occurrence of the case unless the party/parties can condone themselves regarding the reasons behind the delay of filing within the specified period. Such a provision was formulated to increase the accuracy of the function of such forums and also for delivering fast redressal solutions to the parties.

**Relief Available :** If the consumer court is satisfied about the genuineness of the complaint, it can issue one or more of the following directions to the opposite party.

(i) To remove the defect in goods or deficiency in service.

(ii) To replace the defective product with a new one, free from any defect.

(iii) To refund the price paid for the product, or the charges paid for the service.

(iv) To pay a reasonable amount of compensation for any loss or injury suffered by the consumer due to the negligence of the opposite party.

(v) To pay punitive damages in appropriate circumstances.

(vi) To discontinue the unfair/ restrictive trade practice and not to repeat it in the future.

(vii) Not to offer hazardous goods for sale.

(viii) To withdraw the hazardous goods from sale.

(ix) To cease manufactur e of hazardous goods and to desist from offering hazardous services.

(x) To pay any amount (not less than 5% of the value of the defective goods or deficient services provided), to be credited to the Consumer Welfare Fund or any other organisation/person, to be utilised in the prescribed manner.

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(xi) To issue corrective advertisement to neutralise the effect of a misleading advertisement.

(xii) To pay adequate costs to the appropriate party.

Bring out some decided cases where a complaint was filed in a consumer court for defective goods and deficient services.

**Role of Consumer Organisations and NGOs**

In India, several consumer organisations and non-governmental organisations (NGOs) have been set up for the protection and promotion of consumers' interests. Nongovernmental organisations are non profit organisations which aim at promoting the welfare of people. They have a constitution of their own and are free from government interference. Consumer organisations and NGOs perform several functions for the protection and promotion of interest of consumers. These include :

(i) Educating the general public about consumer rights by organising training programmes, seminars and workshops.

(ii) Publishing periodicals and other publications to impart knowledge about consumer problems, legal reporting, reliefs available and other matters of interest.

(iii) Carrying out comparative testing of consumer products in accredited laboratories to test relative qualities of competing brands and publishing the test results for the benefit of consumers.

(iv) Encouraging consumers to strongly protest and take an action against unscrupulous, exploitative and unfair trade practices of sellers.

(v) Providing legal assistance to consumers by way of providing aid, legal advice etc. in seeking legal remedy.

(vi) Filing complaints in appropriate consumer courts on behalf of the consumers.

(vii) Taking an initiative in filing cases in consumer courts in the interest of the general public, not for any individual.

Some of the important consumer organisations and NGOs engaged in protecting and promoting consumers' interests include the following :

(i) Consumer Coordination Council, Delhi

(ii) Common Cause, Delhi

(iii) Voluntary Organisation in Interest of Consumer Education (VOICE), Delhi

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(iv) Consumer Education and Research Centre (C E RC), Ahmedabad
(v) Consumer Protection Council (CPC), Ahmedabad
(vi) Consumer Guidance Society of India (CGSI), Mumbai
(vii) Mumbai Grahak Panchayat, Mumbai
(viii) Karnataka Consumer Service Society, Bangalore
(ix) Consumers' Association, Kolkata
(x) Consumer Unity and Trust Society (CUTS), Jaipur

### 4.2.4 Procedure for Compalant Under the Act, 1986

India is the fastest growing and the fifth largest economy in the world and hence, has one of the biggest consumer markets. With the increase in purchasing capacity and choices of products in the market, consumers are now more aware and conscious of their rights. Whether it be shopping complex, showrooms or a grocery store, oftentimes consumers are asked to pay or are being charged for carry bags. Which is clearly an unfair means to compel a customer to pay for a paper bag which is a clear deficiency in service as it was the store's duty to provide a free bag to the customer who had purchased their product. Similarly, many a times consumers have numerous grievances however, they do not know how and where to file their complaints. Here is a description of how you can file a complaint under the Consumer Protection Act, 1986.

**Firstly, we need to understand who is a consumer?**

According to the Consumer Protection Act, A consumer is an individual who buys any product/goods or avails any service for a consideration, either for his personal use or to earn his livelihood by means of self-employment. Also, a beneficiary of such goods/services with the approval of the person who bought that product or who employed the service would be considered as a consumer. The consideration (in exchange of) may be: Paid, Promised, or partly paid and partly promised.

**Who can file a complaint?**

- Anyconsumer;
- Any voluntary consumer association;
- Central Government or any State Government;
- One or more consumers, where there are numerous consumers having same interest;
- In case of death of a consumer, his legal heir or representative.

**Where to file a complaint?**

According the Consumer Protection Act, 1986, A complaint can be filed in :

- District Consumer Disputes Redressal Forum (DCDRF): If the value of the claim is up to twenty lakhs.

- State Consumer Disputes Redressal Commission (SCDRC): If the value of the claim exceeds twenty lakhs but is within one crore.
- National Consumer Disputes Redressal Commission (NCDRC) If the value of the claim exceeds one crore.
- Each of these forums has to provide the resolution within thirty days failing to which the consumer can escalate the complaint to the next commission.

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**How to decide jurisdiction?**

A complaint shall be instituted in a Consumer Forum within the local limits of whose jurisdiction the opposite party resides or carries on business or has a branch office or personally works for gain, or where the cause of action, wholly or in part, arises.

**When can complaint be made?**

A complaint may be made in writing under the following circumstances :

- If there is a Loss or damage caused to the consumer due to unfair or restrictive trade practice of a trader or service provider;
- If the article purchased by a consumer is defective;
- If the services availed of by a consumer suffer from any deficiency;
- If a trader or service provider, as the case may be, has charged for the goods or for the service mentioned in the complaint a price in excess of the stipulated price;
- If the goods or services, which will be hazardous to life and safety, when used, are being offered for sale to the public.

**How to file a complaint?**

- The complaint can be simply filed on a plain paper.-
- Stamp paper is not necessary for declaration.
- It should contain the details of the complainant and the opposite party.
- Complaint can be registered, in person, by the complainant or through his authorized agent or by post addressed to the Redressal Agency.
- It is not compulsory to engage a lawyer to file a case.
- The fees charged are very nominal according to the value of the claim.

**Steps/Procedure to file a complaint in Consumer Fora?**

Step one : Drafting the complaint : A complaint needs to be drafted precisely. It shall contain all the facts like date, amount etc. and proofs (bills, receipts, documents if any).

It should contain all the details which could be required i.e., Name and complete address of the complainant and the opposite party.

Details of complaint, whether it is against Unfair Trade Practice / supply of defective goods / deficiency in service provided / collection of excess prices, should explicitly be mentioned in the complaint petition. Relief sought for under this Act and the complaint should be signed by the complainant or his authorized agent.

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Step two : After the drafting is done, the complainant has to determine as to which court the complaint should be filed i.e., District, State, National, depending upon the value of the consideration.

Step three : After deciding the jurisdiction, the complainant needs to deposit the statutory fees for filing the complaint.

Step four : If either party is not satisfied with the verdict of these forums, they have an option to apply for a revision to the honorable Supreme Court of India.

**What are the remedies/reliefs available to consumers?**

- The remedies or relief depends upon the grievances of the consumer. However, some of the probable remedies could be:
- Replacement of goods;
- Removal of defects or insufficiency from the product/goods or service availed;
- Restoration or refund of the price paid;
- Compensation for the damage or injury suffered;
- Restrain hazardous products from being offered to sale.

**When can an appeal be made?**

- An appeal petition against the order issued by the District Forum can be filled before the State Commission within 30 days from the date of receipt of order.
- An appeal petition against the order issued by the State Commission can be filled before the National Commission within 30 days from the date of receipt of order.
- An appeal petition against the order issued by the National Commission can be filled before the Supreme Court of India within 30 days from the date of receipt of order.

**What is the time limit for filing the complaint?**

The complaint has to be filed within two years from the date on which the cause of action arises. However, a complaint may also be filed after two years, if the complainant satisfies the District Forum that he/she has sufficient reasons for not filing the complaint within such period.

**Is there any provision to challenge Consumer forum's order in High Court?**

The Supreme Court of India in the case of Cicilly Kallarackal gave a landmark judgement. It ruled out that the High Courts cannot entertain writ petitions against the orders of Consumer Forums. According to it, the Consumer Protection Act, already has a precise and speedy mechanism for making an appeal. And clearly it will make the complainant party frustrate and exhausted. Also, the consumers will find it costly to contest the case in HC.

**How to lodge a consumer complaint online?**

The Government of India, Department of Consumer Affairs and Ministry of Consumer Affairs, Food & public Distribution, runs an online portal called INGRAM (Integrated grievance Redressal Mechanism), which is a National Consumer Helpline (NHC) and it has been launched by the Department of Consumer Affairs. There are several ways in which one can register grievance;

- The complainant can call or drop a message to register their grievance;
- Or can register online;
- or through the NHC app or Consumer app or through the UMANG app.

**Consumer Protection Councils**

**1. The Central Consumer Protection Council :**

1. The Central Government ***shall***, by notification, establish with effect from such date as it may specify in such notification, a Council to be known as the Central Consumer Protection Council (hereinafter referred to as the Central Council).
2. The Central Council shall consist of the following members, namely :
   (a) the Minister in charge of the consumer affairs in the Central Government, who shall be its Chairman, and
   (b) such number of other official or non-official members representing such interests as may be prescribed.

**2. Procedure for meetings of the Central Council :**

1. The Central Council shall meet as and when necessary, but at least one meeting of the Council shall be held every year.
2. The Central Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed.

**3. Objects of the Central Council :** The objects of the Central Council shall be to promote and protect the rights of the consumers such as, :

(a) the right to be protected against the marketing of goods and services which are hazardous to life and property;
(b) the right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be so as to protect the consumer against unfair trade practices;
(c) the right to be assured, wherever possible, access to a variety of goods and services at competitive prices;
(d) the right to be heard and to be assured that consumer's interests will receive due consideration at appropriate forums;
(e) the right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers; and
(f) the right to consumer education.

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**4. The State Consumer Protection Councils :**

1. The State Government shall, by notification, establish with effect from such date as it may specify in such notification, a Council to be known as the Consumer Protection Council for..... (hereinafter referred to as the State Council).
2. The State Council shall consist of the following members, namely :
   (a) the Minister incharge of consumer affairs in the State Government who shall be its Chairman;
   (b) such number of other official or non-official members representing such interests as may be prescribed by the State Government.
   (c) such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.
3. The State Council shall meet as and when necessary but not less than two meetings shall be held every year.
4. The State Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government.

**5. Objects of the State Council :** The objects of every State Council shall be to promote and protect within the State the rights of the consumers laid down in clauses (a) to (f) of section 6.

5A. 1. The State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection Council with effect from such date as it may specify in such notification.

2. The District Consumer Protection Council (hereinafter referred to as the District Council) shall consist of the following members, namely :
   (a) the Collector of the district (by whatever name called), who shall be its Chairman; and
   (b) such number of other official and non-official members representing such interests as may be prescribed by the State Government.
3. The District Council shall meet as and when necessary but not less than two meetings shall be held every year.
4. The District Council shall meet at such time and place within the district as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government.

5B. The objects of every District Council shall be to promote and protect within the district the rights of the consumers laid down in clauses (a) to (f) of section 6.

**Importance of Consumer Protection**

Consumer Protection has a wide agenda. It not only includes educating consumers about their rights and responsibilities, but also helps in getting their grievances redressed. It not only requires a judicial machinery for protecting the interests of consumers but also requires the consumers to get together and form themselves into consumer associations for protection and promotion of their interests. At the same time, consumer protection has a special significance for businesses too.

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From Consumers' point of view The importance of consumer protection from the consumers' point of view can be understood from the following points:

(i) **Consumer Ignorance :** In the light of widespread ignorance of consumers about their rights and reliefs available to them, it becomes necessary to educate them about the same so as to achieve consumer awareness.

(ii) **Unorganised Consumers :** Consumers need to be organised in the form of consumer organisations which would take care of their interests. Though, in India, we do have consumer organisations which are working in this direction, adequate protection is required to be given to consumers till these organisations become powerful enough to protect and promote the interests of consumers.

(iii) **Widespread Exploitation of Consumers :** Consumers might be exploited by unscrupulous, exploitative and unfair trade practices like defective and unsafe products, adulteration, false and misleading advertising, hoarding, black marketing, etc. Consumers need protection against such malpractices of the sellers.

**From the point of view of Business**

A business must also lay emphasis on protecting the consumers and adequately satisfying them. This is important because of the following reasons :

(i) **Long-term Interest of Business :** Enlightened businesses realise that it is in their long-term interest to satisfy their customers. Satisfied customers not only lead to repeat sales but also provide good feedback to prospective customers and thus, help in increasing the customer-base of business. Thus, business firms should aim at long term profit maximisation through customer satisfaction.

(ii) **Business uses Society' s Resources :** Business organisations use resources which belong to the society. They, thus, have a responsibility to supply such products and render such services which are in public interest and would not impair public confidence in them.

(iii) **Social Responsibility :** A business has social responsibilities towards various interest groups. Business organisations make money by selling

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goods and providing services to consumers. Thus, consumers form an important group among the many stakeholders of business and like other stakeholders, their interest has to be well taken care of.

(iv) **Moral Justification :** It is the moral duty of any business to take care of consumer's interest and avoid any form of their exploitation. Thus, a business must avoid unscrupulous, exploitative and unfair trade practices like defective and unsafe products, adulteration, false and misleading advertising, hoarding, black marketing, etc.

(v) **Government Intervention :** A business engaging in any form of exploitative trade practices would invite government intervention or action. This can impair and tarnish the image of the company. Thus, it is advisable that business organisations voluntarily resort to such practices where the customers' needs and interests will well be taken care of.

In view of the above, the government of India has enacted several regulations designed to provide adequate protection to consumers. We shall now discuss some of these regulations.

**Legal Protection to Consumers**

The Indian legal framework consists of a number of regulations which provide protection to consumers. As per the Right to Information Act 2005, Section 4, all relevant information is required to be made available to all citizens of the country. Other regulations are as under.

1. **The Consumer Protection Act, 1986 :** The Consumer Protection Act, 1986 seeks to protect and promote the interests of consumers. The Act provides safeguards to consumers against defective goods, deficient services, unfair trade practices, and other forms of their exploitation. The Act provides for the setting up of a three-tier machinery, consisting of District Forums, State Commissions and the National Commission. It also provides for the formation of consumer protection councils in every District and State, and at the apex level.
2. **The Indian Contract Act, 1872 :** The Act lays down the conditions in which the promises made by parties to a contract will be binding on each other. The Act also specifies the remedies available to parties in case of breach of contract.
3. **The Sale of Goods Act, 1930 :** The Act provides some safeguards and reliefs to the buyers of the goods in case the goods purchased do not comply with express or implied conditions or warranties.
4. **The Essential Commodities Act, 1955 :** The Act aims at controlling production, supply and distribution of essential commodities, checking inflationary trend in their prices and ensuring equal distribution of essential commodities. The Act also provides for action against anti-social activities of profiteers, hoarders and black-marketers.
5. **The Agricultural Produce (Grading and Marking) Act, 1937 :** The Act prescribes grade standards for agricultural commodities and

livestock products. The Act stipulates the conditions which govern the use of standards and lays down the procedure for grading, marking and packing of agricultural produce. The quality mark provided under the Act is known as AGMARK, an acronym for Agricultural Marketing.

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6. **The Prevention of Food Adulteration Act, 1954 :** The Act aims to check adulteration of food articles and ensure their purity so as to maintain public health.
7. **The Standards of Weights and Measures Act, 1976 :** The provisions of this Act are applicable in case of those goods which are sold or distributed by weight, measure or number. It provides protection to consumers against the malpractice of underweight or under-measure.
8. **The Trade Marks Act, 1999 : This Act has repealed and replaced the Trade and Merchandise Marks Act, 1958.**

   The Act prevents the use of fraudulent marks on products and thus, provides protection to the consumers against such products.
9. **The Competition Act, 2002 :** This Act has repealed and replaced the Monopolies and Restrictive Trade Practices Act, 1969. The Act provides protection to the consumers in case of practices adopted by business firms which hamper competition in the market.
10. **The Bureau of Indian Standards Act, 1986 :** The Bureau of Indian Standards has been set up under the Act. The Bureau has two major activities: formulation of quality standards for goods and their certification through the BIS certification scheme. Manufacturers are permitted to use the ISI mark on their products only after ensuring that the goods conform to the prescribed quality standards. The Bureau has also setup a grievance cell where consumers can make a complaint about the quality of products carrying the ISI mark.

The most important of these regulations is the Consumer Protection Act which provides for six consumer rights and helps consumers in getting their grievances redressed for any shortcoming in the goods purchased or services availed.

**The Consumer Protection Act, 1986**

The Consumer Protection Act (CPA) seeks to protect and promote the consumers' interest through speedy and inexpensive redressal of their grievances. The scope of the Act is very wide. It is applicable to all types of undertakings, big and small, whether in the private or public sector, or in the co-operative sector, whether a manufacturer or a trader, and whether supplying goods or providing services. The Act confers certain rights to consumers with a view to empowering them and to protect their interests.

**Consumer Rights :** The Consumer Protection Act provides for six rights of consumers. The consumer protection councils set up under the Act are intended to promote and protect the various rights of consumers. These rights include the following :

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1. **Right to Safety :** The consumer has a right to be protected against goods and services which are hazardous to life and health. For instance, electrical appliances which are manufactured with substandard products or do not conform to the safety norms might cause serious injury. Thus, consumers are educated that they should use electrical appliances which are ISI marked as this would be an assurance of such products meeting quality specifications.
2. **Right to be Informed :** The consumer has a right to have complete information about the product he intends to buy including its ingredients, date of manufacture, price, quantity, directions for use, etc. It is because of this reason that the legal framework in India requires the manufactures to provide such information on the package and label of the product.
3. **Right to Choose :** The consumer has the freedom to choose from a variety of products at competitive prices. This implies that the marketers should offer a wide variety of products in terms of quality, brand, prices, size, etc. and allow the consumer to make a choice from amongst these.
4. **Right to be Heard :** The consumer has a right to file a complaint and to be heard in case of dissatisfaction with a good or a service. It is because of this reason that many enlightened business firms have set up their own consumer service and grievance cells. Many consumer organisations are also working towards this direction and helping consumers in redressal of their grievances.
5. **Right to seek Redressal :** The consumer has a right to get relief in case the product or service falls short of his expectations. The Consumer Protection Act provides a number of reliefs to the consumers including replacement of the product, removal of defect in the product, compensation paid for any loss or injury suffered by the consumer, etc.
6. **Right to Consumer Education :** The consumer has a right to acquire knowledge and to be a well informed consumer throughout life. He should be aware about his rights and the reliefs available to him in case of a product or service falling short of his expectations. Many consumer organisations and some enlightened businesses are taking an active part in educating consumers in this respect.

The Consumer Protection Act by conferring these rights on the consumers empowers them to fight against any unscrupulous, exploitative and unfair trade practices adopted by sellers. The Box on East Delhi eatery shows how a restaurant owner was fined for overpricing bottled water. Consumer rights, by themselves, cannot be effective in achieving the objective of consumer protection. Consumer protection can, in effect, be achieved only when the consumers also understand their responsibilities.

**Consumer Responsibilities :** A consumer should keep in mind the following responsibilities while purchasing, using and consuming goods and services :

(i) Be aware about various goods and services available in the market so that an intelligent and wise choice can be made.

(ii) Buy only standardised goods as they provide quality assurance. Thus, look for ISI mark on electrical goods, FPO mark on food products, Hallmark on jewelry, etc.

(iii) Learn about the risks associated with products and services, follow manufacturer's instructions and use the products safely.

(iv) Read labels carefully so as to have information about prices, net weight, manufacturing and expiry dates, etc.

(v) Assert yourself to ensure that you get a fair deal.

(vi) Be honest in your dealings. Choose only from legal goods and services and discourage unscrupulous practices like black-marketing, hoarding, etc.

(vii) Ask for a cash memo on purchase of goods or services. This would serve as a proof of the purchase made.

(viii) File a complaint in an appropriate consumer forum in case of a shortcoming in the quality of goods purchased or services availed. Do not fail to take an action even when the amount involved is small.

(ix) Form consumer societies which would play an active part in educating consumers and safeguarding their interests.

(x) Respect the environment. Avoid waste, littering and contributing to pollution.

A consumers' awareness about his rights and responsibilities is just one of the ways in which the objective of consumer protection can be achieved. There are other ways in which this objective may be achieved. Ways and means of Consumer Protection There are various ways in which the objective of consumer protection can be achieved.

**1. Self Regulation by Business :** Enlightened business firms realise that it is in their long-term interest to serve the customers well. Socially responsible firms follow ethical standards and practices in dealing with their customers. Many firms have set up their customer service and grievance cells to redress the problems and grievances of their consumers.

**2. Business Associations :** The associations of trade, commerce and business like Federation of Indian Chambers of Commerce of India (FICCI) and Confederation of Indian Industries (CII) have laid down their code of conduct which lay down for their members the guidelines in their dealings with the customers.

**3. Consumer Awareness :** A consumer, who is well-informed about his rights and the reliefs available to him, would be in a position to raise his voice

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against any unfair trade practices or unscrupulous exploitation. In addition to this, an understanding of his responsibilities would also enable a consumer to safeguard his interests. In this regard, the Department of Consumer Affairs, GOI, has been undertaking the campaign, Jago Grahak Jago through multimedia awareness.

**4. Consumer Organisations :** Consumer organisations play an important role in educating consumers about their rights and providing protection to them. These organisations can force business firms to avoid malpractices and exploitation of consumers.

**5. Government :** The government can protect the interests of the consumers by enacting various measures. For example, the GOI has set up a toll-free national consumer Helpline Number 1800114000 (9:30 am – 5:30 pm) for this purpose. The legal framework in India encompasses various legislations which provide protection to consumers. The most important of these regulations is the Consumer Protection Act, 1986. The Act provides for a three-tier machinery at the district, state and national levels for redressal of consumer grievances. The redressal mechanism under this three tier machinery has been explained hereunder.

### 4.2.5 Remedies

The Consumer Protection Act provides consumers with various remedies. **Following are the remedies available under the act :**

- **Removal of Defects :** if the consumer after conducting a proper test by using the product finds the product to be defective then the authority can pass an order of removing the defects in the product.
- Replacement of goods
- Refund of the price paid by the consumer while purchasing the product.
- **Award of Consumption :** a consumer can demand compensation from the trader or service provider if because of his negligence the consumer has suffered some physical or any other loss.
- **Removal of Deficiency in Service :** the authority can pass orders for removal of the deficiency if there is any deficiency in delivery of the service, for instance, if the consumer has applied for a loan and has fulfilled all the formalities but the bank is making unnecessary delay in sanctioning the loan, then the court can pass orders to sanction the loan.
- **Discontinuance of Unfair/ Restrictive Trade Practice :** if a complaint is filed by the consumer against any unfair trade practice in the market, the authority can order an immediate withdrawal of such practice and can also pass an order for banning such trade practice.
- Stopping of sale of hazardous goods.
- Withdrawal of hazardous goods from the market.
- Payment of the adequate cost.

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### 4.2.6 Appeals

Any person aggrieved by an order made by the District Forum may prefer an appeal against such order to the State Commission within a period of thirty days from the date of the order, in such form and manner as may be prescribed: Provided that the State Commission may entertain an appeal after the expiry of the said period of thirty days if it is satisfied that there was sufficient cause for not filing it within that period: 1[Provided further that no appeal by a person, who is required to pay any amount in terms of an order of the District Forum, shall be entertained by the State Commission unless the appellant has deposited in the prescribed manner fifty per cent. of that amount or twenty-five thousand rupees, whichever is less.

### 4.2.7 Enforcement of Orders and Penalties

**Enforcement of orders :**

1. Where an interim order made under this Act, is not complied with the District Forum or the State Commission or the National Commission, as the case may be, may order the property of the person, not complying with such order to be attached.
2. No attachment made under sub-section (1) shall remain in force for more than three months at the end of which, if the non-compliance continues, the property attached may be sold and out of the proceeds thereof, the District Forum or the State Commission or the National Commission may award such damages as it thinks fit to the complainant and shall pay the balance, if any, to the party entitled thereto.
3. Where any amount is due from any person under an order made by a District Forum, State Commission or the National Commission, as the case may be, the person entitled to the amount may make an application to the District Forum, the State Commission or the National Commission, as the case may be, and such District Forum or the State Commission or the National Commission may issue a certificate for the said amount to the Collector of the district (by whatever name called) and the Collector shall proceed to recover the amount in the same manner as arrears of land revenue.

**Dismissal of frivolous or vexatious complaints :** Where a complaint instituted before the District Forum, the State Commission or as the case may be, the National Commission, is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, dismiss the complaint and make an order that the complainant shall pay to the opposite party such cost, not exceeding ten thousand rupees, as may be specified in the order

**Penalties :**

1. Where a trader or a person against whom a complaint is made or the complainant fails or omits to comply with any order made by the District Forum, the State Commission or the National Commission, as the case may be, such trader or person or complainant shall be punishable with imprisonment for a term which shall not be less than

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one month but which may extend to three years, or with fine which shall not be less than two thousands rupees but which may extend to ten thousand rupees, or with both:

2. Notwithstanding anything contained in the Code of Criminal Procedure, 1973, (2 of 1974), the District Forum or the State Commission or the National Commission, as the case may be, shall have the power of a Judicial Magistrate of the first class for the trial of offences under this Act, and on such conferment of powers, the District Forum or the State Commission or the National Commission, as the case may be, on whom the powers are so conferred, shall be deemed to be a Judicial Magistrate of the first class for the purpose of the Code of Criminal Procedure, 1973 (2 of 1974).
3. All offences under this Act may be tried summarily by the District Forum or the State Commission or the National Commission, as the case may be.

**Appeal against order passed under section 27 :**

1. Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), an appeal under section 27, both on facts and on law, shall lie from :
   (a) the order made by the District Forum to the State Commission ;
   (b) the order made by the State Commission to the National Commission; and
   (c) the order made by the National Commission to the Supreme Court.
2. Except as aforesaid, no appeal shall lie to any court from any order of a District Forum or a State Commission or the National Commission.
3. Every appeal under this section shall be preferred within a period of thirty days from the date of an order of a District Forum or a State Commission or, as the case may be, the National Commission :

   Provided that the State Commission or the National Commission or the Supreme Court, as the case may be, may entertain an appeal after the expiry of the said period of thirty days, if, it is satisfied that the appellant had sufficient cause for not preferring the appeal within the period of thirty days.

### 4.2.8 The Consumer Protection Amendment Act 2002

The Consumer Protection Act 1986 held great hopes for the helpless consumers who have been denied fair deal by the unscrupulous producers or traders. In the implementation of Consumer Protection Act 1986 some deficiencies in the Act were noticed. Therefore, some important amendments were made in the Act by Consumer Amendment Act 2002. With this amendment all the redressal agencies (District Forums, State Consumer Commissions and Central Consumer Commission) have been given the powers of a judicial magistrate of a first class for trial of offences within their jurisdiction, subject of course to the right of appeal from a lower redressal agency to a higher one.

**The important changes made by the Consumer Protection Amendment Act 2002 are the following :**

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1. Both MRTP Act and Consumer Protection Act deal with unfair and restrictive trade practices. Amendment made in Consumer Protection Act in 2002 has clarified that the expression 'restrictive trade practices' will also include delay in supply of goods or services and rise in prices in the mean time.
2. Provisions regarding unfair trade practices have been made more stringent. It is now provided that if the representations contained in an advertisement for the sale or supply of a good or service are misleading, the advertiser can be held responsible for taking corrective steps at his own cost apart from other obligations.
3. The District Forums would be able to deal with cases involving the payment of compensation of Rs. 20 lakhs against the pre-existing Rs. 5 lakhs. Similarly, the State Consumer Commissions can now deal with cases involving compensation up to Rs. 1 crore while National Consumer Commission can deal with cases involving compensation of Rs. 1 crore or more instead of pre-existing Rs. 25 lakhs.
4. In the event of the death of the complainant, amendment in the Act in 2002 now provides for substitution of his legal representatives. Surviving legal representatives can file a complaint or get substitution in place of the existing one.
5. In regard to goods hazardous to life or safety of the public, traders supplying goods will be liable if it can be proved that the supplier could have known with due care that the goods or services supplied were hazardous to the public. Besides, liability of suppliers of spurious products and services is made clear in the Amendment Act 2002.
6. An important amendment relates to the meaning of expression 'manufacturing'. Manufacturing has now been defined to include merely assembling parts of goods made by others or putting one s own mark on any good manufactured by others.
7. Amendment Act 2002 makes the restrictive trade practices more stringent by including under it trade practice which tends to the manipulation of price or the conditions of delivery of goods or affect the flow of supplies of goods in the market in a manner that imposes undue costs or restrictions on the consumers. Restrictive trade practice also includes delay in the delivery of goods beyond the period agreed to by the traders or delay in providing services when such delay is likely to lead to rise in their prices.
8. According to an important provision in the 2002 Amendment Act, in trading or commerce of goods or services misleading or deceptive conduct of traders or suppliers would be treated as unfair trade practice. Those who make misleading or false representation luring consumers to buy goods or services would fall within unfair trade practice and

would be held liable. Under the Consumer Protection Amendment Act 2002 the consumers who are lured to enter into such a contract would be entitled to get the damages.

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Similarly, Amendment Act 2002 also covers the unfair treatment to the consumers who have suffered by being lured in the schemes offering gifts, concessional prices or some items free of charge depending on the official results of a particular scheme. This amendment provides remedy to the consumers who might be unfairly treated in such schemes by requiring the promoter to disclose proper information regarding the results of a scheme by appropriate timely publication of results in newspapers, etc.

**Proposed Amendments in Consumer Act, 2010 :** The Cabinet has given clearance to the proposed amendments to the Consumer Protection Act which is likely to be passed by the parliament in winter session of 2010. These amendments seek to make the consumer protection law more responsive to consumer complaints through quicker disposal of cases. The proposed amendments have widened the scope of the law, specified time limit for quicker disposal of cases and rationalized qualifications for appointment of members of consumer forums at the state and national level.

**Evaluation of Consumer Protection Act :** Consumer Protection Act with amendments made in it in 2002 is a quite comprehensive piece of legislation that seeks to protect the consumers against unfair and exploitative practices of manufacturers. Consumer awareness in India is now fast growing. As a result, the number of complaints by the end of 2002 before District Forums had been about 14 lakhs, that before State Commissions 2 lakhs and that before National Commission about 21,000 all of which amount to the total of about 162,100.

It is important to note that Consumer Protection Act is additional law protecting consumers but not a derogation of any other laws which protect consumers. Services or goods provided by those dealing in information technology, electronic commerce (E-Commerce) are also liable under the Consumer Protection Act apart from the Act governing Telecommunication Regulatory Authority of India (TRAI) which regulates not only transactions between competing providers of telecommunication services but also regulate them to protect consumer interests.

Similarly, the Consumer Protection Act is in addition to MRTP Act which also tries to protect the interests of consumers by controlling monopolistic and restrictive trade practices. According to G.L. Sanghi, "The tribunals created under the Consumer Protection Act are in substantial matters not different from the ordinary civil courts. They are quasi-judicial tribunals created to render inexpensive and speedy justice. They provide additional remedies through the newly created forums".

**A Comprehensive Act :** The Consumer Protection Act is quite a comprehensive legislation. Under the Consumer Protection Act not only manufacturers and suppliers of goods but also of such services as insurance providers, medical treatment, lending and recovery of bank loans also come within the purview of the Act. A few such important cases are worth explaining.

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**Consumer Protection Act and Medical Practitioners :** The applicability of Consumer Protection Act to medical practitioners is a highly complicated issue and the case relating to it went even up to the Supreme Court of India. In defence of medical practitioners it was argued that their services are excluded category being services under "Control of Personal Services". Supreme Court rejected these arguments and brought medical practitioners, hospitals and nursing homes where services are rendered for valuable consideration under the purview of Consumer Protection Act.

Doctors and hospitals committing medical negligence have therefore become liable and damages for medical negligence can be claimed from them. Though this has created fear and concern among medical practitioners and private hospitals but this will help in preventing medical negligence on the part of doctors and hospitals.

It has been widely reported in the media about medical negligence, for example, of operating a wrong eye, removing a kidney of a person without his consent, leaving screw, scissors and a towel in the abdomen of a patient, giving a wrong injection leading to the death of a patient. For all these acts of negligence compensation can be claimed from doctors and hospitals and also penalties can be imposed on them.

In an important case Supreme Court held that a medical practitioner may be liable if there was a negligence in respect of diagnosis and/or treatment given to a patient provided it can be demonstrated that the negligent act was not based on reasonable and responsible information as to the kind and quality of treatment.

**Insurance Companies and Consumer Protection Act :** One of the important categories where Consumer Protection Act has been usefully applied is the claims against insurance companies. Many insurance companies (including public sector insurance companies) often deny medi-claims to the insurers on one pretext or the other.

Generally insurance companies deny claims for damages to the insurers that they did not disclose the pre-existing disease they were suffering from at the time of getting insured. In many cases consumer commissions have rejected the arguments of insurance companies and have awarded damages to the insurers and require insurance companies to fulfill their contractual obligations.

In a recent case of accident claim the United India Insurance Company denied to pay the damages on a car which met with an accident on the ground that it was being plied without the 'fitness certificate' as required under the Motor Vehicles Act. In this case in Nov. 2007, National Consumer.

Commission held that the insurance companies, if the terms of the policy were not breached, cannot refuse to entertain claims on the pretext that the insured violated some other laws or conditions "as the insurance is a matter of contract between the two parties."

**Recovery of Bank Loans and Consumer Protection Act :** The wide applicability of Consumer Protection Act can be understood from the recent judgment of the State Consumer Commission of Delhi which slapped a fine

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of Rs. 55 lakhs on ICICI Bank for trying to recover a vehicle loan by hiring musclemen. The goons of recovery agent of the bank forcibly dragged out a youth from the car, beat him up with iron rods and left him bleeding and drove away with the vehicle. Justice J.D. Kapoor, president of the commission, said, "We hold ICICI Bank guilty of the grossest kind of deficiency in service and unfair trade practice for breach of terms of contract of hire-purchase/loan agreement by seizing the vehicle illegally."

## 4.5 SUMMARY

In view of the above usefulness and wide applicability of Consumer Protection Act, Mr. G.L. Sanghi is right in concluding, "In each and every area involving sale of goods and services for valuable consideration a consumer stands protected. The polarity of this law is unlimited. Its machinery is effective and awesome to the delinquent trader with solace to the consumer. As experience grows further improvements will un-doubtetedly make this remedy more and more useful".

From various landmark judgments by the Supreme Court in connection with cases affecting consumer rights, it will be clear that there is an increase in the number of cases involving consumer protection when compared to the past. It indicates that people are now aware of their various rights as consumers. The Act not only covers the rights of the consumers but also provides certain duties for them too. It has been stated that it is the duty of a consumer to ask clearly about various characteristics and features of the product which he/she wishes to buy. The Act does not entertain certain malicious acts such as black marketing and selling a good above the prescribed rate of MRP. The doctrine of 'caveat venditor' (let the seller beware) has been changed into 'caveat emptor' (let the purchaser beware) so that the purchaser will also be aware of various features, merits and demerits of the good as well as protection of their rights themselves. There is still an emerging need of various other redressal machineries in this field due to the increased number of pending cases as well as for implementing alternative means in the field of consumer protection. The Act may be amended in such a way that it includes certain dispute redressal mechanisms like 'Alternative Disputes Resolution' as a core function of the said redressal agencies dealing with consumer rights.

## 4.6 EXERCISE

1. What is Consumer Protection Act 1986 and it features ?
2. Define the Consumer Rights.
3. Discuss the Redressal Mechinary under the Act ?
4. Who can fill a complaints ?
5. How to ladge a consumer complaint online ?

# UNIT 5 : NEGOTIABLE INSTRUMENT ACT 1881

**Structure:**



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## 5.0 OBJECTIVES

After reading this lesson, you should be able to :

- understand meaning, essential characteristics and types of negotiable instruments;
- describe the meaning and marketing of cheques, crossing of cheques and cancellation of crossing of a cheque;
- explain capacity and liability parties to a negotiable instruments; and
- companies act 2013 : registration in corporation memorandum of association etc.

(a) define negotiable instrument and discuss the characteristics of negotiable instruments.

(b) describe the various types of negotiable instruments.

(c) discuss the parties to negotiable instruments.

## 5.1 INTRODUCTION

The law relating to Negotiable Instruments is laid down in Negotiable Instruments Act, 1881, which came into force from March 1,1882. It extends to the whole of India except the State of Jammu and Kashmir. The Act operates subject to the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. Section 31 of the Reserve Bank of India Act provides that no person in India other than the Bank or as expressly authorised by this Act, the Central Government shall draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand. This Section further provides that no one except the RBI or the Central Government can make or issue a promissory note expressed to be payable or demand or after a certain time. Section 32 of the Reserve Bank of India Act makes issue of such bills or notes punishable with fine which may extend to the amount of the instrument. The effect or the consequences of these provisions are :

1. A promissory note cannot be made payable to the bearer, no matter whether it is payable on demand or after a certain time.
2. A bill of exchange cannot be made payable to the bearer on demand though it can be made payable to the bearer after a certain time.
3. But a cheque {though a bill of exchange} payable to bearer or demand can be drawn on a person's account with a banker.

## 5.2 NEGOTIBLE INSTRUMENT ACT 1881

### 5.2.1 Definition of Negotiable Instruments

According to Section 13 (a) of the Act, "Negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the word "order" or " bearer" appear on the instrument or not." In the words of Justice, Willis, "A negotiable instrument is one, the property in which

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is acquired by anyone who takes it bonafide and for value notwithstanding any defects of the title in the person from whom he took it". Thus, the term, negotiable instrument means a written document which creates a right in favour of some person and which is freely transferable. Although the Act mentions only these three instruments (such as a promissory note, a bill of exchange and cheque), it does not exclude the possibility of adding any other instrument which satisfies the following two conditions of negotiability :

1. the instrument should be freely transferable (by delivery or by endorsement. and delivery) by the custom of the trade; and
2. the person who obtains it in good faith and for value should get it free from all defects, and be entitled to recover the money of the instrument in his own name.

As such, documents like share warrants payable to bearer, debentures payable to bearer and dividend warrants are negotiable instruments. But the money orders and postal orders, deposit receipts, share certificates, bill of lading, dock warrant, etc. are not negotiable instruments. Although they are transferable by delivery and endorsements, yet they are not able to give better title to the bonafide transferee for value than what the transferor has.

### 5.2.2 Characteristics of A Negotiable Instruments

A negotiable instrument has the following characteristics :

**1. Property :** The possessor of the negotiable instrument is presumed to be the owner of the property contained therein. A negotiable instrument does not merely give possession of the instrument but right to property also. The property in a negotiable instrument can be transferred without any formality. In the case of bearer instrument, the property passes by mere delivery to the transferee. In the case of an order instrument, endorsement and delivery are required for the transfer of property.

**2. Title :** The transferee of a negotiable instrument is known as 'holder in due course.' A bona fide transferee for value is not affected by any defect of title on the part of the transferor or of any of the previous holders of the instrument.

**3. Rights :** The transferee of the negotiable instrument can sue in his own name, in case of dishonour A negotiable instrument can be transferred any number of times till it is at maturity. The holder of the instrument need not give notice of transfer to the party liable on the instrument to pay.

**4. Presumptions :** Certain presumptions apply to all negotiable instruments e.g., a presumption that consideration has been paid under it. It is not necessary to write in a promissory note the words 'for value received' or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration.

**5. Prompt payment :** A negotiable instrument enables the holder to expect prompt payment because a dishonour means the ruin of the credit of all persons who are parties to the instrument.

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## 5.3 KINDS OF NEGOTIABLE INSTRUMENTS

(a) Negotiable instruments recognised by statute are :

(i) Promissory notes

(ii) Bills of exchange

(iii) Cheques

(b) Negotiable instruments recognised by usage or custom are :

(i) Hundis

(ii) Share warrants

(iii) Dividend warrants

(iv) Bankers draft

(v) Circular notes

(vi) Bearer debentures

(vii) Debentures of Bombay Port Trust

(viii) Railway receipts

(ix) Delivery orders.

This list of negotiable instrument is not a closed chapter. With the growth of commerce, new kinds of securities may claim recognition as negotiable instruments. The courts in India usually follow the practice of English courts in according the character of negotiability to other instruments.

### 5.2.1 Promissory Notes

Section 4 of the Act defines, "A promissory note is an instrument in writing (note being a bank-note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to or to the order of a certain person, or to the bearer of the instruments." Essential elements An instrument to be a promissory note must possess the following elements :

**1. It must be in writing :** A mere verbal promise to pay is not a promissory note. The method of writing (either in ink or pencil or printing, etc.) is unimportant, but it must be in any form that cannot be altered easily.

**2. It must certainly an express promise or clear understanding to pay :** There must be an express undertaking to pay. A mere acknowledgment is not enough. The following are not promissory notes as there is no promise to pay.

**If A writes :**

(a) "Mr. B, I.O.U. (I owe you) Rs. 500"

(b) "I am liable to pay you Rs. 500".

(c) "I have taken from you Rs. 100, whenever you ask for it have to pay".

The following will be taken as promissory notes because there is an express promise to pay :

**If A writes:**

(a) "I promise to pay B or order Rs. 500".

(b) "I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for the value received".

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**3. Promise to pay must be unconditional :** A conditional undertaking destroys the negotiable character of an otherwise negotiable instrument. Therefore, the promise to pay must not depend upon the happening of some outside contingency or event. It must be payable absolutely.

**4. It should be signed by the maker :** The person who promise to pay must sign the instrument even though it might have been written by the promisor himself. There are no restrictions regarding the form or place of signatures in the instrument. It may be in any part of the instrument. It may be in pencil or ink, a thumb mark or initials. The pronote can be signed by the authorised agent of the maker, but the agent must expressly state as to on whose behalf he is signing, otherwise he himself may be held liable as a maker. The only legal requirement is that it should indicate with certainty the identity of the person and his intention to be bound by the terms of the agreement.

**5. The maker must be certain :** The note self must show clearly who is the person agreeing to undertake the liability to pay the amount. In case a person signs in an assumed name, he is liable as a maker because a maker is taken as certain if from his description sufficient indication follows about his identity. In case two or more persons promise to pay, they may bind themselves jointly or jointly and severally, but their liability cannot be in the alternative.

**6. The payee must be certain :** The instrument must point out with certainty the person to whom the promise has been made. The payee may be ascertained by name or by designation. A note payable to the maker himself is not pronate unless it is indorsed by him. In case, there is a mistake in the name of the payee or his designation; the note is valid, if the payee can be ascertained by evidence. Even where the name of a dead person is entered as payee in ignorance of his death, his legal representative can enforce payment.

**7. The promise should be to pay money and money only :** Money means legal tender money and not old and rare coins. A promise to deliver paddy either in the alternative or in addition to money does not constitute a promissory note.

**8. The amount should be certain :** One of the important characteristics of a promissory note is certainty not only regarding the person to whom or by whom payment is to be made but also regarding the amount. However, paragraph 3 of Section 5 provides that the sum does not become indefinite merely because

(a) there is a promise to pay amount with interest at a specified rate.

(b) the amount is to be paid at an indicated rate of exchange.

(c) the amount is payable by installments with a condition that the whole balance shall fall due for payment on a default being committed in the payment of anyone installment.

**9. Other formalities :** The other formalities regarding number, place, date, consideration etc. though usually found given in the promissory notes but are not essential in law. The date of instrument is not material unless the amount is made payable at a certain time after date. Even in such a case, omission of date does not invalidate the instrument and the date of execution can be independently ascertained and proved.

Notes

**Specimen of Promissory Notes**

| Rs. 1000 | Delhi<br>August 30, 2003 |
|---|---|

On demand (or six month after date) I promise to pay Peter or order the sum of rupees one thousand with interest at 8 per cent per annum until payment.

| Drucker is the maker<br>and Peter is the Payee | Stamp<br>Sd. by Drucker |
|---|---|

### 5.2.3 Bill of Exchange

Section 5 of the Act defines, "A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument".

A bill of exchange, therefore, is a written acknowledgement of the debt, written by the creditor and accepted by the debtor. There are usually three parties to a bill of exchange drawer, acceptor or drawee and payee. Drawer himself may be the payee.

**Essential conditions of a bill of exchange :**

1. It must be in writing.
2. It must be signed by the drawer.
3. The drawer, drawee and payee must be certain.
4. The sum payable must also be certain.
5. It should be properly stamped.
6. It must contain an express order to pay money and money alone.

For example, In the following cases, there is no order to pay, but only a request to pay. Therefore, none can be considered as a bill of exchange:

(a) "I shall be highly obliged if you make it convenient to pay Rs. 1000 to Suresh".

(b) "Mr. Ramesh, please let the bearer have one thousand rupees, and place it to my account and oblige".

However, there is an order to pay, though it is politely made, in the following examples :

(a) "Please pay Rs. 500 to the order of 'A'.

(b) 'Mr. A will oblige Mr. C, by paying to the order of' P".

7. The order must be unconditional.

**Distinction Between Bill of Exchange and Promissory Note :**

**1. Number of parties :** In a promissory note there are only two parties – the maker (debtor) and the payee (creditor). In a bill of exchange, there are three parties; drawer, drawee and payee; although any two out of the three may be filled by one and the same person.

**2. Payment to the maker :** A promissory note cannot be made payable the maker himself, while in a bill of exchange to the drawer and payee or drawee and payee may be same person.

**3. Unconditional promise :** A promissory note contains an unconditional promise by the maker to pay to the payee or his order, whereas in a bill of exchange, there is an unconditional order to the drawee to pay according to the direction of the drawer.

Notes

**4. Prior acceptance :** A note is presented for payment without any prior acceptance by the maker. A bill of exchange is payable after sight must be accepted by the drawee or someone else on his behalf, before it can be presented for payment.

**5. Primary or absolute liability :** The liability of the maker of a promissory note is primary and absolute, but the liability of the drawer of a bill of exchange is secondary and conditional.

**6. Relation :** The maker of the promissory note stands in immediate relation with the payee, while the maker or drawer of an accepted bill stands in immediate relations with the acceptor and not the payee.

**7. Protest for dishonour :** Foreign bill of exchange must be protested for dishonour when such protest is required to be made by the law of the country where they are drawn, but no such protest is needed in the case of a promissory note.

**8. Notice of dishonour :** When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate indorsers, but no such notice need be given in the case of a note.

**Classification of Bills**

Bills can be classified as :

1. Inland and foreign bills.
2. Time and demand bills.
3. Trade and accommodation bills.

**1. Inland and Foreign Bills Inland bill :** A bill is, named as an inland bill if :

(a) it is drawn in India on a person residing in India, whether payable in or outside India, or

(b) it is drawn in India on a person residing outside India but payable in India.

**The following are the Inland bills :**

(i) A bill is drawn by a merchant in Delhi on a merchant in Madras. It is payable in Bombay. The bill is an inland bill.

(ii) A bill is drawn by a Delhi merchant on a person in London, but is made payable in India. This is an inland bill.

(iii) A bill is drawn by a merchant in Delhi on a merchant in Madras. It is accepted for payment in Japan. The bill is an inland bill. Specimen of Inland Bill of is :

Notes

Rs. 1000 Delhi
August 30 2003

Stamp

Three months after date pay William or order the sum of one thousand rupees only for value received.

To.
R.C. Patel,
Park Street,
Bombay. Simon

(Here Simon is the drawer, William is the payee and R.K. Gupta the drawee who, on testifying his willingness to pay by 'accepting" the bill, becomes acceptor.)

**Foreign Bill :** A bill which is not an inland bill is a foreign bill. The following are the foreign bills :

1. A bill drawn outside India and made payable in India.
2. A bill drawn outside India on any person residing outside India.
3. A bill drawn in India on a person residing outside India and made payable outside India.
4. A bill drawn outside India on a person residing in India.
5. A bill drawn outside India and made payable outside India.

**Specimen of foreign bills**

London
August 30 2003

Stamp

Sixty days after sight of the first of Exchange (second and third of same tenor and date unpaid) pay to the order of Messers Hindustan Liver Ltd. Mumbai, the sum of Rupees Five thousand only, value received Rs. 5000

Messers Willian Jack & Co.
Lamigton Road
Mumbai Hindu

**Bills in sets (Secs. 132 and 133) :** The foreign bills are generally drawn in sets of three, and each sets is termed as a 'via'.

As soon as anyone of the set is paid, the others becomes inoperative. These bills are drawn in different parts. They are drawn in order to avoid their loss or miscarriage during transit. Each part is despatched separately. To avoid delay, all the parts are sent on the same day, by different mode of conveyance.

**Rules :** Sections 132 and 133 provide for the following rules :

(i) A bill of exchange may be drawn in parts, each part being numbered and containing a provision that it shall continue payable only so long as the others remain unpaid. All parts make one bill and the entire bill is extinguished, i.e. when payment is made on one part the other parts will become inoperative (Section 132).

(ii) The drawer should sign and deliver all the parts but the acceptance is to be conveyed only on one of the parts. In case a person accepts or endorses different parts of the bill in favour of different persons, he and the subsequent endorsers of each part are liable on such part as if it were a separate bill (Sec. 132).

(iii) As between holders in due course of the different parts of the same bill, he who first acquired title to anyone part is entitled to the other parts and is also entitled to claim the money represented by bill (Sec. 133).

Notes

**Specimen of a Bill in Sets (First Copy)**

**2. Time and Demand Bill**

Rs. 10000 London
August 30,2003

Sixty days after sight of the first of Exchange (second and third of same tenor and date unpaid) pay to the order of Ms Whiteway & Co. Mumbai, the sum of Rupees ten thousand only, value received

To
M/s Henry Flint & Brothers
Church gate
Mumbai

**Time bill :** A bill payable after a fixed time is termed as a time bill. In other words, bill payable "after date" is a time bill.

**Demand bill :** A bill payable at sight or on demand is termed as a demand bill.

**3. Trade and Accommodation Bill Trade bill :** A bill drawn and accepted for a genuine trade transaction is termed as a "trade bill".

**Accommodation bill :** A bill drawn and accepted not for a genuine trade transaction but only to provide financial help to some party is termed as an "accommodation bill".

**Example :** A, is need of money for three months. He induces his friend B to accept a bill of exchange drawn on him for Rs. 1,000 for three months. The bill is drawn and accepted. The bill is an "accommodation bill". A may get the bill discounted from his bankers immediately, paying a small sum as discount. Thus, he can use the funds for three months and then just before maturity he may remit the money to B, who will meet the bill on maturity.

In the above example A is the "accommodated party" while B is the "accommodating party".

It is to be noted that an recommendation bill may be for accommodation of both the drawer arid acceptor.

In such a case, they share the proceeds of the discounted bill. Rules regarding accommodation bills are :

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(i) In case the patty accommodated continues to hold the bill till maturity, the accommodating party shall not be liable to him for payment of, the bill since the contract between them is not based on any consideration (Section 43).

(ii) But the accommodating party shall be liable to any subsequent holder for value who may be knowing the exact position that the bill is an accommodation bill and that the full consideration has not been received by the acceptor. The accommodating party can, in turn, claim compensation from the accommodated party for the amount it has been asked to pay the holder for value.

(iii) An accommodation bill may be negotiated after maturity. The holder or such a bill after maturity is in the same position as a holder before maturity, provided he takes it in good faith and for value (Sec. 59)

In form and all other respects an accommodation bill is quite similar to an ordinary bill of exchange. There is nothing on the face of the accommodation bill to distinguish it from an ordinary trade bill.

### 5.2.4 Cheques

Section 6 of the Act defines "A cheque is a bill of exchange drawn on a specified banker, and not expressed to be payable otherwise than on demand".

A cheque is bill of exchange with two more qualifications, namely, (i) it is always drawn on a specified banker, and (ii) it is always payable on demand. Consequently, all cheque are bill of exchange, but all bills are not cheque. A cheque must satisfy all the requirements of a bill of exchange; that is, it must be signed by the drawer, and must contain an unconditional order on a specified banker to pay a certain sum of money to or to the order of a certain person or to the bearer of the cheque. It does not require acceptance.

**Distinction Between Bills of Exchange and Cheque**

1. A bill of exchange is usually drawn on some person or firm, while a cheque is always drawn on a bank.
2. It is essential that a bill of exchange must be accepted before its payment can be claimed A cheque does not require any such acceptance.
3. A cheque can only be drawn payable on demand, a bill may be also drawn payable on demand, or on the expiry of a certain period after date or sight.
4. A grace of three days is allowed in the case of time bills while no grace is given in the case of a cheque.
5. The drawer of the bill is discharged from his liability, if it is not presented for payment, but the drawer of a cheque is discharged only if he suffers any damage by delay in presenting the cheque for payment.
6. Notice of dishonour of a bill is necessary, but no such notice is necessary in the case of cheque.
7. A cheque may be crossed, but not needed in the case of bill.
8. A bill of exchange must be properly stamped, while a cheque does not require any stamp.

9. A cheque drawn to bearer payable on demand shall be valid but a bill payable on demand can never be drawn to bearer.
10. Unlike cheques, the payment of a bill cannot be countermanded by the drawer.

**Hundis :** A "Hundi" is a negotiable instrument written in an oriental language. The term hundi includes all indigenous negotiable instrument whether they be in the form of notes or bills. The word 'hundi' is said to be derived from the Sanskrit word 'hundi', which means "to collect". They are quite popular among the Indian merchants from very old days. They are used to finance trade and commerce and provide a fascile and sound medium of currency and credit.

Notes

Hundis are governed by the custom and usage of the locality in which they are intended to be used and not by the provision of the Negotiable Instruments Act. In case there is no customary rule known as to a certain point, the court may apply the provisions of the Negotiable Instruments Act. It is also open to the parties to expressly exclude the applicability of any custom relating to hundis by agreement.

**Parties To Negotiable Instruments**

**Parties to Bill of Exchange :**

1. **Drawer :** The maker of a bill of exchange is called the 'drawer'.
2. **Drawee :** The person directed to pay the money by the drawer is called the 'drawee'.
3. **Acceptor :** After a drawee of a bill has signed his assent upon the bill, or if there are more parts than one, upon one of such pares and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the ' acceptor'.
4. **Payee :** The person named in the instrument, to whom or to whose order the money is directed to be paid by the instrument is called the 'payee'. He is the real beneficiary under the instrument. Where he signs his name and makes the instrument payable to some other person, that other person does not become the payee.
5. **Indorser :** When the holder transfers or indorses the instrument to anyone else, the holder becomes the 'indorser'.
6. **Indorsee :** The person to whom the bill is indorsed is called an 'indorsee'.
7. **Holder :** A person who is legally entitled to the possession of the negotiable instrument in his own name and to receive the amount thereof, is called a 'holder'. He is either the original payee, or the indorsee. In case the bill is payable to the bearer, the person in possession of the negotiable instrument is called the 'holder'.
8. **Drawee in case of need :** When in the bill or in any endorsement, the name of any person is given, in addition to the drawee, to be resorted to in case of need, such a person is called 'drawee in case of need'. In such a case it is obligatory on the part of the holder to present the bill to such a drawee in case the original drawee refuses to accept the bill. The

Notes

bill is taken to be dishonoured by non-acceptance or for nonpayment, only when such a drawee refuses to accept or pay the bill.

9. **Acceptor for honour :** In case the original drawee refuses to accept the bill or to furnish better security when demanded by the notary, any person who is not liable on the bill, may accept it with the consent of the holder, for the honour of any party liable on the bill. Such an acceptor is called 'acceptor for honour.'

**Parties to a Promissory Note :**

1. Maker. He is the person who promises to pay the amount stated in the note. He is the debtor.
2. Payee. He is the person to whom the amount is payable i.e. the creditor.
3. Holder. He is the payee or the person to whom the note might have been indorsed.
4. The indorser and indorsee (the same as in the case of a bill).

**Parties to a Cheque :**

1. Drawer. He is the person who draws the cheque, i.e., the depositor of money in the bank.
2. Drawee. It is the drawer's banker on whom the cheque has been drawn.
3. Payee. He is the person who is entitled to receive the payment of the cheque.
4. The holder, indorser and indorsee (the same as in the case of a bill or note)

### 5.2.5 Holder In Due Course

**Holder :** The "holder" of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction. Section 9 of the Act defines 'holder in due course' as any person who (i) for valuable consideration, (ii) becomes the possessor of a negotiable instrument payable to bearer or the indorsee or payee thereof, (iii) before the amount mentioned in the document becomes payable, and (iv) without having sufficient cause to believe that any defect existed in the title of the person from whom he derives his title. (English law does not regard payee as a holder in due course).

The essential qualification of a holder in due course may, therefore, be summed up as follows :

1. He must be a holder for valuable consideration. Consideration must not be void or illegal, e.g. a debt due on a wagering agreement. It may, however, be inadequate. A donee, who acquired title to the instrument by way of gift, is not a holder in due course, since there is no consideration to the contract. He cannot maintain any action against the debtor on the instrument. Similarly, money due on a promissory note executed in consideration of the balance of the security deposit for the lease of a house taken for immoral purposes cannot be recovered by a suit.

Notes

2. He must have become a holder (passessor) before the date of maturity of the negotiable instrument. Therefore, a person who takes a bill or promissory note on the day on which it becomes payable cannot claim rights of a holder in due course because he takes it after it becomes payable, as the bill or note can be discharged at any time on that day.

3. He must have become holder of the negotiable instrument in good faith. Good faith implies that he should not have accepted the negotiable instrument after knowing about any defect in the title to the instrument. But, notice of defect in the title received subsequent to the acquisition of the title will not affect the rights of a holder in due course. Besides good faith, the Indian Law also requires reasonable care on the part of the holder before he acquires title of the negotiable instrument. He should take the instrument without any negligence on his part.

Reasonable care and due caution will be the proper test of his bona fides. It will not be enough to show that the holder acquired the instrument honestly, if in fact, he was negligent or careless. Under conditions of sufficient indications showing the existence of a defect in the title of the transferor, the holder will not become a holder in due course even though he might have taken the instrument without any suspicion or knowledge.

**Example :** (i) A bill made out by pasting together pieces of a tom bill taken without enquiry will not make the holder, a holder in due course. It was sufficient to show the intention to cancel the bill. A bill should not be taken without enquiry if suspicion has been aroused.

(ii) A post-dated cheque is not irregular. It will not preclude a bonafide purchase instrument from claiming the rights of a holder in due course. It is to be noted that it is the notice of the defect in the title of his immediate transferor, which deprives a person from claiming the right of a holder in due course. Notice of defect in the title of any prior party does not affect the title of the holder.

4. A holder in due course must take the negotiable instrument complete and regular on the face of it.

**Privileges of a holder in due course :**

**1. Instrument purged of all defects :** A holder in due course who gets the instrument in good faith in the course of its currency is not only himself protected against all defects of title of the person from whom he has received it, but also serves, as a channel to protect all subsequent holders. A holder in due course can recover the amount of the instrument from all previous parties although, as a matter of fact, no consideration was paid by some of the previous parties to instrument or there was a defect of title in the party from whom he took it. Once an instrument passes through the hands of a holder in due course, it is purged of all defects.

It is like a current coin. Who-so-ever takes it can recover the amount from all parties previous to such holder (Sec. 53). It is to be noted that a holder in due course can purify a defective title but cannot create any title unless the instrument happens to be a bearer one.

Notes

**Examples :**

(i) A obtains Bs acceptance to a bill by fraud. A indorses it to C who takes it as a holder in due course. The instrument is purged of its defects and C gets a good title to it. In case C indorses it to some other person he will also get a good title to it except when he is also a party to the fraud played by A.

(ii) A bill is payable to "A or order". It is stolen from A and the thief forges A's signatures and indorses it to B who takes it as a holder in due course. B cannot recover the money. It is not a case of defective title but a case where title is absolutely absent. The thief does not get any title therefore, cannot transfer any title to it.

(iii) A bill of exchange payable to bearer is stolen. The thief delivers it to B, a holder in due course. B can recover the money of the bill.

**2. Rights not affected in case of an inchoate instrument :** Right of a holder in due course to recover money is not at all affected even though the instrument was originally an inchoate stamped instrument and the transferor completed the instrument for a sum greater than what was intended by the maker. (Sec. 20)

**3. All prior parties liable :** All prior parties to the instrument (the maker or drawer, acceptor and intervening indorers) continue to remain liable to the holder in due course until the instrument is duty satisfied. The holder in due course can file a suit against the parties liable to pay, in his own name (Sec. 36)

**4. Can enforce payment of a fictitious bill :** Where both drawer and payee of a bill are fictitious persons, the acceptor is liable on the bill to a holder in due course. If the latter can show that the signature of the supposed drawer and the first indorser are in the same hand, for the bill being payable to the drawer's order the fictitious drawer must indorse the bill before he can negotiate it. (Sec. 42).

**5. No effect of conditional delivery :** Where negotiable instrument is delivered conditionally or for a special purpose and is negotiated to a holder in due course, a valid delivery of it is conclusively presumed and he acquired good title to it. (Sec. 46).

**Example :** A, the holder of a bill indorses it "B or order" for the express purpose that B may get it discounted. B does not do so and negotiates it to C, a holder in due course. D acquires a good title to the bill and can sue all the parties on it.

**6. No effect of absence of consideration or presence of an unlawful consideration :** The plea of absence of or unlawful consideration is not available against the holder in due course. The party responsible will have to make payment (Sec. 58).

**7. Estoppel against denying original validity of instrument :** The plea of original invalidity of the instrument cannot be put forth, against the holder in due course by the drawer of a bill of exchange or cheque or by an acceptor for the honour of the drawer. But where the instrument is void on the face of it

e.g. promissory note made payable to "bearer", even the holder in due course cannot recover the money. Similarly, a minor cannot be prevented from taking the defence of minority. Also, there is no liability if the signatures are forged. (Sec. 120).

Notes

**8. Estoppel against denying capacity of the payee to indorsee :** No maker of promissory note and no acceptor of a bill of exchange payable to order shall, in a suit therein by a holder in due course, be permitted to resist the claim of the holder in due course on the plea that the payee had not the capacity to indorse the instrument on the date of the note as he was a minor or insane or that he had no legal existence (Sec 121)

**9. Estoppel against indorser to deny capacity of parties :** An indorser of the bill by his endorsement guarantees that all previous endorsements are genuine and that all prior parties had capacity to enter into valid contracts. Therefore, he on a suit thereon by the subsequent holder, cannot deny the signature or capacity to contract of any prior party to the instrument.

**Dishonour of A Negotiable Instrument**

When a negotiable instrument is dishonoured, the holder must give a notice of dishonour to all the previous parties in order to make them liable. A negotiable instrument can be dishonoured either by nonacceptance or by non-payment. A cheque and a promissory note can only be dishonoured by non-payment but a bill of exchange can be dishohoured either by non-acceptance or by non-payment.

**Dishonour by non-acceptance (Section 91) :** A bill of exchange can be dishonoured by non-acceptance in the following ways :

1. If a bill is presented to the drawee for acceptance and he does not accept it within 48 hours from the time of presentment for acceptance. When there are several drawees even if one of them makes a default in acceptance, the bill is deemed to be dishonoured unless these several drawees are partners. Ordinarily when there are a number of drawees all of them must accept the same, but when the drawees are partners acceptance by one of them means acceptance by all.
2. When the drawee is a fictitious person or if he cannot be traced after reasonable search.
3. When the drawee is incompetent to contract, the bill is treated as dishonoured.
4. When a bill is accepted with a qualified acceptance, the holder may treat the bill of exchange having been dishonoured.
5. When the drawee has either become insolvent or is dead.
6. When presentment for acceptance is excused and the bill is not accepted. Where a drawee in case of need is named in a bill or in any indorsement thereon, the bill is not dishonoured until it has been dishonoured by such drawee.

Notes

**Dishonour by non-payment (Section 92)**

A bill after being accepted has got to be presented for payment on the date of its maturity. If the acceptor fails to make payment when it is due, the bill is dishonoured by non-payment. In the case of a promissory note if the maker fails to make payment on the due date the note is dishonoured by non-payment. A cheque is dishonoured by non-payment as soon as a banker refuses to pay.

An instrument is also dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid (Sec 76).

**Effect of dishonour :** When a negotiable instrument is dishonoured either by non acceptance or by non-payment, the other parties thereto can be charged with liability. For example if the acceptor of a bill dishonours the bill, the holder may bring an action against the drawer and the indorsers. There is a duty cast upon the holder towards those whom he wants to make liable to give notice of dishonour to them.

**Notice of dishonour :** Notice of dishonour means the actual notification of the dishonour of the instrument by non-acceptance or by non-payment. When a negotiable instrument is refused acceptance or payment notice of such refusal must immediately be given to parties to whom the holder wishes to make liable. Failure to give notice of the dishonour by the holder would discharge all parties other than the maker or the acceptor (Sec. 93).

**Notice by whom :** Where a negotiable instrument is dishonoured either by non- acceptance or by non-payment, the holder of the instrument or some party to it who is liable thereon must give a notice of dishonour to all the prior parties whom he wants to make liable on the instrument (Section 93). The agent of any such party may also be given notice of dishonour. A notice given by a stranger is not valid. Each party receiving notice of dishonour must, in order to render any prior party liable give notice of dishonour to such party within a reasonable time after he has received it. (Sec. 95).

When an instrument is deposited with an agent for presentment and is dishonoured, he may either himself give notice to the parties liable on the instrument or he may give notice to his principal. If he gives notice to his principal, he must do so within the same time as if he were the holder. The principal, too, in his turn has the same time for giving notice as if the agent is an independent holder. (Sec. 96)

**Notice to whom ?**

Notice of dishonour must be given to all parties to whom the holder seeks to make liable. No notice need be given to a maker, acceptor or drawee, who are the principal debtors (Section 93). Notice of dishonour may be given to an endorser. Notice of dishonour may be given to a duly authorised agent of the person to whom it is required to be given. In case of the death of such a person, it may be given to his legal representative. Where he has been declared insolvent the notice may be given to him or to his official assignee (Section 94). Where a party entitled to a notice of dishonour is dead, and notice is given to him in ignorance of his death, it is sufficient (Section 97).

Notes

**Mode of notice :** The notice of dishonour may be oral or written or partly oral and partly written. It may be sent by post. It may be in any form but it must inform the party to whom it is given either in express terms or by reasonable intendment that the instrument has been dishonoured and in what way it has been dishonoured and that the person served with the notice will be held liable thereon.

**What is reasonable time ?**

It is not possible to lay down any hard and fast rule for determining what is reasonable time. In determining what is reasonable time, regard shall be had to the nature of the instrument, the usual course the dealings with respect to similar instrument, the distance between the parties and the nature of communication between them. In calculating reasonable time, public holidays shall be excluded. (Section 105)

Section 106 lays down two different rules for determining reasonable time in connection with the notice of disnonour

(a) when the holder and the party to whom notice is due carry on business or live in different places,

(b) when the parties live or carry on business in the same place. In the first case the notice of dishonour must be dispatched by the next post or on the day next after the day of dishonour. In the second case the notice of dishonour should reach its destination on the day next after dishonour.

**Place of notice :** The place of business or (in case such party has no place of business) at the residence of the party for whom it is intended, is the place where the notice is to given. If the person who is to give the notice does not know the address of the person to whom the notice is to be given, he must make reasonable efforts to find the latter's address. But if the party entitled to the notice cannot after due search be found, notice of dishonour is dispensed with.

**Duties of the holder upon dishonour :**

**1. Notice of dishonour :** When a promissory note, bill of exchange or cheque is dishonoured by non-acceptance or non-payment the holder must give notice of dishonour to all the parties to the instrument whom he seeks to make liable thereon. (Sec. 93)

**2. Noting and protesting :** When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonour to be noted by a notary public upon the instrument or upon a paper attached thereto or partly upon each (Sec. 99). The holder may also within a reasonable time of the dishonour of the note or bill, get the instrument protested by notary public (Sec. 100).

**3. Suit for money :** After the formality of noting and protesting is gone through, the holder may bring a suit against the parties liable for the recovery of the amount due on the instrument. Instrument acquired after dishonour: The holder for value of a negotiable instrument as a rule, is not affected by the defect of title in his transferor. But this rule is subject to two important exceptions (i) when the holder acquires it after maturity and (ii) when he acquires it with notice of dishonour.

The holder of a negotiable instrument who acquired it after dishonour, whether by non-acceptance or non-payment, with notice thereof, or after maturity, has only, as against the other parties, the rights thereon of his transfer. (Sec. 59).

Notes

## 5.4 NEGOTIATION

Negotiation may be defined as the process by which a third party is constituted the holder of the instrument so as to entitle him to the possession of the same and to receive the amount due thereon in his own name. According to section 14 of the Act, 'when a promissory note, bill of exchange or cheque is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated.' The main purpose and essence of negotiation is to make the transferee of a promissory note, a bill of exchange or a cheque the holder there of.

Negotiation thus requires two conditions to be fulfilled, namely :

1. There must be a transfer of the instrument to another person; and
2. The transfer must be made in such a manner as to constitute the transferee the holder of the instrument. Handing over a negotiable instrument to a servant for safe custody is not negotiation; there must be a transfer with an intention to pass title.

### 5.4.1 Modes of Negotiation

Negotiation may be effected in the following two ways :

**1. Negotiation by delivery (Sec. 47) :** Where a promissory note or a bill of exchange or a cheque is payable to a bearer, it may be negotiated by delivery thereof. Example: A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep it for B. The instrument has been negotiated.

**2. Negotiation by endorsement and delivery (Sec. 48) :** A promissory note, a cheque or a bill of exchange payable to order can be negotiated only be endorsement and delivery. Unless the holder signs his endorsement on the instrument and delivers it, the transferee does not become a holder. If there are more payees than one, all must endorse it.

### 5.4.2 Importance of Delivery in Negotiation

Delivery is a voluntary transfer of possession from one person to another. Delivery is essential to complete any contract on a negotiable instrument whether it be contract of making endorsement or acceptance. The property in the instrument does not pass unless the delivery is fully completed. Section 46 of the Act provides that a negotiable instrument is not made or accepted or endorsed unless it is delivered to a proper person. For instance, if a person signs a promissory note and keeps it with himself, he cannot be said to have made a promissory note; only when it is delivered to the payee that the promissory note is made. Delivery may be actual or constructive. Delivery is actual when it is accompanied by actual change of possession of the instrument. Constructive delivery is effected without any change of actual possession.

## 5.5 PRESENTMENT

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**Presentment for acceptance :** A bill of exchange payable after sight must, if no time or place is specified therein for presentment, be presented to the drawee thereof for acceptance, if he can, after reasonable search, be found, by a person entitled to demand acceptance, within a reasonable time after it is drawn, and in business hours on a business day. In default of such presentment, no party thereto is liable thereon to the person making such default. If the drawee cannot, after reasonable search, be found, the bill is dishonoured. If the bill is directed to the drawee at a particular place, it must be presented at that place; and if at the due date for presentment he cannot, after reasonable search be found there, the till is dishonoured.

[Where authorized by agreement or usage, a presentment through the post office by means of a registered letter is sufficient.]

**Presentment of promissory note for sight :** A promissory note, payable at a certain period after sight, must be presented to the maker thereof for sight (if he can after reasonable search be found) by a person entitled to demand payment, within a reasonable time after it is made and in business hours on a business day. In default of such presentment, no party thereto is liable thereon to the person making such default.

**Drawee's time for deliberation :** The holder must, if so required by the drawee of a bill of exchange presented to him for acceptance, allow the drawee [forty-eight] hours (exclusive of public holidays) to consider whether he will accept it.

**Presentment for payment :** Promissory notes, bills of exchange and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively, by or on behalf of the holder as hereinafter provided. In default of such presentment, the other parties there to are not liable thereon to such holder.

[Where authorized by agreement or usage, a presentment through the post office by means of a registered letter is sufficient.]

**Exception :** Where a promissory note is payable on demand and is not payable at a specified place, no presentment is necessary in order to charge the maker thereof. Notwithstanding anything contained in section 6, where an electronic image of a truncated cheque is presented for payment, the drawee bank is entitled to demand any further information regarding the truncated cheque from the bank holding the truncated cheque in case of any reasonable suspicion about the genuineness of the apparent tenor of instrument, and if the suspicion is that of any fraud, forgery, tampering or destruction of the instrument, it is entitled to further demand the presentment of the truncated cheque itself for verification: Provided that the truncated cheque so demanded by the drawee bank shall be retained by it, if the payment is made accordingly.

**Hours for presentment :** Presentment for payment must be made during the usual hours of business, and, if at a banker's within banking hours.

**Presentment for payment of instrument payable after date or sight :** A promissory note or bill of exchange, made payable at a specified period after date or sight thereof, must be presented for payment at maturity.

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**Presentment for payment of promissory note payable by instalments :** A promissory note payable by instalments must be presented for payment on the third day after the date fixed for payment of each instalment; and non-payment on such presentment has the same effect as non-payment of a note at maturity.

**Presentment for payment of instrument payable at specified place and not elsewhere :** A promissory note, bill of exchange or cheque made, drawn or accepted payable at a specified place and not elsewhere must, in order to charge any party thereto, be presented for payment at that place.

**Instrument payable at specified place :** A promissory note or bill of exchange made, drawn or accepted payable at a specified place must, in order to charge the maker or drawer thereof, be presented for payment at that place.

**Presentment where no exclusive place specified :** A promissory note or bill of exchange, not made payable as mentioned in sections 68 and 69, must be presented for payment at the place of business (if any), or at the usual residence, of the maker, drawee or acceptor thereof, as the case may be.

**Presentment when maker, etc., has no known place of business or residence :** If the maker, drawee or acceptor of a negotiable instrument has no known place of business or fixed residence, and no place is specified in the instrument for presentment for acceptance or payment, such presentment may be made to him in person wherever he can be found.

**Presentment of cheque to charge drawer :** [Subject to the provisions of section 84,] a cheque must, in order to charge the drawer be presented at the bank upon which it is drawn before the relation between the drawer and his banker has been altered to the prejudice of the drawer.

**Presentment of cheque to charge any other person :** A cheque must, in order to charge any person except the drawer, be presented within a reasonable time after delivery thereof by such person.

**Presentment of instrument payable on demand :** Subject to the provisions of section 31, a negotiable instrument payable on demand must be presented for payment within a reasonable time after it is received by the holder.

**Presentment by or to agent, representative of deceased, or assignee of insolvent :** Presentment for acceptance or payment may be made to the duly authorized agent of the drawee, maker or acceptor, as the case may be, or, where the drawee, maker or acceptor has died, to his legal representative, or, where he has been declared an insolvent, to his assignee.

**[75A. Excuse for delay in presentment for acceptance or payment :** Delay in presentment [for acceptance or payment] is excused if the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate, presentment must be made within a reasonable time.]

**When presentment unnecessary :** No presentment for payment is necessary, and the instrument is dishonoured at the due date for presentment, in any of the following cases :

(a) if the maker, drawee or acceptor intentionally prevents the presentment of the instrument, or, if the instrument being payable at his place of business, he closes such place on a business day during the usual business hours, or, if the instrument being payable at some other specified place, neither he nor any person authorized to pay it attends at such place during the usual business hours, or, if the instrument not being payable at any specified place, he cannot after due search be found;

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(b) as against any party sought to be charged therewith, if he has engaged to pay notwithstanding non-presentment;

(c) as against any party if, after maturity, with knowledge that the instrument has not been presented he makes a part payment on account of the amount due on the instrument, or promises to pay the amount due thereon in whole or in part, or otherwise waives his right to take advantage of any default in presentment for payment;

(d) as against the drawer, if the drawer could not suffer damage from the want of such presentment.

**Liability of banker for negligently dealing with bill presented for payment :** When a bill of exchange, accepted payable at a specified bank, has been duly presented there for payment and dishonoured, if the banker so negligently or improperly keeps, deals with or delivers back such bill as to cause loss to the holder, he must compensate the holder for such loss.

## 5.6 DISCHARGE FROM LIABILITY

The maker, acceptor or indorser respectively of a negotiable instrument is discharged from liability thereon :

1. by cancellation; to a holder thereof who cancels such acceptor's or indorser's name with intent to discharge him, and to all parties claiming under such holder;
2. by release; to a holder thereof who otherwise discharges such maker, acceptor or indorser, and to all parties deriving title under such holder after notice of such discharge;
3. by payment to all parties thereto, if the instrument is payable to bearer, or has been indorsed in blank, and such maker, acceptor or indorser makes payment in due course of the amount due thereon.

**(Section 83) Discharge by allowing drawee more than forty-eight hours to accept :** If the holder of a bill of exchange allows the drawee more than forty-eight hours, exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder.

**(Section 84) When cheque not duly presented and drawer damaged thereby :** Where a cheque is not presented for payment within a reasonable time of its issue, and the drawer or person on whose account it is drawn had the right, at the time when presentment ought to have been made, as between

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himself and the banker, to have the cheque paid and suffers actual damage through the delay, he is discharged to the extent of such damage, that is to say, to the extent to which such drawer or person is a creditor of the banker to a larger amount than he would have been if such cheque had been paid. In determining what is a reasonable time, regard shall be had to the nature of the instrument, the usage of trade and of bankers, and the facts of the particular case. The holder of the cheque as to which such drawer or person is so discharged shall be a creditor, in lieu of such drawer or person, of such banker to the extent of such discharge and entitled to recover the amount from him.

**Illustrations**

1. A draws a cheque for Rs. 1,000 and, when the cheque ought to be presented, has funds at the bank to meet it. The bank fails before the cheque is presented. The drawer is discharged, but the holder can prove against the bank for the amount of the cheque.
2. A draws a cheque at Ambala on a bank in Calcutta. The bank fails before the cheque could be presented in ordinary course. A is not discharged, for he has not suffered actual damage through any delay in presenting the cheque.

**(Section 85) Cheque payable to order :** Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course. Where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in full or in blank appearing thereon, and notwithstanding that any such endorsement purports to restrict or exclude further negotiation.

**(Section 85A)– Drafts drawn by one branch of a bank on another payable to order :** Where any draft, that is, an order to pay money, drawn by one office of a bank upon another office of the same bank for a sum of money payable to order on demand, purports to be endorsed by or on behalf of the payee, the bank is discharged by payment in due course.

**(Section 86) Parties not consenting discharged by qualified or limited acceptance :** If the holder of a bill of exchange acquiesces in a qualified acceptance, or one limited to part of the sum mentioned in the bill, or which substitutes a different place or time for payment, or which, where the drawees are not partners, is not signed by all the drawees, all previous parties whose consent is not obtained to such acceptance are discharged as against the holder and those claiming under him, unless on notice given by the holder they assent to such acceptance.

**Explanations :**

An acceptance is qualified :

1. where it is conditional, declaring the payment to be dependent on the happening, of an event therein stated;
2. where it undertakes the payment of part only of the sum ordered to be paid;

3. where no place of payment being specified on the order, it undertakes the payment at a specified place, and not otherwise or elsewhere; or where, a place of payment being specified in the order, it undertakes the payment at some other place and not otherwise or elsewhere;
4. where it undertakes the payment at a time other than that at which under the order it would be legally due.

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**(Section 87) Effect of material alteration :** Alteration by indorsee. Any material alteration of a negotiable instrument renders the same void as against any one who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties. Alteration by indorsee. And any such alteration, if made by an indorsee, discharges his indorser from all liability to him in respect of the consideration thereof. The provisions of this section are subject to those of sections 20, 49, 86 and 125.

**(Section 88) Acceptor or indorser bound notwithstanding previous alteration :** An acceptor or indorser of a negotiable instrument is bound by his acceptance or indorsement notwithstanding any previous alteration of the instrument.

**(Section 89) Payment of instrument on which alteration is not apparent :**

1. Where a promissory note, bill of exchange or cheque has been materially altered but does not appear to have been so altered, or where a cheque is presented for payment which does not at the time of presentation appear to be crossed or to have had a crossing which has been obliterated, payment thereof by a person or banker liable to pay, and paying the same according to the apparent tenor thereof at the time of payment and otherwise in due course, shall discharge such person or banker from all liability thereon; and such payment shall not be questioned by reason of the instrument having been altered or the cheque crossed.
2. Where the cheque is an electronic image of a truncated cheque, any difference in apparent tenor of such electronic image and the truncated cheque shall be a material alteration and it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image.
3. Any bank or a clearing house which receives a transmitted electronic image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same.

**(Section 90) Extinguishment of rights of action on bill in acceptor's hands :** If a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all rights of action thereon are extinguished.

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## 5.7 NOTING AND PROTEST

When a negotiable instrument is dishonoured the holder may sue his prior parties i.e the drawer and the indorsers after he has given a notice of dishonour to them. The holder may need an authentic evidence of the fact that a negotiable instrument has been dishonoured. When a cheque is dishonoured generally the bank who refuses payment returns back the cheque giving reasons in writing for the dishonour of the cheque. Sections 99 and 100 provide convenient methods of authenticating the fact of dishonour of a bill of exchange and a promissory note by means of 'noting' and 'protest'.

### 5.7.1 Noting

As soon as a bill of exchange or a promissory note is dishonoured, the holder can after giving the parties due notice of dishonour, sue the parties liable thereon. Section 99 provides a mode of authenticating the fact of the bill having been dishonoured. Such mode is by noting the instrument. Noting is a minute recorded by a notary public on the dishonoured instrument or on a paper attached to such instrument. When a bill is to be noted, the bill is taken to a notary public who represents it for acceptance or payment as the case may be and if the drawee or acceptor still refuses to accept or pay the bill, the bill is noted as stated above.

Noting should specify in the instrument, (a) the fact of dishonour, (b) the date of dishonour, (c) the reason for such dishonour, if any (d) the notary's charges, (e) a reference to the notary's register and (f) the notary's initials.

Noting should be made by the notary within a reasonable time after dishonour. Noting and protesting is not compulsory but foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn. Cheques do not require noting and protesting. Noting by itself has no legal effect. Still it has some advantages. If noting is done within a reasonable time protest may be drawn later on. Noting without protest is sufficient to allow a bill to be accepted for honour.

### 5.7.2 Protest

Protest is a formal certificate of the notary public attesting the dishonour of the bill by non-acceptance or by non-payment. After noting, the next step for notary is to draw a certificate of protest, which is a formal declaration on the bill or a copy thereof. The chief advantage of protest is that the court on proof of the protest shall presume the fact of dishonour.

Besides the protest for non-acceptance and for non-payment the holder may protest the bill for better security. When the acceptor of a bill becomes insolvent or suspends payment before the date of maturity, or when he absconds the holder may protest it in order to obtain better security for the amount due. For this purpose the holder may employ a notary public to make the demand on the acceptor and if refused, protest may be made. Notice of protest may be given to prior parties. When promissory notes and bills of exchange are required to be protested, notice of protest must be given instead of notice of dishonour. (Sec. 102)

Inland bills may or may not be protested. But foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn (Sec. 104).

Where a bill is required to be protested under the Act within a specified time, it is sufficient if it is 'noted for protest' within such time. The formal protest may be given at anytime after the noting (Sec. 104A)

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### 5.7.3 Contents of Protest.

Section 101 of the Act lays down the contents of a regular and perfect protest which are as follows :

1. The instrument itself or a literal transcript of the instrument; and of everything written or printed thereupon.
2. The name of the person for whom and against whom the instrument has been protested.
3. The fact of and reasons for dishonour i.e. a statement that payment or acceptance or better security, as the case may be, has been demanded of such person by the notary public from the person concerned and he refused to give it or did not answer or that he could not be found.
4. The time and place of demand and dishonour.
5. The signature of the notary public.
6. In the case of acceptance for honour or payment for honour the person by whom or for whom such acceptance or payment was offered and effected.

## 5.8 PRESUMPTIONS

Sections 118 and 119 of the Negotiable Instrument Act lay down certain presumptions which the court presumes in regard to negotiable instruments. In other words these presumptions need not be proved as they are presumed to exist in every negotiable instrument. Until the contrary is proved the following presumptions shall be made in case of all negotiable instruments :

**1. Consideration :** It shall be presumed that every negotiable instrument was made drawn, accepted or endorsed for consideration. It is presumed that, consideration is present in every negotiable instrument until the contrary is presumed. The presumption of consideration, however may be rebutted by proof that the instrument had been obtained from, its lawful owner by means of fraud or undue influence.

**2. Date :** Where a negotiable instrument is dated, the presumption is that it has been made or drawn on such date, unless the contrary is proved.

**3. Time of acceptance :** Unless the contrary is proved, every accepted bill of exchange is presumed to have been accepted within a reasonable time after its issue and before its maturity. This presumption only applies when the acceptance is not dated; if the acceptance bears a date, it will prima facie be taken as evidence of the date on which it was made.

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**4. Time of transfer :** Unless the contrary is presumed it shall be presumed that every transfer of a negotiable instrument was made before its maturity.

**5. Order of endorsement :** Until the contrary is proved it shall be presumed that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.

**6. Stamp :** Unless the contrary is proved, it shall be presumed that a lost promissory note, bill of exchange or cheque was duly stamped.

**7. Holder in due course :** Until the contrary is proved, it shall be presumed that the holder of a negotiable instrument is the holder in due course. Every holder of a negotiable instrument is presumed to have paid consideration for it and to have taken it in good faith. But if the instrument was obtained from its lawful owner by means of an offence or fraud, the holder has to prove that he is a holder in due course.

**8. Proof of protest :** Section 119 lays down that in a suit upon an instrument which has been dishonoured, the court shall on proof of the protest, presume the fact of dishonour, unless and until such fact is disproved.

## 5.9 CROSSING OF CHEQUE

There are serious risks associated with payments to the wrong person. These risks can be avoided by giving the paying banker a clear direction about the person to whom the cheque is to be paid by specifying certain words on the cheque itself. This is crossing of a cheque. "Crossing is an instruction given to the paying banker to pay the amount of the cheque through a banker only and not directly to the person presenting it at the counter." The Negotiable Instruments Act, 1881, sets out in Section 123 – 131 the provisions concerning the crossing of cheques.

**Section 6 of the Negotiable Instruments Act, 1881 :** The term cheque is defined as "A bill of exchange drawn on a banker specified and not expressed to be payable other than on request." To understand this definition clearly, however, it is important that we also consider how an exchange bill was defined in accordance with the Act.

**Section 5 of the Negotiable Instruments Act, 1881 :** "Bill of exchange is a written instrument containing an unconditional order signed by the manufacturer that directs a certain person to pay a certain amount of money only to, or to, a certain person or to the instrument holder."

**What is Crossing of Cheques ?**

- Cheque crossing is recognized in the Negotiable Instruments Act of 1881.
- Crossing a cheque means drawing two parallel transverse lines between the lines on the cheque with or without additional words such as "& CO." or "Account Payee" or "Not Negotiable."

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**Why Cross a Cheque ?**

- **Minimizing the risk :** The crossing of the cheque gives the paying banker instructions to pay the amount only through the banker and not directly to the payee or holder presenting the amount at the counter. It is an effective way to minimize the risk of loss or falsification.
- **Paying instructions :** Crossing is a way for the paying banker to generally pay the money to a bank or to a particular bank, as applicable.
- **Payment through the bank :** Only a banker can secure the payment of a crossed cheque, which makes it easy for the holder to present it with a quarter of the respectability and credit that is known. By using a crossed cheque, you can ensure that the specified amount cannot be cashed but can only be credited to the bank account of the payee.
- **The receiver of the amount :** As only a banker secures the payment of a crossed cheque, the money received can easily be traced for whose use.
- **Negotiability :** Merely a cheque crossing does not affect its negotiability.

**Who is authorized to Cross a Cheque ?**

In accordance with the Sec. 125 of the Negotiable Instruments Act, the following persons are authorized to cross the cheque, apart from the drawer :

**The Holder**

- The holder of a cheque is authorized to cross a cheque, either in general or in particular if the cheque is not crossed.
- He is also entitled to cross a cheque, especially if the same is generally crossed.
- He can also add the words "non- negotiable" to crossed cheques in general and in particular.

**The Banker**

- The banker in whose favour a cheque is crossed in particular can also cross it in favour of another banker or his agent for collection purposes. Such a crossing is called Special Double-crossing.

**Different Types of Crossing of Cheque**

A crossing of cheques is basically of 2 types :

- General Crossing
- Special Crossing of cheques.

**General Crossing : Section 123** of the Negotiable Instruments Act deals with the general crossing of cheque, In the following cases, a cheque is generally considered to be crossed :

- If two parallel transverse lines are marked across the cheque face.
- If the cheque has an abbreviation "& C" between the two parallel transverse lines.
- If the cheque is written between the two parallel lines, the words "Not Negotiable".

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- When the cheque comes with the words "A / C. Payee" between the two parallel transverse lines.

**Implications of General Crossing**

- The effect of the general crossing is that any other banker must submit such a cheque to the paying banker.
- Payment can only be made by bank account and should not be made at the bank's payment counter.
- The banker then credits the cheque amount to either the owner of the cheque or the payee 's account.

**Special Crossing**

According to section 124 of the Negotiable instruments Act,

- For a cheque to be deemed to have been crossed, the banker's name had to be added across the face of the cheque.
- In case of a special crossing, a cheque must not be crossed by drawing two parallel lines.

**Section 124 of The Negotiable Instruments Act, 1881** defines Special Crossing as : "Where a cheque bears across its face an addition of the name of a banker, either with or without the words "not negotiable", that in addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially and to be crossed to that banker."

- Also known as Restricted Crossing.
- Two transverse lines must not necessarily be drawn.
- The banker's name is added across the face of the cheque.
- The banker's name may or may not carry the abbreviated word' & Co.
- Payment can only be made through the bank of the crossing. The banker mentioned at the crossing can appoint another banker to collect such cheques as his agent. Therefore, it is safer than 'generally' crossed cheques.
- Specially Crossed Cheques are not convertible into General Crossing.

**Implications of Special Crossing :** The bank pays the banker with his name between the crossing lines.

**General Crossing v. Special Crossing**

There are also substantial differences between the special and general crossing of cheques. Whereas the inclusion of the banker's name is a must in the case of a special crossing, the need for a general crossing is to draw two parallel lines. The special crossing of a cheque indicates that the paying banker must only honour the cheque if it is presented to him by the bank mentioned at the crossing. No other person can receive the cheque.

**Double Crossing**

**Section 127 of The Negotiable Instruments Act, 1881 :** "Where a cheque is crossed specially to more than one banker except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof."

- A double-crossed cheque shall be paid by the banker if the second banker acts only as of the agent of the first collecting banker and this is clearly stated on the cheque. i.e., Crossing must specify that the banker to whom it was particularly crossed again acts as the first banker's agent for the purpose of collecting the cheque.

**Why Double Crossing a Cheque ?**

- In the case that the banker to whom a cheque is crossed, has no branch at the place of the paying banker,
- Or if he feels the need otherwise, he can cross the cheque to another banker (specifying clearly).

**Non-Negotiable Crossing**

- Although the non- negotiable crossing does not result in the cheque becoming non- transferable, it still loses much of the negotiability of the cheques.
- This prevents anyone other than the cheque transferor from holding a better title than the one he has.
- However, if such a cheque is transferred for consideration and if such a transfer does not lead to a defect in the transferor 's title, the validity of such a non- negotiable crossing is still not removed from the cheque.

**Section 130 of the Negotiable Instrument Act** which deals with Non-Negotiable crossing states that "a person taking a cheque crossed generally or especially, bearing in either case the words 'not negotiable' shall not have and shall not be capable of giving a better title to the cheque than that which person from whom he took it had."

**A/C Payee Crossing**

In order to ensure that a cheque will not be able to be encashed by anyone but the rightful owner of the cheque, the words "account payee" are often added to the crossing ensuring that the bank receiving such a cheque is to collect the amount only for the purposes of the payee's account.

**The Advantages of A/C Payee Crossing**

- The same does not lead to a reduction in the cheque 's negotiability or transferability. The Court held that this was also the case in various matters like **National Bank v. Lilke** and also in the case of **A.Z. Underwood Ltd. v. Bank of Liverpool & Martins Ltd.**
- Checking with an account payee crossing does not affect the paying banker in any way since it only has to ensure that even if the cheque cannot be collected by the payee himself, the proceeds of the payee are credited to the account of the payee.

**Usage of A/C Payee : A Custom**

Although the words ''account payee' is not mentioned in the Negotiable Instrument Act, they are still considered to be part of the law because of their widespread practice and use.

Notes

**Non-Negotiable A/C Payee Crossing**

It has often been observed that both non- negotiable crossing and crossing of accounts payee help to ensure that cheques are extremely secure. Sometimes, a type of crossing is referred to as a' non- negotiable account payee crossing.'

**Advantages of Non-Negotiable Account Payee Crossing for the Payee :**

- The non- negotiable element of the crossing makes the cheque non-negotiable and therefore removes the more insecure element of the cheque's negotiability;
- The crossing of the' account payee' element serves as a direction for the payee banker to collect the cheque from the payee only, serving as a warning of the banker's responsibility if he does not do the same.

**The Implication of Non-Negotiable Account Payee Crossing :** Payment will be credited to the payee account named in the cheque.

**Paying Banker Accountability**

Paying banker is also accountable to :

1. The true owner of the cheque;
2. The drawer of such a cheque.

**Reasons for such Accountability :**

- If the paying banker pays for a cross-cheque that does not comply with the wishes of the drawer that is transmitted through the cheque, Then the banker in question shall be held liable for any loss suffered by him as a result of such payment to the true owner of the crossed cheque.
- Similarly, if the paying banker fails to make the payment in accordance with the provisions of **Sec. 126 of the Negotiable Instrument Act,** the law considers it to be a payment not made in accordance with the instructions of the drawer. This law prevents such a banker from debiting the check amount on his customer's account, as such payment is considered to have been made to the wrong person.

**Duties of a paying banker as to crossed cheques**

1. **For general Crossing : Sec. 126 of the Negotiable Instruments Act** states that crossed cheques are usually only paid to a banker.
2. **For Special Crossing :** A cheque crossed in particular should only be paid to the banker to whom it is crossed or who is a collection agent.
3. **For Second Special Crossing : Sec. 127 of the Negotiable Instruments Act, 1881,** allows the banker who would act as the agent of the first banker to collect a second special crossing. In the second special crossing, it is, therefore, necessary to specify that the banker in whose favour he is made is the collection agent on behalf of the first banker.
4. **Care and Attention :** A banker must not pay a cheque by ignoring the crossing since it is not legally justified to pay the payee in cash over the counter.

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**Duties of a Collecting Banker**

1. **Drafts Collection :** The collecting banker's duty is to collect and place the proceeds of both cheques and drafts for his customer's account, since 85-A of the Negotiable Instruments Act, 1881, defined drafts as "an order to pay money, drawn from one bank office to another bank office".
2. **Checking Account Holder bona-fides :** Establish the Bona- fides of the Account Holder : the banker must ask to determine the Bona- fides of the person who wishes to become a customer. If the banker fails to do so or fails to make a proper introduction or a reliable reference from the proposed customer, he will commit a breach of duty in accordance with section 131 of the Negotiable Instruments Act, 1881.
3. **Crossings Examination :** The collecting banker must carefully examine all the crossings and cheques he receives for collection. If the customer gives him a cheque crossed to any banker, in particular, he should not accept it for collection. Likewise, a cheque crossed "Account Payee Only" should only be collected for the payee named in the cheque and nobody else.
4. **Indorsements Examination :** While paying, the paying banker usually relies on the discharge of the collecting banker. It is, therefore, a very important duty of the collecting banker to examine all approvals and other material parts of all cheques and drafts before submitting them for collection and discharge on the instruments.
5. **Dishonour Notice :** If a cheque is dishonoured upon presentation, the collecting banker is responsible for informing his client accordingly. In addition, the banker has the right to debit a dishonoured cheque to the account of his customer if he has already credited the cheque.

In accordance with Sec. 126 of the Negotiable Instrument Act, the paying banker is obliged to make the payment in accordance with the terms of the crossing on a crossed cheque. This was also laid down in Sec. 126 of the Negotiable Instrument Act, according to which :

"Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker and where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed or his agent for collection."

- Therefore, only a banker is allowed to receive a crossed cheque.
- The paying banker is not authorized to send the proceeds of a crossed cheque to the payer or the cheque holder.
- Any failure by the paying banker to pay a crossed cheque shall be punishable by liability as defined in Sec. 129 of the Negotiable Instrument Act.

Notes

### 3.9.1 Bouncing of Cheque

A cheque is an unconditional order addressed to a banker, signed by a person who has deposited money with a banker, demanding a certain amount of money to be paid on request only by order of that person or by order of the instrument bearer.

(Or)

A cheque is a document that orders a bank to pay the individual on whose behalf the cheque has been issued a certain sum of money. The cheque is used to make a safe and convenient payment.

The cheque is a financial and a negotiable instrument which can be transferred to another party by simply endorsing it.

The four main items on a cheque are :

- Drawer, the person or entity who makes the cheque
- Payee, the recipient of the money
- Drawee, the bank or other financial institution where the cheque can be presented for payment
- Amount, the currency amount

The cheque was introduced in India by the Bank of Hindustan. In 1881, the Negotiable Instruments Act was enacted in India. The NI Act has established a legal structure for non-cash paper payment instruments in India. The Calcutta Clearing Banks' Association, which at that time was the largest bankers' association, implemented the clearing-house in 1938.

Till 1st April 2012, cheques in India were valid for six months from the date of its issue. After that, the Reserve Bank of India reduced its validity to three months from the date of issue.

Cheques continue to be used till date in different settings, and business transactions on a large scale do take place through the medium of cheques. However, in recent years "cheque bouncing" have become very common. Though cheques continue to be a reliable instrument of payment, cheques have been dishonoured in recent years. Cheque bouncing has been termed a legal offence within the country to protect the interests of the holder. The Negotiable Instruments Act, 1881 is the legal instrument which states that cheque bouncing is a crime. Section 138 of the Negotiable Instruments Act is applicable for the dishonour of the cheque. However, if the drawer makes payment of the cheque amount within fifteen days from the date of receipt of the notice, then the drawer does not commit any offence. If the drawer does not pay until the expiry of the 15 days' time, the payee has the right to file a complaint in the court of law.

**Causes of Cheque Bouncing**

There are several reasons for cheque bouncing :

1. **Insufficient Funds or Exceeds Arrangements :** If your account lacked funds when the cheque was issued, then the cheque may bounce. If the amount held in the account is less than the stipulated amount, then the cheque can bounce in such a situation.

2. **Date Mentioned on Cheques :** It is a vital part of the cheque, and any discrepancy on that front could lead to the cheque being bounced.
3. **Signature Mismatch & Overwriting :** This is a very common reason for bouncing cheques in India. Disfigured cheques with overwriting are not entertained.
4. **Drawer Stopped Payment :** This is also a common reason for cheque bouncing.

Notes

**Possible Solutions to Cheque Bouncing :** Bloomberg Quint has enthusiastically opined that "a commercial problem needs a commercial solution" because this topic passionately divides the masses and classes alike. In lieu of this fact, a perfect solution to this enduring problem would require skill and ingenuity. Legal remedies are available to all. For example, a complaint has to be filed within thirty days from the receipt of a reply to the cheque bouncing notice or from the lapse of 15 days of statutory notice. It needs to be recalled in this context that a cheque expires three months after its issuance.

Interestingly, cheque bouncing offences are common but tend to drag on in courts for years. Earlier, filing a civil suit was the only available option. Still, since these courts are unable to resolve the issue within a specified time frame, new amendments were made to the Negotiable Instruments Act in the year 1989. With the insertion of Chapter XVII in the Negotiable Instruments Act, 1881, the person issuing the dishonoured cheque can be punished with imprisonment up to 2 years or with fine, which may extend to twice the amount of the cheque or with both. The legislative intent behind this move was to ensure faith in the efficacy of banking operations and improve the credibility of cheques as a mode of payment. It was to provide a strong criminal remedy to deter people from issuing cheques that will be eventually dishonoured and also to ensure compensation to the complainant.

The newly inserted S. 143-A also provides for interim compensation to the complainant. Time is an essential factor here that often dissuades parties from moving ahead with the legal options available. Now the courts' enquiring complaint under Negotiable Instrument Act was made into Fast Track Courts to expedite the process of trial.

Furthermore, Section 139 of the Negotiable Instruments Act, 1881 requires that, unless it is proven otherwise, it is to be assumed that the issuer of a cheque received the cheque of nature referred to in Section 138 of the Act above for the discharge, in whole or in part, of any liability or liability whatsoever. This assumption is refutable by the accused by providing convincing proof that there was no debt or liability.

Now the Government of India is proposed to decriminalize the offences under the Negotiable Instruments Act 1881 to boost the economy of the country which has gone to a downfall in the recent covid-19 pandemic. If it is done so, then the flood gate for civil disputes will be opened, and it would be another burden upon the courts in India.

Notes

## 5.10 COMPANIES ACT 2013

### 5.10.1 Nature and Definition of A Company

A company is a business entity registered under the Companies Act. It is a legal entity with a separate identity from those who are its members or operate it. Therefore it can be considered as an artificial person created by the law.In terms of the Companies Act, 2013 (Act No. 18 of 2013) a "company" means a company incorporated under the Act [i.e Companies Act, 2013] or under any previous company law [Section 2(20)].

According to Chief Justice Marshall of USA, "A company is a person, artificial, invisible, intangible, and existing only in the contemplation of the law. Being a mere creature of law, it possesses only those properties which the character of its creation confers upon it either expressly or as incidental to its very existence". Another comprehensive and clear definition of a company is given by Lord Justice Lindley, "A company is meant as 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 there from. The common stock contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are 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".

According to Haney, "Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares. The ownership of which is the condition of membership" The advantages of incorporating a company (i.e registering a company under the Companies Act) are as under :

**1. Separate Legal Entity :** A company is perceived to be a distinct legal entity. Once incorporated under the Act, the company is vested with a corporate personality which does not depend on its members. The money credited by the creditors of the company can be recovered only from the company and the properties owned by the company. Individual members cannot be sued. Similarly, the company in any way is not liable for the individual debts of the members.

The company bears its own name, acts under its own name, has a seal of its own and its assets are separate and distinct from those of its members. It is a different 'person' from the members who compose it. Therefore it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The shareholders are not the agents of the company and so they cannot bind it by their acts.

The company does not hold its property as an agent or trustee for its members and they cannot sue to enforce its rights, nor can they be sued in respect of its liabilities. Thus, 'incorporation' is the act of forming a legal corporation

as a juristic person. A juristic person is in law also conferred with rights and obligations and is dealt with in accordance with law. In other words, the entity acts like a natural person but only through a designated person, whose acts are processed within the ambit of law.

Notes

The principal of separate of legal entity was explained and emphasized in the famous case of Solomon v Solomon & Co. Ltd. The facts of the case are as follows :

Mr. Soloman, the owner of a very prosperous shoe business, sold his business for the sum of $ 39,000 to Soloman and Co. Ltd. which consisted of Soloman himself,his wife, his daughter and his four sons. The purchase consideration was paid by the company by allotment of & 20,000 shares and $ 10,000 debentures and the balance in cash to Mr. Soloman. The debentures carried a floating charge on the assets of the company. One share of $ 1 each was subscribed by the remaining six members of his family. Soloman and his two sons became the directors of this company. Soloman was the managing director. After a short duration, the company went into liquidation. At that time the statement of affairs' was like this: Assets: $ 6000, liabilities: Soloman as debenture holder $ 10,000 and unsecured creditors : $ 7,000. Thus, its assets were running short of its liabilities by $11,000.

The unsecured creditors claimed a priority over the debenture holder on the ground that company and Soloman were one and the same person. But the House of Lords held that the existence of a company is quite independent and distinct from its members and that the assets of the company must be utilized in payment of the debentures first in priority to unsecured creditors. Soloman's case established beyond doubt that in law a registered company is an entity distinct from its members, even if the person holds all the shares in the company.

**2. Limited liability :** Limited liability means the company's debts are its own and members are protected from personal liability unless they are negligent or gave personal guarantees. A company may be limited by shares or by guarantee. In a company limited by shares, the liability of members is limited to the unpaid value of the shares. If the shares are fully paid i.e if the amount has already been fully paid to the company, then the member need not contribute any more towards the company's debts. If the amount has not been fully paid, then the member's liability is limited to the unpaid amount. For example, if X holds shares of the total nominal value of Rs.10,000 and has already paid Rs.5000/- (or 50% of the value) as part payment at the time of allotment, he cannot be called upon to pay more than Rs.5000/-, the amount remaining unpaid on his shares. If he holds fully-paid shares, he has no further liability to pay even if the company is declared insolvent.

In the case of a company limited by guarantee, the liability of members is limited to a specified amount of the guarantee mentioned in the memorandum.

**3. Perpetual Existence :** Perpetual succession means that the membership of a company may keep changing from time to time, but that shall not affect its continuity. Its life does not depend upon the death, insolvency or retirement of any or all shareholder (s) or director (s). Law creates it and law alone can

Notes

dissolve it. Professor L.C.B. Gower rightly mentions, "Members may come and go, but the company can go on forever. During the war all the members of one private company, while in general meeting, were killed by a bomb, but the company survived not even a hydrogen bomb could have destroyed it".

**4. Separate Property :** As a company is a legal person distinct from its members, it is capable of owning, enjoying and disposing of property in its own name. Although its capital and assets are contributed by its shareholders, they are not the private and joint owners of its property. The company is the juristic person in which all its property is vested and by which it is controlled, managed and disposed of.

**5. Shares :** In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision in the articles. However, the articles shall prescribe the manner in which such transfer of shares shall be made and it may also contain bona fide and reasonable restrictions on the right of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be ultra vires. However, the law allows, in the case of a private company to have such articles which restrict the right of member to transfer his shares in company.

**6. Capacity to Sue and Be Sued :** A company being a body corporate can sue and be sued in its own name. All legal proceedings against the company are to be instituted in its name. Similarly, the company may bring an action against anyone in its own name. A company's right to sue arises when some loss is caused to the company, i.e. to the property or the personality of the company. Hence, the company is entitled to sue for damages in libel or slander as the case may be.A company, as a person distinct from its members, may even sue one of its own members.

**7. Common Seal :** A company cannot sign documents by itself. It acts through natural persons who are called its directors. A common seal is used with the name of the company engraved on it as a substitute of its signature. To be legally binding on the company, a document has to carry the company seal on it.

**Definition of Company**

According to Black law's dictionary, the definition of company is "a voluntary association of a certain number of people having some common interests united by some commercial or industrial undertaking to carry out legitimate business."

The Companies Act of 2013 in India defines company in the Section 2(20) as "a company incorporated under this actor under any previous company law". This means that any corporation which is incorporated and registered under this Act or under other previous company Act will be called as a company.

A company is considered to be an artificial legal person according to Indian Constitution which have an independent legal entity and a common legal seal for its signatures.

### 5.10.2 Registration and Incorporation

The Section 7 of the Companies Act, 2013 explains to us the "incorporation of company". The word 'registration' and 'incorporation' is often confused. The main difference between these two words is that when the company is incorporated, only those assets are taken into account which have been invested but in the registration, even the personal assets will be taken into consideration if the company runs into losses.

Notes

**Procedure of incorporation of the company**

- The company shall have to register itself with the Registrar within its jurisdiction with the following documents and information of registration :
  1. The memorandum and articles of the company shall be signed by all the members ascertaining the memorandum.
  2. A declaration shall be prescribed by the Chartered Accountant, Advocate, Cost Accountant or Company Secretary, whoever is involved in the process. This declaration paper shall have a name of a person who may be a director, manager or secretary confirming that the rules made under the registration are complied with.
  3. The correspondence address will be provided until the registered office is established.
  4. An affidavit shall be signed by all the members for the promotion, formation and management of the company.
  5. All members, directors and the other interested person shall provide their names with surnames, Director Identification Number, residential address, nationality and other particulars as may be required including the proof of identity.
- The registrar on receiving the documents and information required for registration, shall issue a certificate of incorporation in the prescribed form and register the company under this Act.
- On the date of issue of certificate of incorporation, the registrar shall allot a separate distinct corporate identity to the company.
- There shall keep a copy of all the documents presented during the incorporation of the company till its dissolution.
- If a member furnishes false information in any matters, of which he/she is aware of, he/she shall be liable for committing fraud under Section 447 of the Companies Act, 2013.
- In any case, if it is proved that the company incorporated has furnished any information falsely, incorrectly or fraudulently, then the promoters, the person named as first directors and person making the declaration shall be held liable for committing fraud under Section 447 of the Companies Act, 2013.
- In the case of fraudulency, the tribunal will be constituted who after giving reasonable opportunity of being heard to the company shall pass such orders which it shall deem to be fit and sufficient. Following orders may be passed by the tribunal :

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1. Regulation of management of the company and its members.
2. Liability of the members.
3. Removal of the name of companies from the register of companies.
4. Winding up of company.
5. As the tribunal deems fit.

**Certificate of incorporation**

Section 18 of The Companies(Incorporation) Rules, 2014 provides for the issuing of a certificate of incorporation. The Certificate of Incorporation is the 'birth certificate' of the company showing its legal name and the date of incorporation. It is issued to all the entities who have registered with the Registrar of Companies. The certificate confirms the company's existence and other important information like its date of incorporation, registration number, etc. The Certificate of Incorporation is important for a company because this helps an investor to sell his/her shares. Even when the company applies for loans, this certificate is required.

**Pre-incorporation contracts**

As the word suggests, Pre-incorporation contract means those contracts which are made by or on behalf of the corporation at the time when it wasn't registered under Register of Companies.

**Legal status of Pre-incorporation Contracts :** Since, the contract is signed by the promoter on behalf of the corporation acting as an agent of the company which is still not registered, the liability of such contracts comes under the promoters itself. However, before 1963, although the promoter was acting for the company, yet he was solely responsible for any activity of the company. After enforcement of Special Relief Act of 1963, the promoters heaved a deep sigh of relief because according to Section 15(h) of the Special Relief Act, the companies were made liable for the acts done.

In the case of **Weaver Mills Ltd. v. Balkis Ammals**, the scope of this principle was extended by the Madras High Court. The court held that the promoters even though fail to convey the properties bought on behalf of the company after its incorporation, will automatically be acquired by the company as its own asset. On the other hand, under Section 19(e) of Special Relief Act, 1963, the company can be held liable by the other party of pre-incorporation contract, if there is such terms written in the contract.

Pre-incorporation contracts can be undertaken by the company in the following manners :

1. Introducing the contract when the company is being incorporated.
2. Making a fresh contract with the members of the company.
3. Accepting the benefits of the contract, either expressly or impliedly.

**Commencement of business :** The provision of the 'Commencement Of Business' was initially incorporated under the Companies Act, 1956, and was also included under section 11 of the Companies Act, 2013. Later on, in 2015, it was omitted by the legislature.

Notes

Recently by The Companies (Amendment) Act, 2018, it was added under Section 10A of the Companies Act, 2013. According to section 10A of Companies Act, 2013, a company after its incorporation cannot begin its business unless and until it has obtained the **Certificate of Commencement of Business** and fulfilled the following conditions :

1. Filed a declaration within 180 days of incorporation which has a confirmation that all the members of the company have paid the value of their shares as per the agreement.
2. Filed a verification of its registered office address with the Registrar of Companies within 30 days of its incorporation.
3. Removal of the name of companies from the Registrar of Companies if the provisions of the Act is not complied with or if the company is not carrying out any business.

Steps to obtain Certificate of Commencement of Business

1. A declaration form has to be filled up along with bank statements of the company showing the payment of value of shares by the shareholders.
2. A certificate of registration have to be submitted.

**Consequences of Non-Compliance :** There is a penal provision for the non compliance of this provision under this Act. the defaulter is charged with a penalty of Rs. 50,000 on the company and Rs. 1,000 per day on every member of the company.

**Other Provisions :** Apart from complying with the rules, regulations and procedures, one must keep the following in mind while running the business. These provisions must be intimated or approved by the Registrar of Companies so that there is smooth running of business. They are :

1. Change in the members of the company.
2. Change in statutory auditor of the company.
3. Change of registered office.
4. Change in Memorandum or Articles.
5. Increase in capital.

The following provisions, according to the Companies Act, 2013 should never be violated.

1. The company should not do other activities which are not mentioned in the objective clause of the company's contract.
2. The company should not issue securities to third party or to the public at large.

### 5.10.3 Memorandum of Association

A company is formed when a number of people come together for achieving a specific purpose. This purpose is usually commercial in nature. Companies are generally formed to earn profit from business activities. To incorporate a company, an application has to be filed with the Registrar of Companies (ROC). This application is required to be submitted with a number of documents. One of the fundamental documents that are required to be submitted with the application for incorporation is the Memorandum of Association.

Notes

**Definition of Memorandum of Association**

Section 2(56) of the Companies Act, 2013 defines Memorandum of Association. It states that a "memorandum" means two things :

- Memorandum of Association as originally framed;

Memorandum as originally framed refers to the memorandum as it was during the incorporation of the company.

- Memorandum as altered from time to time;

This means that all the alterations that are made in the memorandum from time to time will also be a part of Memorandum of Association.

The section also states that the alterations must be made in pursuance of any previous company law or the present Act.

In addition to this, according to Section 399 of the Companies Act, 2013, any person can inspect any document filed with the Registrar in pursuance of the provisions of the Act. Hence, any person who wants to deal with the company can know about the company through the Memorandum of Association.

**Meaning of Memorandum of Association :** Memorandum of Association is a legal document which describes the purpose for which the company is formed. It defines the powers of the company and the conditions under which it operates. It is a document that contains all the rules and regulations that govern a company's relations with the outside world.

It is mandatory for every company to have a Memorandum of Association which defines the scope of its operations. Once prepared, the company cannot operate beyond the scope of the document. If the company goes beyond the scope, then the action will be considered ultra vires and hence will be void.

It is a foundation on which the company is made. The entire structure of the company is detailed in the Memorandum of Association.

The memorandum is a public document. Thus, if a person wants to enter into any contracts with the company, all he has to do is pay the required fees to the Registrar of Companies and obtain the Memorandum of Association. Through the Memorandum of Association he will get all the details of the company. It is the duty of the person who indulges in any transactions with the company to know about its memorandum.

**Object of registering a Memorandum of Association or MOA :** Memorandum of Association is an essential document that contains all the details of the company. It governs the relationship between the company and its stakeholders. Section 3 of the Companies Act, 2013 describes the importance of memorandum by stating that, for registering a company,

1. In case of a public company, seven or more people are required;
2. In case of a private company, two or more people are required;
3. In case of a one person company, only one person is required.

In all the above cases, the concerned people should first subscribe to a memorandum before registering the company with Registrar.

Notes

Thus, Memorandum of Association is essential for registration of a company. Section 7(1)(a) of the Act states that for incorporation of a company, Memorandum of Association and Articles of Association of the company should be duly signed by the subscribers and filed with the Registrar. In addition to this, a memorandum has other objects as well. These are :

1. It allows the shareholders to know about the company before buying it shares. This helps the shareholders determine how much capital will they invest in the company.
2. It provides information to all the stakeholders who are willing to associate with the company in any way.

**Format of Memorandum of Association :** Section 4(5) of the Companies Act states that a memorandum should be in any form as given in Tables A, B, C, D, and E of Schedule 1. The Tables are of different kinds because of different kinds of companies.

**Table A :** It is applicable to a company limited by shares.

**Table B :** It is applicable to a company limited by guarantee and not having a share capital.

**Table C :** It is applicable to a company limited by guarantee and having a share capital.

**Table D :** It is applicable to an unlimited company not having a share capital.

**Table E :** It is applicable to an unlimited company having a share capital.

The memorandum should be printed, numbered and divided into paragraphs. It should also be signed by the subscribers of the company.

**Sample of Memorandum of a Company Limited by Shares :** XYZ Private Limited, a company, situated in Punjab, is engaged in the business of manufacturing security devices. It wants to register with the Registrar of Companies. For registration, the company has to first subscribe to a memorandum.

The Memorandum of Association of XYZ Private Limited will look like this.:

(Since XYZ Private Limited is a company limited by shares, the form given in Table A will be applicable to it.)

The Companies Act, 2013

Company Limited by Shares

Memorandum of Association

Of

XYZ Private Limited

1. The name of the company is XYZ Private Limited. *(Name Clause)*
2. The registered office of the company will be situated in the state of Punjab. *(Registered Office Clause)*
3. The object for which the company is established are *(Object Clause)*:

(a) The objects to be pursued by the company on its incorporation are :

Notes

I. To carry on business of manufacturing, converting, altering, designing, producing security systems.

II. To trade, buy, sell or act as agents to import or export all security related devices.

III. To carry on the business and act as buyers, sellers, traders, agents and dealers for obtaining the above objects.

(b) Matters which are necessary for the furtherance of the objects specified in clause 3A are :

1. To manufacture and deal in packaging materials, boxes, grading, branding, weighting, and marketing for all kinds of security devices and other electronic components associated with it.
2. To draw, make, accept, endorse, discount, execute, issue, negotiate, assign and otherwise deal with cheques, drafts, bills of exchange, promissory notes, hundies, debentures, bonds, bills of lading, railway receipts, warrants and all other negotiable or transferable instruments.
3. To amalgamate with any other company or companies.
4. To acquire or merge with any other company.
5. To start a joint venture with any other company.
6. To distribute any of the property of the Company amongst the members in specie or kind subject to the provisions of the Companies Act in the event of winding up.
7. To apply for, tender, purchase, or otherwise acquire any contracts, subcontracts licences and concessions for or in relation to the objects or business herein mentioned or any of them, and to undertake, execute, carry out, dispose of or otherwise turn to account the same.

- The liability of the member(s) is limited and this liability is limited to the amount unpaid, if any, on the shares held by them. (Liability Clause)
- The share capital of the company is 70,00,000 rupees, divided into 2000 shares of 3500 rupees each. (Capital Clause)
- We, the several persons, whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set against our respective names :

Notes

| Names, addresses, descriptions and occupations of subscribers | No. of shares taken by each subscriber | Signature of subscriber | Signature, names, addresses, descriptions and occupations of witnesses |
|---|---|---|---|
| A.B. of...Merchant | ..... | | Signed before me:<br>Signature..... |
| C.D. of...Merchant | ..... | | Signed before me:<br>Signature..... |
| E.F. of...Merchant | ..... | | Signed before me:<br>Signature..... |
| G.H. of...Merchant | ..... | | Signed before me:<br>Signature..... |
| I.J. of...Merchant | ..... | | Signed before me:<br>Signature..... |
| K.L. of...Merchant | ..... | | Signed before me:<br>Signature..... |
| M.N. of...Merchant | ..... | | Signed before me:<br>Signature..... |
| Total shares taken : 1400 | | | |

7. I, whose name and address are given below, am desirous of forming a company in pursuance of this memorandum of association and agree to take all the shares in the capital of the company *(Applicable in case of one person company)* :

| Name, address, description and occupation of subscriber | Signature of subscriber | Signature, name, address, description and occupation of witness |
|---|---|---|
| A.B. .....Merchant | | Signed before me:<br>Signature..... |

8. Shri/Smt_____, son/daughter of _____, resident of_____ aged_____ years shall be the nominee in the event of death of the sole member (*Applicable in case of one person company)*

Dated_____ the day of_____

**Content of Memorandum of Association :** Section 4 of the Companies Act, 2013 states the contents of the memorandum. It details all the essential information that the memorandum should contain:

Notes

**Name Clause :** The first clause states the name of the company. Any name can be chosen for the company. But there are certain conditions that need to be complied with.

Section 4(1)(a) states :

1. If a company is a public company, then the word 'Limited' should be there in the name. Example, "Robotics", a public company, its registered name will be "Robotics Limited".
2. If a company is a private company, then 'Private Limited' should be there in the name. "Secure"a private company, its registered name will be "Secure Private Limited".
2. This condition is not applicable to Section 8 companies.

**What are Section 8 companies ?**

Section 8 Company is named after Section 8 of the Companies Act,2013. It describes companies which are established to promote commerce, art, sports, education, research, social welfare, religion etc. Section 8 companies are similar to Trust and Societies but they have a better recognition and legal standing than Trust and Societies.

**What kind of names are not allowed ?**

The name stated in the memorandum shall not be,

1. Identical to the name of another company;
2. Too nearly resembling the name of an existing company.

According to Rule 8 of the Company (Incorporation) Rules,2014.

- If a company adds 'Limited', 'Private Limited', 'LLP', 'Company', 'Corporation', 'Corp', 'inc' and any other kind of designation to its name to differentiate it from the name of the other company, the name would still not be accepted.

**Illustration :** Precious Technology Limited is same as Precious Technology Company.

- If plural or singular forms are added to differentiate between names. Illustrations: Greentech Solution is same as GreenTech Solutions.

Colors Technology is same as Color Technology.

- If type, and case of letters, or punctuation marks are added.

**Illustration :** We work is same as We.work.

- Different tenses are used in names.

**Illustration :** Ascend Solution is same as Ascended Solutions.

- If there is an intentional spelling mistake in the name or phonetic changes in the name.

**Illustrations :** Greentech is same as Green tek.

DQ is same as Dee Qew.

- Internet related designations are used like .org, .com, etc.

**Illustration :** Greentech Solution Ltd. is same as Greentech Solutions. com Ltd.

**Exception :** The name will not be disregarded if the existing company by a board of resolution allows it.

- Change in order of combination of words.

**Illustration :** Shah Builders and Contractors is same as Shah Contractors and Builders.

**Exception :** The name will not be disregarded if the existing company by a board of resolution allows it.

- Addition of a definite or indefinite article.

**Illustration :** Greentech Solutions Ltd is same as The Greentech Solutions Ltd.

**Exception :** The name will not be disregarded if the existing company by a board of resolution allows it.

- Slight variation in spelling of two names, including a grammatical variation.

**Illustration :** Colours TV Channel is same as Colors TV Channel.

- Translation of a name, from one language to another.

**Illustration :** Om Electricity Corporation is same as Om Vidyut Nigam.

- Addition of the name of a place to the name.

**Illustration :** Greentech Solutions Ltd. Is same as Greentech Mumbai Solutions Ltd.

**Exception :** The name will not be disregarded if the existing company by a board of resolution allows it.

- Addition, deletion or modification of numericals in the name:

**Illustration :** Greentech Solutions Ltd. Is same as 5 Greentech Solutions Ltd.

**Exception :** The name will not be disregarded if the existing company by a board of resolution allows it.

In addition to this, an undesirable name will also not be allowed to be chosen.

Undesirable names are those names which in the opinion of the Central Government are :

1. Prohibited under the Provisions of Section 3 of Emblems and Names (Prevention and Improper Use) Act, 1950.
2. Names which resemble each other, which are chosen to deceive.
3. The name includes a registered trademark.
4. The name includes any word or words which are offensive to a section of people.
5. Name which is identical to or too nearly resembles the name of an existing Limited Liability Partnership.

Furthermore, statutory names such as the UN, Red Cross, World Bank, Amnesty International etc. are also not allowed to be chosen.

Notes

Notes

Names which in any way indicate that the company is working for the government are also not allowed.

**Reservation of a Name :** Section 4(5)(i) of the Act states that for formation of the Company, the Registrar on receiving the required documents can reserve a name for 20 days. If the application is made by an existing company, then once the application is accepted, the name will be reserved for 60 days from the date of application. The company should get incorporated with the reserved name in these 60 days.

If after making the reservation of a name, it is found that some wrong information is given. Then two cases arise.

1. In case the company has not been incorporated. In this case, the Registrar can cancel the reservation of the name and impose a fine of Rupees 1,00,000.
2. In case the company has been incorporated. In this case, after hearing the reasons of the company, the Registrar has 3 options. These are,
   - On being satisfied, he can give 3 months time to the company to change the name by passing an ordinary resolution.
   - He can strike off the name from the Register of Companies.
   - He can file a petition of winding up of the company.

Rule 8 and 9 of the Company (Incorporation) Rules, 2014 state that the application for reservation of name under section 4(4) should be filed on Form INC – 1.

**Registered Office Clause :** The Registered Office of a company determines its nationality and jurisdiction of courts. It is a place of residence and is used for the purpose of all communications with the company.

Section 12 of the Companies Act, 2013 talks about Registered Office of the company.

Before incorporation of the company, it is sufficient to mention only the name of the state where the company is located. But after incorporation, the company has to specify the exact location of the registered office. The company has to then get the location verified as well, within 30 days of incorporation.

It is mandatory for every company to fix its name and address of its registered office on the outside of every office in which the business of the company takes place. If the company is a one-person company, then "One-person Company" should be written in brackets below the affixed name of the company.

Change in place of Registered Office should be notified to the Registrar within the prescribed time period.

**Object Clause :** Section 4(c) of the Act, details the object clause. The Object Clause is the most important clause of Memorandum of Association. It states the purpose for which the company is formed. The object clause contains both, the main objects and matters which are necessary for achieving the stated objects also known as incidental or ancillary objects. The stated objects must be well defined and lawful according to Section 6(b) of the Companies Act, 2013.

By limiting the scope of powers of the company. The object clause provides protection to :

**Shareholders :** The object clause clearly states what operations will the company perform. This helps the shareholders know their investment in the company will be used for what purpose.

**Creditors :** It ensures the creditors that capital is not at risk and the company is working within the limits as stated in the clause.

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**Public Interest :** The object clause limits the number of matters the company can deal with thus, prohibiting diversification of activities of the company.

**Doctrine of Ultra Vires :** If the company operates beyond the scope of the powers stated in the object clause, then the action of the company will be ultra vires and thus void.

**Consequences of Ultra Vires :**

1. **Liability of Directors :** The directors of the company have a duty to ensure that company's capital is used for the right purpose only. If the capital is diverted for another purpose not stated in the memorandum, then the directors will be held personally liable.
2. **Ultra Vires Borrowing by the Company :** If a bank lends to the company for the purpose not stated in the object clause, then the borrowing would be Ultra Vires and the bank will not be able to recover the amount.
3. **Ultra Vires Lending by the Company :** If the company lends money for an ultra vires purpose, then the lending would be ultra vires.
4. **Void ab initio :** Ultra Vires acts of the company are considered void from the beginning.
5. **Injunction :** Any member of the company can use the remedy of injunction to prevent the company from doing ultra vires acts.

**Liability Clause :** The Liability Clause provides legal protection to the shareholders by protecting them from being held personally liable for the loss of the company.

**There are two kinds of limited liabilities :**

**Limited By Shares :** Section 2(22) of the Companies Act, 2013 defines a company limited by shares. In a company limited by shares, the shareholders only have to pay the price of the shares they have subscribed to. If for some reason they have not paid the full amount for the shares and the company winds up then their liability will only be limited to the unpaid amount.

**Limited By Guarantee :** It is defined in Section 2(21) of the Companies Act, 2013.A company limited by guarantee has members instead of shareholders. These members undertake to contribute to the assets of the company at the time of winding up. The members give guarantee of a fixed amount that they will be liable for. Non-profit Organizations and other charities usually have a structure of companies limited by guarantee.

Notes

**Capital Clause :** It states the total amount of share capital in the company and how it is divided into shares. The way the amount of capital is divided into what kind of shares. The shares can be equity shares or preference shares.

**Illustration :** The share capital of the company is 80,00,000 rupees, divided into 3000 shares of 4000 rupees each.

**Subscription Clause :** The Subscription Clause states who are signing the memorandum. Each subscriber must state the number of shares he is subscribing to. The subscribers have to sign the memorandum in the presence of two witnesses. Each subscriber must subscribe to at least one share.

**Association Clause :** In this clause, the subscribers to the memorandum make a declaration that they want to associate themselves to the company and form an association.

**Memorandum of Association for One-Person-Company**

A one-person company is called so because it can be formed by one person. The minimum capital required to form a one-person company is 1,00,000 Rupees. It is a new concept which has been introduced to promote entrepreneurship. All the laws which are applicable on private companies will be applicable on one-person company.

Section 2(62) of the Companies Act, 2013 defines one-person company.

A one-person company is a separate legal entity from its owner. It is mandatory for the company to be converted into a private limited company in case its annual turnover crosses the 2 Crore mark.

In case of one-person-company, in addition to all the other clauses, the Memorandum of Association contains a clause called the Nomination Clause. This clause mentions the name of an individual who will become the member in case the subscriber dies or becomes incapacitated. The nominee must be an Indian citizen and resident of India i. e. he must have been living in India for at least 182 days in the preceding year. A minor cannot be a nominee.

The individual whose name is mentioned should give his consent in written form and it is required to be filed with the Registrar of Companies at the time of incorporation.

If the nominee wants to withdraw, he shall give it in writing and the owner of the company will have to nominate a new person within 15 days.

**What's the use of Memorandum of Association ?**

1. It defines the scope & powers of a company, beyond which the company cannot operate.
2. It regulates company's relation with the outside world.
3. It is used in the registration process, without it the company cannot be incorporated.
4. It helps anyone who wants to enter into a contractual relationship with the company to gain knowledge about the company.
5. It is also called the charter of the Company, as it contains all the details of the company, its members and their liabilities.

Notes

**Subscription of Memorandum of Association**

Subscribers are the first shareholders of the company. They are the people who agreed to come together and form the company. The name of each subscriber along with their particulars are mentioned in the memorandum.

Different kinds of companies require different number of subscribers for incorporation.

1. **Private Company :** In case of a private company, the minimum number of subscribers required are 2.
2. **Public Company :** In case of a public company, 7 or more subscribers are required.
3. **One-Person-Company :** In case of one-person-company, only one person is required.

**Who can Subscribe ?**

Rule 13 of the Companies (Incorporation) Rules, 2014 describes the provisions of subscribing to the memorandum.

There are specific kinds of persons (natural or artificial) who can subscribe to the memorandum. These are :

1. **Individuals :** An individual or a group of individuals can subscribe to the memorandum.
2. **Foreign citizens and Non Resident Indians :** Rule 13(5) of the Companies (Incorporation) Rules, states that for a foreign citizen to subscribe to a company in India, his signature, address and proof of identity will need to be notarized.

The foreign national must have visited India and should have a Business Visa.

For a Non Resident Indian, the photograph, address and identity proof should be attested at the Embassy with a certified copy of a passport. There is no requirement of Business Visa.

1. Minor – A minor can only be a subscriber through his guardian.
2. Company incorporated under the Companies Act – The company can be a subscriber to the memorandum. The Director, officer or employee of the company or any other person authorized by the board of resolution.
3. Company incorporated outside India – Foreign Company is defined in Section 2(42) of the act, it states that a foreign company is a company incorporated outside India. A company registered outside India can also subscribe to the memorandum by fulfilling the additional formalities.
4. Society registered under the Societies Registration Act, 1860.
5. Limited Liability Partnership – A partner of a limited liability partnership can sign the memorandum with the agreement of all the other partners.
6. Body corporate incorporated under an Act of Parliament or State Legislature can also be a subscriber to the memorandum.

Notes

**Subscription to Memorandum of Association**

Every subscriber should sign the memorandum in presence of at least one witness. The following particulars of the witness should also be mentioned.

1. Name of the witness
2. Address
3. Description
4. Occupation

If the signature is in any other language then, then an affidavit is required that declares that the signature is the actual signature of the person. According to Circular No. 8/15/8, dated 1-9-1958. The subscriber can also authorize another person to affix the signature by granting a power of attorney to the person. Department Circular No. 1/95, dated 16th February 1995 states that only one power of attorney is required.

The person who is granted the power of attorney may be known as an agent.

He should also state the following particulars in the memorandum :

1. Name of the agent
2. Address
3. Description
4. Occupation

**Particulars to be Mentioned in Memorandum of Association**

Rule 16 of the Companies (Incorporation) Rules, 2014 details the particulars that are to be mentioned in the memorandum. Every Subscriber's following details should be mentioned.

1. Name (includes last name and family name), a photograph should be affixed and scanned with the memorandum.
2. Father's Name and Mother's Name
3. Nationality
4. Date of Birth
5. Place of Birth
6. Qualifications
7. Occupation
8. Permanent Account Number
9. Permanent and Current Address
10. Contact Number
11. Fax Number (Optional)
12. 2 Identity Proofs in which Permanent Account Number is mandatory.
13. Residential Proof (not older than 2 months)
14. Proof of nationality, if subscriber is a foreign national
15. If the subscriber is a current director or promoter, then his designation along with Name and Company Identity Number

If a body corporate is subscribing to the memorandum then the following particulars should be mentioned.

1. Corporate identity number of the company or registration number of the body corporate.
2. Global location number, which is used to identify the location of the legal entity. (Optional)
3. The name of the body corporate.
4. The registered address of the business.
5. Email address.

In case the body corporate is a company, then a certified copy of Board resolution which authorizes the subscription to the memorandum. The particulars required in this case are,

1. Number of shares to be subscribed by a body corporate.
2. Name, designation and address of the authorized person.

In case the body corporate is a limited liability partnership. The particulars required are,

1. A certified copy of the resolution.
2. The number of shares that the firm is subscribing to.
3. The name of the authorized partner.

In case the body corporate is registered outside the country. The particulars required are,

1. The copy of certificate of incorporation.
2. The address of the registered office.

**Printing and Signing of Memorandum of Association**

Section 7(1)(a) states that the memorandum should be duly signed by all the subscribers and should be in a manner prescribed by the Act.

Rule 13 of the Company (Incorporation) Rules, 2014 describes the manner in which the memorandum should be signed.

1. The Memorandum of Association should be signed by each subscriber to the memorandum. The subscriber shall mention his name, address, occupation and the number of shares he is subscribing to. The documents should be signed in the presence of at least one witness. The witness would also mention his name, address, and occupation. By signing the memorandum, the witness states that, "I witness to subscriber/subscriber(s)who has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity Details (ID) for their identification and satisfied myself of his/her/their identification particulars as filled in."
2. If the person subscribing to the document is illiterate, he can either authorize an agent to sign the document through Power of Attorney or he can put his thumb impression on the column for signatures. The person's name, address, occupation and the number of shares he is

Notes

subscribing to should be written by a person who has been allowed to write for him. The person who is writing for the illiterate person should read and explain the contents of the document to an illiterate person.

3. Where the person subscribing to the memorandum is an artificial person i. e. a body corporate the memorandum shall be signed by the employee, officer or any person authorized by the Board of Resolution.
4. Where the person subscribing to the memorandum is a foreign national who does not reside in India but in a country,
   - in any part of the Commonwealth, his signatures and address on the memorandum and proof of identity shall be notarized by a Notary (Public) in that part of the Commonwealth.
   - in a country which is a signatory to the Hague Apostille Convention, 1961, his signature and proof of identity and address on the memorandum shall be notarized before the Notary (Public) of the country of his origin and be duly approved in accordance with the said Hague Convention.
   - in a country outside the Commonwealth and which is not a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and proof of identity, shall be notarized before the Notary (Public) of such country and the certificate of the Notary (Public) shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf under section 3 of the Diplomatic and Consular Officers (Oaths and Fees) Act, 1948 (40 of 1948).

Section 3 of the Diplomatic and Consular Officers states that, every Diplomat or any officer in a foreign country can perform the functions of a notary public.

1. Where there is no Diplomatic or Consular officer by any of the officials mentioned in section 6 of the Commissioners of Oaths Act, 1889.
2. If the foreign national visited India and intended to incorporate a company, in such a case the incorporation shall be allowed if, he is having a valid Business Visa.

Section 15 of the Companies Act, 2013 states that the memorandum should be in printed form.

The Ministry of Corporate Affairs has clarified that a document printed in form laser printers will be considered valid provided it is legible and fulfills other requirements as well.

The submission of xerox copies is not allowed. The xerox copies can be submitted to the members of the company.

**Alteration, Amendment & Change in Memorandum of Association under Companies Act, 2013.**

The term "alter" or "alteration" is defined in Section 2(3) of the Act, as any additions, omissions or substitutions. A company can alter the memorandum

only to the extent as permitted by the Act. According to Section 13, the company can alter the clauses in the memorandum by passing a special resolution.

A resolution is a formal decision taken in a meeting. There are two kinds of resolutions, ordinary and special. A special resolution is one which requires at least 2/3rd majority to be effective. The alteration to the clauses also require the approval of the Central Government in writing.

Notes

The alteration of memorandum can happen for a variety of reasons. The alteration can be made if,

1. Enables the company to carry its business more effectively;
2. Helps to achieve the objectives;
3. Helps the company to amalgamate with another company;
4. Helps the company dispose off any undertaking.

**Alteration of Memorandum :** The alteration of various clauses of the memorandum have different procedures :

1. **Alteration to the Name Clause :** To alter the name of the company, a special resolution is required. After the resolution is passed, the copy is sent to the registrar. For changing the name, the application needs to be filed in Form INC- 24 with the prescribed fees. After the name is changed, a new certificate of incorporation is issued.
2. **Alteration to the Registered Office Clause :** The application for changing the place for Registered Office of the company shall be filed with the Central Government in Form INC- 23 with the prescribed fees.

If the company is changing its Registered Office from one to another, then the approval of the Central Government is required. The Central Government is required to dispose off the matter within 60 days and should ensure that the change of place has the consent of all the stakeholders of the company.

- **Alteration to the Object Clause :** To alter the object clause, a special resolution is required to be passed. The changes must be confirmed by the authority. The document which confirms the changes by authority with a printed copy of the altered memorandum should be filed with the Registrar.

If the company is a public company, then the alteration should be published in the newspaper where the Registered Office of the company is located. The changes to the object clause must also mentioned on the company's website.

- **Alteration to the Liability Clause :** The Liability clause of the memorandum cannot be altered except with the written consent of all the members of the company. By altering the liability clause, the liability of the directors of the company can be made unlimited. In any case, the liability of the shareholders cannot be made unlimited. Changes in the liability clause can be made by passing a special a special resolution and sending a copy of the resolution to the Registrar of Companies.

Notes

Alteration to the Capital Clause: The capital clause of a company can be altered by an ordinary resolution.

The company can,

1. Increase its authorised share capital;
2. Convert the shares into stock;
3. Consolidate and divide all of its shares;
4. Cancel the shares which have not been subscribed to;
5. Diminish the share capital of the shares cancelled.

The altered Memorandum of Association should be submitted to the Registrar within 30 days of passing the resolution.

### 5.10.4 Articles of Association (AOA)

**Memorandum of Association** (MOA) and Articles of Association (AOA) are two important business documents of a company. Every company needs a set of rules and regulations to manage its internal affairs and the AOA specifies the internal regulations of the company. In simple words, AOA contains the bye-laws of the company, according to which the director and other members must perform their functions.

In this article we will discuss the following topics under AOA in detail :

1. Articles of Association (AOA) Definition
2. Objectives of Articles of Association (AOA)
3. Forms of Articles of Association (AOA)
4. Content of Articles of Association (AOA)
5. What is the difference between MOA and AOA?

**Articles of Association (AOA) Definition :** As per Section 2(5) of the Companies Act, 2013 articles means the Articles of Association (AOA) of a company originally framed or altered or applied in pursuance of any previous company law or of this Act.

**Objectives of Articles of Association (AOA) :**

- The AOA of a company shall contain the regulations for management of the company.
- The AOA shall also contain such matters, as may be prescribed.
- Further, it shall not prevent a company from including such additional matters in its AOA as may be considered necessary for its management.

**Forms of Articles of Association (AOA)**

Schedule I of the Companies Act, 2013 provides forms for Articles of Association (AOA) in tables F, G, H, I and J for different types of companies. Further, AOA must be in the respective form.

| S.No | Table | Form |
|---|---|---|
| 1 | Table F | Articles of Association of a company limited by shares |
| 2 | Table G | Articles of Association of a company limited by guarantee and having share capital |

| | | |
|---|---|---|
| 3 | Table H | Articles of Association of a company limited by guarantee and not having share capital |
| 4 | Table I | Articles of Association of an unlimited company and having share capital |
| 5 | Table J | Articles of Association of an unlimited company and not having share capital |

Notes

Depending upon the applicability a company may adopt all or any of the regulations contained in the model Article.

In case of any company, which is registered after the commencement of this Act, in so far as the registered AOA of such company does not exclude or modify the regulations contained in the model AOA, those regulations shall be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered AOA of the company, so far as applicable.

**Content of Articles of Association (AOA)**

An AOA contains the rules and regulation regarding the following matters :

- **Share capital** including sub-division, rights of various shareholders, the relationship of these rights, share certificates, payment of commission.
- **Lien of shares :** To retain or hold the possession of shares in case the member is unable to pay his debt to the company
- **Calls on shares :** Calls on shares includes the whole or part unpaid on each share which has to be paid by the shareholders on the demand of the company.
- **Transfer of shares :** The AOA include the process for the transfer of shares by the shareholder to other person (transferee).
- **Transmission of shares :** Transmission includes title devolution by succession, death, marriage, insolvency, etc.
- **Forfeiture of shares :** The AOA provides for the forfeiture of shares if the purchase requirements such as paying call money are not met with.
- **Surrender of shares :** Surrender of shares is when the shareholders voluntary gives back or return the shares they own to the company.
- **Conversion of shares in stock :** In consonance with the Articles of association, the company can convert the shares into stock by an ordinary resolution in a general meeting.
- **Share warrant :** A share warrant is a bearer document relating to the title of shares and cannot be issued by private companies; only public limited companies can issue a share warrant.
- **Alteration of capital :** Increase, decrease or rearrangement of capital must be done as the Articles of association provide.
- **General meetings and proceedings :** All the provisions relating to the general meetings and the manner in which they are to be conducted are to be contained in the Articles of association.

Notes

- **Voting rights of members, voting by poll, proxies :** The members right to vote on certain company matters and the manner in which voting can be done is provided in the Articles of association.
- **Directors**, their appointment, remuneration, qualifications, powers and proceedings of the boards of directors meetings.
- **Dividends and reserves :** The Articles of association of a company also provide for the distribution of dividend to the shareholders.
- **Accounts and Audits :** The auditing of a company shall be done subject to the provisions of the Articles of association of the company.
- **Borrowing Powers :** Every company has powers to borrow. However; this must be done according to the Articles of association of the company.
- **Winding Up :** Provisions relating to the winding up of the company finds mention in Articles of association of the company and must be done accordingly.

**Difference between Memorandum of Association and Articles of Association :** While Memorandum of Association is a document that governs a company's relationship with the outside world. The Articles of association governs a company's internal affairs and management. The directors and all other officers of the company should perform the functions in accordance with the Articles of Association. The Articles of Association are subordinate to the memorandum. Thus, while framing the Articles of Association it is very important to keep in mind that the Articles do not, in any way contradict or exceed the scope of the memorandum.

The Articles of Association form a contract,

1. Between members of the company;
2. Between the company and its members.

The Articles of Association are important for a company because,

1. They bind the company with its members.
2. They bind the members with each other.
3. They are not concerned with the outside world, they only deal with the internal affairs of the company which are essential for the smooth functioning of the business.

| Parameters | MOA | AOA |
|---|---|---|
| Objectives | It defines the objectives of a company. Further, it specifies the conditions of incorporation. | It contains the rules and regulations as well as bye-laws for the internal management of the company. |
| Relationship | It defines the relationship of the company with the external world. | It defines the relationship between the members and the company. |
| Alteration | Only under special circumstances, it can be altered. | By passing a special resolution, It can be altered. |

| | | |
|---|---|---|
| Ultra-Vires | Any acts beyond the scope of the MOA are ultra-vires and void. Furthermore, even unanimous votes for the consent of such act from all the shareholders cannot ratify it. | Acts which are ultra-vires the AOA can be ratified by a special resolution of the shareholders. However, such acts should not ultra-vires the MOA. |

Notes

Both Memorandum of Association and Articles of Association are essential documents which describe the procedure for companies to deal with the outside world and manage its internal affairs.

### 5.10.5 Prospectus

The Companies Act, 2013 defines a prospectus under section 2(70). Prospectus can be defined as "any document which is described or issued as a prospectus". This also includes any notice, circular, advertisement or any other document acting as an invitation to offers from the public. Such an invitation to offer should be for the purchase of any securities of a corporate body. Shelf prospectus and red herring prospectus are also considered as a prospectus.

**Essentials for a document to be called as a prospectus**

For any document to considered as a prospectus, it should satisfy two conditions.

1. The document should invite the subscription to public share or debentures, or it should invite deposits.
2. Such an invitation should be made to the public.
3. The invitation should be made by the company or on the behalf, company.
4. The invitation should relate to shares, debentures or such other instruments.

**Statement in lieu of prospectus :** Every public company either issue a prospectus or file a statement in lieu of prospectus. This is not mandatory for a private company. But when a private company converts from private to public company, it must have to either file a prospectus if earlier issued or it has to file a statement in lieu of prospectus.

The provisions regarding the statement in lieu of prospectus have been stated under section 70 of the Companies Act 2013.

**Advertisement of prospectus :** Section 30 of the Companies Act 2013 contains the provisions regarding the advertisement of the prospectus. This section states that when in any manner the advertisement of a prospectus is published, it is mandatory to specify the contents of the memorandum of the company regarding the object, member's liabilities, amount of the company's share capital, signatories and the number of shares subscribed by them and the capital structure of the company. Types of the prospectus as follows.

- Red Herring Prospectus
- Shelf Prospectus
- Abridged prospectus
- Deemed Prospectus

Notes

**Shelf Prospectus :** Shelf prospectus can be defined as a prospectus that has been issued by any public financial institution, company or bank for one or more issues of securities or class of securities as mentioned in the prospectus. When a shelf prospectus is issued then the issuer does not need to issue a separate prospectus for each offering he can offer or sell securities without issuing any further prospectus.

The provisions related to shelf prospectus has been discussed under section 31 of the Companies Act, 2013.

The regulations are to be provided by the Securities and Exchange Board of India for any class or classes of companies that may file a shelf prospectus at the stage of the first offer of securities to the registrar.

The prospectus shall prescribe the validity period of the prospectus and it should be not be exceeding one year. This period commences from the opening date of the first offer of the securities. For any second or further offer, no separate prospectus is required.

While filing for a shelf prospectus, a company is required to file an information memorandum along with it.

**Information Memorandum [Section 31(2)] :** The company which is filing a shelf prospectus is required to file the information memorandum. It should contain all the facts regarding the new charges created, what changes have undergone in the financial position of the company since the first offer of the security or between the two offers.

It should be filed with the registrar within three months before the issue of the second or subsequent offer made under the shelf prospectus as given under **Rule 4CCA of section 60A(3) under the Companies (Central Government's) General Rules and Forms, 1956.**

When any company or a person has received an application for the allotment of securities with advance payment of subscription before any changes have been made, then he must be informed about the changes. If he desires to withdraw the application within 15 days then the money must be refunded to them. After the information memorandum has been filed, if any offer or securities is made, the memorandum along with the shelf prospectus is considered as a prospectus.

**Red herring prospectus :** Red herring prospectus is the prospectus which lacks the complete particulars about the quantum of the price of the securities. A company may issue a red herring prospectus prior to the issue of prospectus when it is proposing to make an offer of securities. This type of prospectus needs to be filed with the registrar at least three days prior to the opening of the subscription list or the offer. The obligations carried by a red herring prospectus are same as a prospectus. If there is any variation between a red herring prospectus and a prospectus then it should be highlighted in the prospectus as variations. When the offer of securities closes then the prospectus has to state the total capital raised either raised by the way of debt or share capital. It also has to state the closing price of the securities. Any other details which have not been included in the prospectus need to be registered with the registrar and SEBI. The applicant

or subscriber has right under Section60B(7) to withdraw the application on any intimation of variation within 7 days of such intimation and the withdrawal should be communicated in writing.

**Abridged Prospectus :** The abridged prospectus is a summary of a prospectus filed before the registrar. It contains all the features of a prospectus. An abridged prospectus contains all the information of the prospectus in brief so that it should be convenient and quick for an investor to know all the useful information in short.

Notes

**Section33(1)** of the Companies Act, 2013 also states that when any form for the purchase of securities of a company is issued, it must be accompanied by an abridged prospectus.

It contains all the useful and materialistic information so that the investor can take a rational decision and it also reduces the cost of public issue of the capital as it is a short form of a prospectus.

**Deemed Prospectus :** A deemed prospectus has been stated under section 25(1) of the Companies Act, 2013.

When any company to offer securities for sale to the public, allots or agrees to allot securities, the document will be considered as a deemed prospectus through which the offer is made to the public for sale. The document is deemed to be a prospectus of a company for all purposes and all the provision of content and liabilities of a prospectus will be applied upon it.

In the case of **SEBI v. Kunnamkulam Paper Mills Ltd.**, it was held by the court that where a rights issue is made to the existing members with a right to renounce in the favour of others, it becomes a deemed prospectus if the number of such others exceeds fifty.

In general parlance prospectus refers to an information booklet or offer document on the basis of which an investor invests in the securities of an issuer company. It has been defined under section 2(70) so as to mean any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

Red herring Prospectus under Explanation to section 32 has been referred to mean a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

Shelf Prospectus under Explanation to section 31 has been referred to mean a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

The definition clarifies that any notice, circular, advertisement or any other document inviting offers from public for the subscription or purchase of securities shall be included in the definition of Prospectus.

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## Matters To Be Stated In Prospectus

According to section 26(1) of the Act read with Companies (Prospectus and Allotment of Securities) Rules, 2014 (hereinafter referred to as "Rules"), the following are the matters to be included in a prospectus :

(i) Names and addresses of the registered office of the company, Company Secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, if any, underwriters and such other persons as may be prescribed.

The rules provide that the names, addresses and contact details of the corporate office of the issuer company, compliance officer of the issuer company, merchant bankers and co-managers to the issue, registrar to the issue, bankers to the issue, stock brokers to the issue, credit rating agency for the issue, arrangers, if any, of the instrument, names and addresses of such other persons as may be specified by the Securities and Exchange Board in its regulations shall be included in prospectus.

(ii) Dates of the opening and closing of the issue, and declaration about the issue of allotment letters and refunds within the prescribed time;

The rules clearly specify that the dates of opening and closing of the issue shall be prominently disclosed. Further the rules provide that the Board or the Committee authorized thereof shall make a declaration in the prospectus that the allotment letters shall be issued or application money shall be refunded within fifteen days from the closure of the issue or such lesser time as may be specified by SEBI or else the application money shall be refunded to the applicants forthwith, failing which interest shall be due to be paid to the applicants at the rate of fifteen per cent per annum for the delayed period.

(iii) A statement by the Board of Directors about the separate bank account where all monies received out of the issue are to be transferred and disclosure of details of all monies including utilised and unutilised monies out of the previous issue in the prescribed manner.

The rules specify that the a statement shall be given by the Board of directors that all monies received out of the issue shall be transferred to a separate bank account maintained with a Scheduled Bank.

Section 2(80) of the Act "scheduled bank" means the scheduled bank as defined in clause (e) of section 2 of the Reserve Bank of India Act, 1934. The referred section enumerates a list of scheduled banks under second schedule of the Reserve Bank of India Act, 1934.

Further the aforesaid rules provide that the details of all utilized and unutilised monies out of the monies collected in the previous issue made by way of public offer shall be disclosed and continued to be disclosed in the balance sheet till the time any part of the proceeds of such previous issue remains

unutilized indicating the purpose for which such monies have been utilized, and the securities or other forms of financial assets in which such unutilized monies have been invested.

(iv) Details about underwriting of the issue. As per the rules, the details about underwriting of the issue shall include the names, addresses, telephone numbers, fax numbers and e-mail addresses of the underwriters and the amount underwritten by them.

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(v) Consent of the directors, auditors, bankers to the issue, expert's opinion, if any, and of such other persons, as may be prescribed.

As per the rules, the consent of trustees, solicitors or advocates, merchant bankers to the issue, registrar to the issue, lenders and experts shall also be included in prospectus.

(vi) The authority for the issue and the details of the resolution passed therefor. (vii) Procedure and time schedule for allotment and issue of securities.

(viii) Capital structure of the company in the prescribed manner. As per the rules, capital structure of the company shall be presented in the following manner :

(i). (a) the authorised, issued, subscribed and paid up capital (number of securities, description and aggregate nominal value);

(b) the size of the present issue;

(c) the paid up capital- (A) after the issue; (B) after conversion of convertible instruments (if applicable);

(d) the share premium account (before and after the issue);

(ii) The details of the existing share capital of the issuer company in a tabular form, indicating therein with regard to each allotment, the date of allotment, the number of shares allotted, the face value of the shares allotted, the price and the form of consideration. In the case of an initial public offer of an existing company, the details regarding individual allotment shall be given from the date of incorporation of the issuer and in the case of a listed issuer company the details shall be given for five years immediately preceding the date of filing of the prospectus.

The issuer company shall also disclose the number and price at which each of the allotments were made in the last two years preceding the date of the prospectus separately indicating the allotments made for considerations other than cash and the details of the consideration in each case.

(iii) main objects of public offer, terms of the present issue and such other particulars as may be prescribed. As per the rules the prospectus to be issued shall contain the following particulars, namely :

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(a) the objects of the issue;

(b) the purpose for which there is a requirement of funds;

(c) the funding plan (means of finance);

(d) the summary of the project appraisal report (if any);

(e) the schedule of implementation of the project;

(f) the interim use of funds, if any

(iv) main objects and present business of the company and its location, schedule of implementation of the project.

(v) particulars relating to :

(a) management perception of risk factors specific to the project;

(b) gestation period of the project;

(c) extent of progress made in the project;

(d) deadlines for completion of the project; and

(e) any litigation or legal action pending or taken by a Government Department or a statutory body during the last five years immediately preceding the year of the issue of prospectus against the promoter of the company.

The rules with respect to sub part (e) states that the prospectus to be issued shall contain the following details and disclosures, namely :-

(i) the details of any litigation or legal action pending or taken by any Ministry or Department of the Government or a statutory authority against any promoter of the issuer company during the last five years immediately preceding the year of the issue of the prospectus and any direction issued by such Ministry or Department or statutory authority upon conclusion of such litigation or legal action shall be disclosed;

(ii) the details of pending litigation involving the issuer, promoter, director, subsidiaries, group companies or any other person, whose outcome could have material adverse effect on the position of the issuer;

(iii) the details of pending proceedings initiated against the issuer company for economic offences;

(iv) the details of default and non-payment of statutory dues etc.

(v) minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash.

(vi) details of directors including their appointments and remuneration, and such particulars of the nature and extent of their interests in the company as may be prescribed.

As per the rules the details of directors including their appointment and remuneration, and particulars of the nature and extent of their interests in the company shall be disclosed in the following manner, namely :

(i) the name, designation, Director Identification Number (DIN), age, address, period of directorship, details of other directorships;

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(ii) the remuneration payable or paid to the director by the issuer company, its subsidiary and associate company; shareholding of the director in the company including any stock options; shareholding in subsidiaries and associate companies; appointment of any relatives to an office or place of profit;

(iii) the full particulars of the nature and extent of interest, if any, of every director:

(a) in the promotion of the issuer company; or

(b) in any immoveable property acquired by the issuer company in the two years preceding the date of the Prospectus or any immoveable property proposed to be acquired by it.

(iv) where the interest of such a director consists in being a member of a firm or company, the nature and extent of his interest in the firm or company, with a statement of all sums paid or agreed to be paid to him or to the firm or company in cash or shares or otherwise by any person either to induce him to become, or to help him qualify as a director, or otherwise for services rendered by him or by the firm or company, in connection with the promotion or formation of the issuer company shall be disclosed.

(v) disclosures in such manner as may be prescribed about sources of promoter's contribution; As per the rules the sources of promoters' contribution, if any, shall be disclosed in the following manner, namely :

(i) the total shareholding of the promoters, clearly stating the name of the promoter, nature of issue, date of allotment, number of shares, face value, issue price or consideration, source of funds contributed , date when the shares were made fully paid up, percentage of the total pre and post issue capital;

(ii) the proceeds out of the sale of shares of the company and shares of its subsidiary companies previously held by each of the promoters;

(iii) the disclosure for sources of promoters contribution shall also include the particulars of name, address and the amount so raised as loan, financial assistance etc , if any, by promoters for making such contributions and in case of own sources, complete details thereof.

The Prospectus shall also contain the following reports for the purpose of financial information :

(i) Reports by the auditors of the company with respect to its profits and losses and assets and liabilities and such other matters as may be prescribed. The rules under the prescribed power provide that

(a) reports by the auditors with respect to profits and losses and assets and liabilities shall also include the amounts or rates of dividends, if any, paid by the issuer company in respect of each class of shares for each of the five financial years immediately preceding the year of issue of

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the prospectus, giving particulars of each class of shares on which such dividends have been paid and particulars of the cases in which no dividends have been paid in respect of any class of shares for any of those years; and

(b) if no accounts have been made up in respect of any part of the period of five years ending on a date three months before the issue of the prospectus, a statement of that fact accompanied by a statement of the accounts of the issuer company in respect of that part of the said period up to a date not earlier than six months of the date of issue of the prospectus indicating the profit or loss for that period and assets and liabilities position as at the end of that period together with a certificate from the auditors that such accounts have been examined and found correct and the said statement may indicate the nature of provision or adjustments made or which are yet to be made.

(ii) reports relating to profits and losses for each of the five financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries and in such manner as may be prescribed :

Provided that in case of a company with respect to which a period of five years has not elapsed from the date of incorporation, the prospectus shall set out in such manner as may be prescribed, the reports relating to profits and losses for each of the financial years immediately preceding the financial year of the issue of prospectus including such reports of its subsidiaries;

The rules under the prescribed power provides reports relating to profits and losses for each of the five financial years or where five financial years have not expired, for each of the financial year immediately preceding the financial year of the issue of the prospectus shall :

(a) if the company has no subsidiaries, so far as regards its profits and losses, deal separately with the profits or losses of the company (distinguishing items of a non-recurring nature) for each of the five financial years immediately preceding the year of the issue of the prospectus; and

(b) if the company has subsidiaries, deal either :

(i) as a whole with the combined profits or losses of its subsidiaries, so far as they concern members of the issuer company; or

(ii) individually with the profits or losses of each subsidiary, so far as they concern members of the issuer company; or

(iii) as a whole with the profits or losses of the company, and, so far as they concern members of the issuer company, with the combined profits or losses of its subsidiaries.

(c) The mode adopted at 'b' above should be specified in the prospectus

(iii) reports made in the prescribed manner by the auditors upon the profits and losses of the business of the company for each of the five financial years immediately preceding the issue and assets and liabilities of its business on the last date to which the accounts of the business were made up, being a date

not more than one hundred and eighty days before the issue of the prospectus: Provided that in case of a company with respect to which a period of five years has not elapsed from the date of incorporation, the prospectus shall set out in the prescribed manner, the reports made by the auditors upon the profits and losses of the business of the company for all financial years from the date of its incorporation, and assets and liabilities of its business on the last date before the issue of prospectus; and The rules provide that the reports made by the auditors in respect of the business of the company shall be stated in the prospectus in the manner provided in rules for subsection 26(1) (b)(ii) (above stated).

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(iv) reports about the business or transaction to which the proceeds of the securities are to be applied directly or indirectly; Section 26(1)(c) of the Act provides that the issuer company shall make a declaration in the prospectus about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder; and Under the empowerment of delegated authority under section 26(1)(d) of the Act, the rules state other information, matters and reports, as under to be stated in the prospectus :

1. If the proceeds, or any part of the proceeds, of the issue of the shares or debentures are or is to be applied directly or indirectly :

(a) in the purchase of any business; or

(b) in the purchase of an interest in any business and by reason of that purchase, or anything to be done in consequence thereof, or in connection therewith; the company will become entitled to an interest as respects either the capital or profits and losses or both, in such business exceeding fifty per cent, thereof; a report made by chartered accountants (who shall be named in the prospectus) upon :

(i) the profits or losses of the business for each of the five financial years immediately preceding the date of the issue of the prospectus; and

(ii) the assets and liabilities of the business as on the last date to which the accounts of the business were made up, being a date not more than one hundred and twenty days before the date of the issue of the prospectus;

(c) In case of purchase or acquisition of any immovable property including indirect acquisition of immovable property for which advances have been paid to even third parties, the following disclosures shall be made :

(i) the names, addresses, descriptions and occupations of the vendors;

(ii) the amount paid or payable in cash, to the vendor and, where there is more than one separate vendor, or the company is a sub-purchaser, the amount so paid or payable to each vendor, specifying separately the amount, if any, paid or payable for goodwill;

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(iii) the nature of the title or interest in such property proposed to be acquired by the company;

(iv) short particulars of every transaction relating to the property completed within the two preceding years,in which any vendor of the property to the company or any person who is, or was at the time of the transaction, a promoter, or a director or proposed director of the company had any interest, direct or indirect, specifying the date of transaction and the name of such promoter, director or proposed director and stating the amount payable by or to such vendor, promoter, director or proposed director in respect of the transaction.

2. Further the rules provide that a report shall be made by Chartered Accountants (who shall be named in the prospectus) if :

(i) the proceeds, or any part of the proceeds, of the issue of the shares or debentures are or is to be applied directly or indirectly in any manner resulting in the acquisition by the company of shares in any other body corporate; and

(ii) by reason of that acquisition or anything to be done in consequence thereof or in connection therewith, that body corporate will become a subsidiary of the company.

Such report prepared by chartered accountant shall be prepared upon :

(a) the profits or losses of the other body corporate for each of the five financial years immediately preceding the issue of the prospectus; and

(b) the assets and liabilities of the other body corporate as on the last date to which its accounts were made up.

Further the aforesaid report said report shall :

(i) indicate how the profits or losses of the other body corporate dealt with by the report would, in respect of the shares to be acquired, have concerned members of the issuer and what allowance would have fallen to be made, in relation to assets and liabilities so dealt with for holders of other shares, if the issuer had at all material times held the shares to be acquired; and

(ii) where the other body corporate has subsidiaries, deal with the profits or losses and the assets and liabilities of the body corporate and its subsidiaries in the manner similar to that of rules pursuant to 26(1) (b) (ii).

3. The matters relating to terms and conditions of the term loans including re-scheduling, prepayment, penalty, default.

4. The aggregate number of securities of the issuer company and its subsidiary companies purchased or sold by the promoter group and by the directors of the company which is a promoter of the issuer company and by the directors of the issuer company and their relatives within six months immediately preceding the date of filing the prospectus with the Registrar of Companies shall be disclosed.

The term promoter has been defined in section 2(69) so as to mean 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 section 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: Nothing in sub-clause

(d) shall apply to a person who is acting merely in a professional capacity.

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5. The matters relating to :

(a) Material contracts;

(b) Other material contracts;

(c) Time and place at which the contracts together with documents will be available for inspection from the date of prospectus until the date of closing of subscription list.

6. The related party transactions entered during the last five financial years immediately preceding the issue of prospectus as under :

(a) all transactions with related parties with respect to giving of loans or, guarantees, providing securities in connection with loans made, or investments made;

(b) all other transactions which are material to the issuer company or the related party, or any transactions that are unusual in their nature or conditions, involving goods, services, or tangible or intangible assets, to which the issuer company or any of its parent companies was a party. The disclosures for related party transactions for the period prior to notification of these rules shall be to the extent of disclosure requirements as per the Companies Act, 1956 and the relevant accounting standards prevailing at the said time.

7. The summary of reservations or qualifications or adverse remarks of auditors in the last five financial years immediately preceding the year of issue of prospectus and of their impact on the financial statements and financial position of the company and the corrective steps taken and proposed to be taken by the company for each of the said reservations or qualifications or adverse remarks.

8. The details of any inquiry, inspections or investigations initiated or conducted under the Companies Act or any previous companies law in the last five years immediately preceding the year of issue of prospectus in the case of company and all of its subsidiaries; and if there were any prosecutions filed (whether pending or not); fines imposed or compounding of offences done in the last five years immediately preceding the year of the prospectus for the company and all of its subsidiaries.

9. The details of acts of material frauds committed against the company in the last five years, if any, and if so, the action taken by the company.

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10. A fact sheet shall be included at the beginning of the prospectus which shall contain :

(a) the type of offer document ("Red Herring Prospectus" or "Shelf Prospectus" or "Prospectus").

(b) the name of the issuer company, date and place of its incorporation, its logo, address of its registered office, its telephone number, fax number, details of contact person, website address, e-mail address;

(c) the names of the promoters of the issuer company;

(d) the nature, number, price and amount of securities offered and issue size, as may be applicable;

(e) the aggregate amount proposed to be raised through all the stages of offers of specified securities made through the shelf prospectus;

(f) the name, logo and address of the registrar to the issue, along with its telephone number, fax number, website address and e-mail address;

(g) the issue schedule :

(i) date of opening of the issue;

(ii) date of closing of the issue;

(iii) date of earliest closing of the issue, if any.

(h) the credit rating, if applicable;

(i) all the grades obtained for the initial public offer;

(j) the name(s) of the recognised stock exchanges where the securities are proposed to be listed;

(k) the details about eligible investors;

(l) coupon rate, coupon payment frequency, redemption date, redemption amount and details of debenture trustee in case of debt securities.

In case of companies which have not completed five years, it shall be sufficient compliance for a company which has not completed five years, if such company provides such particulars or information for all the previous years since its incorporation.

Sub-section(2) of Section 26 provides that nothing aforesaid (i.e. provisions of section 26(1)) shall apply under following circumstances :

(a) Where a prospectus or form of application relating to shares in or debentures of the company is issued to existing members or debenture-holders of a company, whether an applicant has a right to renounce the shares or not under section 62 sub-section (1) clause (a) sub-clause (ii) in favour of any other person; or;

(b) Where the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognised stock exchange.

**Statement by Experts :** A prospectus issued by public company shall not include a statement purporting to be made by an expert, unless the expert is a person who is not and has not been, engaged or interested in the formation or promotion or management, of the company. Such statement shall be included only when such expert has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for registration. A statement to that effect shall be included in the prospectus.

**Dating & Signing and Registration of Prospectus :** According to Section 26(1) of the Act, every prospectus issued by or on behalf of a public company either with reference to its formation or subsequently, or by or on behalf of any person who is or has been engaged or interested in the formation of a public company, shall be dated and signed. The date indicated in the prospectus shall be deemed to be the date of its publication. The prospectus shall be signed by every person who is named therein as a director or proposed director of the Company or by his duly authorised attorney.

Prospectus shall be issued by or on behalf of a company or in relation to an intended company only when it has been delivered to the Registrar for Registration a copy of signed prospectus on or before the date of its publication. The Registrar shall not register a prospectus unless the requirements with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

Prospectus is to be issued within ninety days from the date of delivery of prospectus to the Registrar. No prospectus shall be valid if it is issued more than ninety days after the date on which a copy thereof is delivered to the Registrar.

**Penalty for non- compliance of Section 26 :** If a prospectus is issued in contravention of the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

**Shelf Prospectus**

Shelf Prospectus means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus. In simple terms Shelf Prospectus is a single prospectus for multiple public. Issuer is permitted to offer and sell securities to the public without a separate prospectus for each act of offering for a certain period.

Under the Act any class or classes of companies, as the Securities and Exchange Board (SEBI) may provide by regulations in this behalf, may file a shelf prospectus with the Registrar. Such prospectus is to be submitted at the stage of the first offer of securities which shall indicate a period not exceeding one year as the period of validity of such prospectus. The validity period shall commence from the date of opening of the first offer of securities under that

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prospectus, and in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required. An information memorandum is required to be filed by a company filing a shelf prospectus which shall contain all material facts relating to

- new charges created,
- changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities, and
- such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

According to the rules the information memorandum shall be prepared in Form PAS-2 and filed with the Registrar along with the fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

The section also provides a benefitting provision for the investors, the proviso provides that where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof.

Form PAS-2 significantly provides for following information to be disclosed:

1. Change in financial position of the company
2. Changes in the Share Capital, i.e. Capitalization Statement
3. Changes in accounting policies
4. Change in the risk factors as stated in the Shelf Prospectus and in the information memorandum filed with respect to previous offer
5. Economic changes that may affect income from continuing operations.
6. Any significant changes in the activities of the company, which may have a material effect on the profit/loss of the company, including the loss of agencies or markets and similar factors
7. Changes in the total turnover of each major industry segment in which the issuer operates
8. Any significant legal proceedings initiated by the company or against the company or its directors, the outcome of which could have an adverse impact on the company
9. Any significant claim made by any person or any authority against the company

10. Any significant change in the business environment of the company whether technological, financial, market related, government policy or otherwise, adversely affecting, in present or in future, the business of the company
11. Any significant change in the management or ownership of the company
12. Any other change which may reasonably influence the investment decision of an investor
13. Gist of details of Proposed objects with reference to the current offering including project plan, financial details, time period of meeting the objects and other relevant factors.
14. Date wise details of charges created on the assets / properties of the company since first offer or previous offer of securities.
    (a) Date of creation of charge
    (b) Purpose for which charge has been created
    (c) Amount for which charge has been created
    (d) Period of charge
    (e) Details of assets / property on which charge has been created
    (f) Name of the charge holder
    (g) Brief terms and conditions of the charge.

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Where an information memorandum is filed, every time an offer of securities is made such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

**Red Herring Prospectus :** Red herring Prospectus means a prospectus which does not include complete particulars of the quantum or price of the securities included therein. In simple terms a red herring prospectus contains most of the information pertaining to the company's operations and prospects, but does not include key details of the issue such as its price and the number of shares offered.

According to section 32 a company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus. Such company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.

A red herring prospectus shall carry the same obligations as are applicable to a prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.

Upon the closing of the offer of securities under this section, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

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**Abridged Prospectus :** According to section 2(1) of the Act "abridged prospectus" means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf Section 33 of the Act provides that no form of application for the purchase of any of the securities of a company shall be issued unless such form is accompanied by an abridged prospectus. A copy of the prospectus shall, on a request being made by any person before the closing of the subscription list and the offer, be furnished to him. Nothing aforesaid shall apply if it is shown that the form of application was issued—

(a) in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to such securities; or

(b) in relation to securities which were not offered to the public. The penal provisions provide that a company which makes any default in complying with the provisions shall be liable to a penalty of fifty thousand rupees for each default.

**Offer For Sale :** Public Offer includes or an offer for sale (OFS) of securities to the public by an existing shareholder, through issue of a prospectus.

Under section 25 of the Act where a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public, any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company. In simple terms any document by which the offer or sale of shares or debentures to public is made shall for all purposes be treated as prospectus. The document "Offer for sale" is an invitation to the general public to purchase the shares of a company through an intermediary, such as an issuing house or a merchant bank. A company may allot or agree to allot any shares or debentures to an "Issue house" without there being any intention on the part of the company to make shares or debentures available directly to the public through issue of prospectus. The issue house in turn makes an "Offer for sale" to the public.

All enactments and rules of law as to the contents of prospectus and as to liability in respect of mis-statements, in and omissions from, prospectus, or otherwise relating to prospectus, shall apply to Offer for sale. Following additional information to the matters required to be stated in a prospectus:

(a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and

(b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected;

According to the section in order to construe "Offer for Sale" either of the following conditions needs to be fulfilled :

(a) "Offer for sale" to the public was made within six months after the allotment or agreement to allot; or

(b) at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it.

As for the signing of the Prospectus the section provides that where a person making an offer to which this section relates is a company or a firm, it shall be sufficient if the Offer document is signed on behalf of the company by two directors of the company and in case of a firm by not less than one-half of the partners in the firm, as the case may be.

Notes

**Offer of sale of shares by certain members of a company :** Section 28 of the Act permits certain members of a company, in consultation with Board of directors, to offer the whole or a part of their holdings of shares to the public. The document by which the offer offer of sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company. All laws and rules made thereunder as to the contents of the prospectus and as to liability in respect of mis-statements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company. The section lays that the members, whether individuals or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively authorise the company, whose shares are offered for sale to the public, to take all actions in respect of offer of sale for and on their behalf and they shall reimburse the company all expenses incurred by it on this matter. The rules in this context provide that the provisions of Part I of Chapter III namely "Prospectus and Allotment of Securities" and rules made there under shall be applicable to an offer of sale referred to in section 28 except for the following, namely :

(a) the provisions relating to minimum subscription;

(b) the provisions for minimum application value;

(c) the provisions requiring any statement to be made by the Board of directors in respect of the utilization of money; and

(d) any other provision or information which cannot be compiled or gathered by the offeror, with detailed justifications for not being able to comply with such provisions. Further the rules provide that such offer document or prospectus issued under the section shall disclose the name of the entity bearing the cost of making the offer for sale along with reasons.

**Variation in Terms of Contract or Objects in Prospectus**

The section aims to protect the interests of those who subscribe to a company's shares and debentures in response to and on faith of a prospectus. Section 27 of the Act provides that a company shall not, at any time, vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, except subject to the approval of, or except subject to an authority given by the company in general meeting by way of special resolution. The section restrains a company from making any unilateral variations in terms of prospectus. For the purpose of variation of terms of contract or objects the rules provide that in Prospectus where the company has raised money from public through prospectus and has any unutilized amount out of the money so raised, it shall not vary the terms of contracts referred to in the prospectus or objects for which the prospectus was issued except by passing a special resolution through postal ballot and the notice of the proposed special resolution shall contain the following particulars, namely :

Notes

(a) the original purpose or object of the Issue;

(b) the total money raised;

(c) the money utilised for the objects of the company stated in the prospectus;

(d) the extent of achievement of proposed objects(that is fifty percent, sixty percent, etc);

(e) the unutilised amount out of the money so raised through prospectus,

(f) the particulars of the proposed variation in the terms of contracts referred to in the prospectus or objects for which prospectus was issued;

(g) the reason and justification for seeking variation;

(h) the proposed time limit within which the proposed varied objects would be achieved;

(i) the clause-wise details as specified in sub-rule (3) of rule 3 as was required with respect to the originally proposed objects of the issue;

(j) the risk factors pertaining to the new objects; and

(k) the other relevant information which is necessary for the members to take an informed decision on the proposed resolution.

According to the first proviso of the section, the details of the notice in respect the resolution shall also be published in a newspaper (one in English and one in vernacular language) in the city where the registered office of the company is situated indicating clearly the justification for such variation. According to the rules such advertisement shall be in Form No. PAS-1 and shall be published simultaneously with dispatch of Postal Ballot Notices to Shareholders. The notice shall also be placed on the web-site of the company, if any.

Significant provisions under form PAS-1 are as under : The details regarding such variation/alteration are as follows :

1. Particulars of the terms of the contract to be varied (or objects to be altered)
2. Particulars of the proposed variation/alteration
3. Reasons/justification for the variation
4. Effect of the proposed variation/alteration on the financial position of the company
5. Major Risk factors pertaining to the new Objects
6. Name of Directors who voted against the proposed variation/ alteration

Second provision provides that a company which proposes to vary the terms of contract referred to in prospectus shall not use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company. The dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations

in this behalf. The section protects the minority dissenting shareholders by providing them with an exit opportunity at a price which shall be determined by SEBI by making regulations.

**Process for filing and issuing a prospectus**

**Application forms :** As stated under section 33, the application form for the securities is issued only when they are accompanied by a memorandum with all the features of prospectus referred to as an abridged prospectus.

Notes

**The exceptions to this rule are :**

- When an application form is issued as an invitation to a person to enter into underwriting agreement regarding securities.
- Application issued for the securities not offered to the public.

**Contents :** For filing and issuing the prospectus of a public company, it must be signed and dated and contain all the necessary information as stated under section 26 of the Companies Act, 2013 :

1. Name and registered address of the office, its secretary, auditor, legal advisor, bankers, trustees, etc.
2. Date of the opening and closing of the issue.
3. Statements of the Board of Directors about separate bank accounts where receipts of issues are to be kept.
4. Statement of the Board of Directors about the details of utilization and non-utilisation of receipts of previous issues.
5. Consent of the directors, auditors, bankers to the issue, expert opinions.
6. Authority for the issue and details of the resolution passed for it.
7. Procedure and time scheduled for the allotment and issue of securities.
8. The capital structure of the in the manner which may be prescribed.
9. The objective of a public offer.
10. The objective of the business and its location.
11. Particulars related to risk factors of the specific project, gestation period of the project, any pending legal action and other important details related to the project.
12. Minimum subscription and what amount is payable on the premium.
13. Details of directors, their remuneration and extent of their interest in the company.
14. Reports for the purpose of financial information such as auditor's report, report of profit and loss of the five financial years, business and transaction reports, statement of compliance with the provisions of the Act and any other report.

**Filing of copy with the registrar :** As stated under sub-section 4 of section26 of the Companies Act, 2013, the prospectus is not to be issued by a company or on its behalf unless on or before the date of publication, a copy of the prospectus is delivered to the registrar for registration. The copy should be signed by every person whose name has been mentioned in the prospectus as a director or proposed director or the assigned attorney on his behalf.

Notes

**Delivery of copy of the prospectus to the registrar :** As per section26(6) of the Companies Act 2013, the prospectus should mention that its copy has been delivered to the registrar on its face. The statement should also mention the document submitted to the registrar along with the copy of the prospectus.

**Registration of prospectus :** Section26(7) states about the registration of a prospectus by the registrar. **According to this section, when the registrar can register a prospectus when :**

1. It fulfils the requirements of this section, i.e., section 26 of the Companies Act, 2013; and
2. It contains the consent of all the persons named in the prospectus in writing.

**Issue of prospectus after registration :** If a prospectus is not issued before 90 days from the date from which a copy was delivered before the registrar, then it is considered to be invalid.

**Contravention of section :** If a prospectus is issued in contravention of the provision under section 26 of the Companies Act 2013, then the company can be punished under section 26(9). The punishment for the contravention is:

- Fine of not less than Rs. 50,000 extending up to 3,00,000.

If any person becomes aware of such prospectus after knowing the fact that such prospectus is being issued in contravention of section 26 then he is punishable with the following penal provisions.

- Imprisonment up to a term of 3 years, or
- Fine of more than Rs. 50,000 not exceeding Rs. 3,00,000.

### 5.10.6 Kind of Companies

The Indian economy has a variety of companies existing in its market such as public companies, private companies, investment companies, limited liability companies etc. These numerous entities in the market may look different from each other on the surface, but based upon certain identifiable common characteristics they can be grouped into below-mentioned classifications. This article aims to draw your attention towards the conventional classification of the companies that are made based upon factors such as liability, control, incorporation, transferability of shares etc.

**Classification of Companies :** The companies may be classified based upon the mode of their incorporation and incorporation process which is defined under Section 7 of the Companies Act, 2013.

Incorporation is the day when the company acquires a legal identity i.e. the day when a company takes birth in the eyes of law. Section 2 of the Companies Act, 2013 defines the various kinds of companies and their facets.

**I. Classification of Companies on the basis of incorporation**

**Royal Charter Company :** It may be better understood as the company born out of the authorization of the sovereign or the crown. This was the mode of incorporation which was followed earlier to the Registration under the Companies Act. A charter is granted by the crown to the people requesting to

form a cooperative or a company. To name a few, The Bank of England (1694), The East India Company (1600) were formed by the means of charters passed by the then Crown of England. The authorization given by the sovereign gives legal existence to these companies by means of the body of the charter. This mode of incorporation is no more recognised in any Companies Act to incorporate new Companies.

Notes

**Statutory Company :** As the name suggests, these are the companies that are formed by the means of a special statute passed by the Parliament or the State Legislature. The examples of statutory companies in India are the Reserve bank of India, the Life Insurance Corporation of India Act, etc.

The Statutory origins of these companies provide power to such companies to be bound by their own statute, i.e. whenever there is any dispute between statute under which these companies were formed and the Companies Act 2013, the statute being special legislation persists over the general law of Companies Act. The parliaments both State and Centre are empowered to make such legislation for incorporation under the power endowed to them by the Constitution of India.

**Registered Company :** As defined under Section 2(20) of the Companies Act, 2013, registered companies are the companies which get registered under the statute of the Companies Act. Companies are also provided with a certificate of incorporation by the Registrar of the Company.

**II. Classification of Companies on the basis of liability of members**

The liability upon the members is also used to classify the companies, it describes the limit to which member will be liable if such liability were to befall upon the company. On the basis of liability of the members, the companies may be classified into :

**Companies limited by shares :** These types of companies are mentioned in Section 2(22) of the Companies Act, 2013. The liability of the members of such a company is based upon the number of shares kept unpaid. This liability against the shares kept may be brought to the authority. Once the payment towards the security is made by the shareholder or member then no liability beyond that is placed upon such member. The liability may be enforced during the company's existence and even during its winding-up process.

**Companies limited by guarantee :** These types of companies are mentioned in Section 2(21) of the Companies Act, 2013. In a Company where the liability is limited by guarantee, it means the member of the Company has agreed on the Memorandum of Association to repay the same amount during winding up of such Company. In such companies, the liability of the members is limited to the undertaking given by them. Trust research associations, etc. are examples of companies liability limited by guarantee.

**Unlimited Liability Company :** These companies as defined under Section 2(92) of the Companies Act, 2013 do not have a cap on the amount of liability that may add on their members in case the company has to repay any debt. For any amount that the company owes these members, the unlimited liability company shall be liable to the extent of their interest in the company. These companies do not draw any popularity when it comes to Indian Market.

Notes

**Difference between limited and unlimited companies :**

| Limited liability company | Unlimited liability company |
|---|---|
| Liability of the members is only in proportion to the sum they have invested in the company. | Liability of the members is not in proportion to the investment in their company. |
| Personal properties or assets will not be forfeited if the company goes bankrupt or winds up. | Even the personal property of the member will be forfeited against the liability of the company. |

**III. Classification of Company on the basis of the number of members**

The number of members in a company is looked upon while classifying them. This classification of the company has been discussed in detail under the below-mentioned headings. On the basis of the number of members in the companies may be classified into :

**Private Company :** The private companies as defined under Section 3(1) (b) of the Companies Act, 2013 are very restrictive in nature wherein it may in its Articles of Association restrict the right to transfer shares. The number of members in such a company might be a maximum of 50. The shares and debentures of such companies are not available for the public at large. The number of members in a company to be called a private company is two, wherein it is clearly set that two members jointly holding a single share shall be considered as one member and not two members. The easy identification of Private companies is the 'Pvt. Ltd.' attached to its name.

**Public Company :** As defined under Section 2(71) of the Companies Act, 2013, Public Companies are the ones which are not a private company. As mandated under Section 3(1)(a) of the Companies Act, 2013, there should be at least 7 members to form a public company. It is the intrinsic nature of the public company that there is the right to transfer shares and debentures of the public company to the public at large.

**IV. Classification of Companies on the basis of domicile**

On the basis of their domicile the companies may be classified into :

**Foreign Company :** A Company, which is situated outside India, but has a registered place in India may be physical or electronic address or perhaps company has ownership itself or through the agents, representatives or managers of the company is known as a foreign company under Section 2 (42) of the Companies Act, 2013. The aforementioned definition included in the new Companies Act has widened the scope of the definition of foreign companies extending the same to the entities having their electronic presence in India. The list of foreign companies listed in India has names of the corporate giants such as Whirlpool of India Ltd., Timex Group India Ltd., Ambuja Cements Ltd., etc.

**Indian Company :** Indian Company has been defined under Section 2(20) of the Companies Act, 2013 as any company registered under the Companies Act, 2013, or any other previous law is known as an Indian Company. An Indian company may prove its locus standi with the help of its office address and the legislation provides a guideline to be followed while using such powers by an Indian company.

**V. Classification of companies on the basis of Miscellaneous factors**

On the basis of other miscellaneous factors the companies may be classified into :

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**Government Company :** As defined under Section 2(45) of the Companies Act, 2013, any company in which a minimum of 51 per cent of the paid-up share capital is held by the Central/State Government, and/or held fractionally by the Central Government and partly by one or more State Governments is known as a Government Company. The major drawback of having a government company is the lack of autonomy.

**Holding, Subsidiary Companies and Associated Companies :** Under Section 2(46) of the Companies Act, 2013, a company is known as the holding company of another company if it has administrative control over another company. Such control may be regarding the affairs of the company. Under Section 2(87) of the Companies Act, 2013, a company is known as a subsidiary company of another company when control is exercised by the other company over the subsidiary company.

A company is deemed to be a subsidiary company of another :

1. If the other company
   - Exercises or controls more than 50% of the total voting power i.e. where the holders of preference shares have the same voting rights as the equity shares holder, or,
   - 50% in nominal value of its equity share capital held, or,
   - Possesses power regarding the composition of the Board of directors.
2. If it is a subsidiary of a company which is a subsidiary of the controlling company.

The holding power also includes another kind of Company known as Associate Company, which is now being explained with respect to the above-mentioned Holding and subsidiary company.

**Associate Company :** These Companies as defined under Section 2(6) of the Companies Act, 2013 are the one in which the other company has significant influence but these Companies are not the subsidiaries of such influencing companies known as the Associate Company. The Joint Venture Companies are such associate companies.

The significant control can be inferred directly from the explanation attached to the provision which requires the influencing company to hold 20% of the share capital or any agreement whereby the decision making of the associate is placed upon such Influencing Company. The Associate Company concept has been seen as a harbinger of transparency in the working of the Company since it provides a more rationale grundnorm for an associated relationship between the two companies.

**One man Company :** Under Section 2(62) of the Companies Act, a company in which one person is the whole and sole owner of the share capital of the company is known as a One Man Company. In order to meet the statutory

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requirement of a minimum number of members, some namesake company shareholders hold one or two shares each. The namesake shareholder members are usually nominated by the principal shareholder. The principal shareholder enjoys all the profits of the business with the protective shield of limited liability. Such companies have been given legal sanctity.

**Difference between One person company and Sole Proprietorship**

The major or fundamental difference between a one-person company and the sole proprietorship is based upon the limitations or extent of liability in the one-person company. One person company is different from the Sole proprietorship as the ne person company differentiates the promoter from the separate entity of the company. The liability of the director of the one-man company is limited in the event of any legal liability or claims made against the company.

**Investment Company :** The Investment Companies as defined under section 186 of the Companies Act, 2013, are the companies which have a fundamental business or transaction relating to the securities of other companies. Securities may be of a nature of shares or debenture or other securities offered by such entity. The word investment in its predominant sense means to acquire a resource and hold it for the interest earned over it, but in the case of an investment company, the investment is aimed not only at the acquisition and holding but perhaps to even the sale of the securities whenever they reach a better price.

The Investment company under Section 186 of the Companies Act, 2013 are based upon the market trend relating to the shares analyses the maximum profit investment for the Company. The commonly used terminology of stock market relating to the bear and bull market and the understanding of the trend plays a crucial role to attain profits aimed at by the company.

There are still two perspectives towards the investment company functioning and the characteristics of the transactions made by such company. One set of claims suggests that the Investment Companies are only supposed to purchase security and earn interest by maintaining them. The other school of thought suggests that the investment company may earn not only by purchase and hold but also selling of the securities.

**New kind of Companies recognised under the Act, 2013**

**Dormant Companies :** Where a company is formed under Section 455 of the Company Act, 2013 for a future endeavour or to hold an asset which may be a physical or intellectual property and has no significant accounting transaction, such a company or inactive company can make an application to the Registrar in the prescribed manner for obtaining the status of the dormant company.

The explanation attached to this provision states about the inactive company prescribing a period of 2 years of inactivity in terms of business transactions, operations etc, or the companies which have not filed their annual returns or the financial statement in the last 2 years. Such transactions do not include all the necessary payment which are made by the company to the Registrar and other payments which are supposed to be made under any other law.

The Registrar allows the certificate of the inactive company to the applicant company. The registrar must maintain the list of dormant companies. A company to remain a dormant company on the books of the registrar has to pay the required sum. The Company on request may make the Dormant Company back to an active company.

## 5.11 DIRECTORS :THEIR POWERS AND DUTIES

Notes

The companies act, 2013 in section 2(34) defines the term "director" as, "a director appointed to the Board of a company"., wherein a "Board" in relation to a company, means the collective body of the directors of the company.

As per Companies Act provisions every director shall be appointed by the company in general meeting, provided they have been allotted the Director Identification Number (DIN) and on submission of a declaration that he/she is not disqualified to become a director. An additional director is also appointed by the Board of Directors through the Boards vested power to hold office till next general meeting. An alternate director may be appointed by the Board of Directors to act as a Director in absence for a period of not less than 3 months and not more than the allotted period for the director for whom the replacement is.

Section 166 (4) provides for the appointment of not less than two-thirds of the total number of the directors of a company, and such appointments may be made once in every three years and casual vacancies of such directors shall be filled.

The companies act 2013 is built on the principle of responsibility of the Board, protection of interests of the Shareholders, self- regulation and openness through disclosures. The 2013 amendment has ensured several effective measures through clearly defining liabilities and responsibilities of the Directors and penal actions on failure to follow the same.

### 5.11.1 Powers of Board of Directors

The board of directors is the highest authority in any company. According to Section 179, Companies Act 2013, the power of directors of a company – entitled to make any and all decisions, and thus exercise all the power, which the company has authority to enact.

**Power of Directors :**

According to Section 179, CA 2013, the powers of the board of directors are as follows :

- Board of Directors can exercise all such powers for which the company is authorised.
- Board of Directors can take all actions on matters in which the company has authority.

**Power of Board subject to other Provisions'**

While using the power vested in the board of directors, the board must adhere to the rules and provisions of the following :

Notes

1. The Companies Act
2. The Memorandum of Association
3. The Articles of Association
4. Any Regulation, made by the company during general meetings.

Specifically, one can say that the authority of the company is the powers of the board. However, if necessary the power of the board can be restricted by the Companies Act, the Memorandum, the Articles. Resolutions passed by shareholders can also limit the powers of the board.

**Power Exercised by Company in General Meeting**

The board of directors are not allowed to exercise any power or take any decisions, which are specifically to be exercised or a decision to be taken in a General Meeting.

**New Regulations Do Not Invalidate Acts made by the Board**

According to Section 179, Companies Act 2013, any resolutions that are passed in a General Meeting cannot invalidate any provisions that the board of directors made prior to the resolution.

**Power Exercised by Passing Resolution at Board Meetings**

There are also certain powers of the board that those resolutions can only be passed by calling a board meeting. This is done as per Section 175, Companies Act 2013. Thus, the board of directors can exercise the following powers, only by passing a resolution in the meetings of the board :

- Make calls on shareholders
- Authorise the buyback of securities and shares
- Issue securities and shares
- Borrow monies
- Investing the funds
- Grant loans
- Approve the financial statement
- Approve amalgamation/merger
- Diversify the business
- Take over a company

Also, in accordance with Section 117, CA 2013, a copy of every board resolution must be submitted with the Registrar within 30 days of the passing of the resolution.

In addition to this, Rule 8 of Companies Rules 2014 has given certain more powers to the board. Namely, resolutions that can be passed at board meetings :

1. Making political contributions
2. Appointing or removing key managerial personnel.
3. Appointing internal auditors and secretarial auditors.

**The Delegation of Powers of the Board :** The Board of Directors may delegate powers such as investing monies, granting loans, giving guarantee or security by passing a resolution in the board meeting :

1. Committee of Directors
2. Managing Director
3. Manager
4. Any other principal officer of the company
5. The principal officer of a branch office

**Restrictions of Powers of the Board :** In accordance with provisions of Section 179, the company can impose restrictions and conditions on the power of the board of directors. Moreover, the shareholders are responsible for imposing restrictions and conditions of the power of the board. Thus, the shareholders pass an ordinary resolution at a general meeting to do this.

Notes

### 5.11.2 Duties of Directors

Section 166 of the new Act provides that a director of a company (including a private company) shall act in accordance with the Articles of the company. His duties are listed in the section as under :

(i) He has to act in good faith in order to promote the objects of the company for the benefit of its members as a whole.

(ii) He has to act in the best interest of the company, its employees, shareholders, community and for the protection of environment.

(iii) He has to carry on his duties with due and reasonable care, skill and diligence and exercise independent judgment.

(iv) He shall not involve in a situation in which he may have a direct or indirect interest that conflicts or likely to conflict with the interest of the company.

(v) He shall not achieve or attempt to achieve any undue gain or advantage either to himself, his relatives, partners or associates.

(vi) He shall not assign his office to any other person.

If he contravenes any of the above provisions of section 166, he shall be punishable with fine which shall not be less than Rs.1 lac which may extend to Rs.5 lacs. It is also provided that if he is found guilty of making any undue gain during the course of discharging his duties as a director, he shall be liable to refund an amount equal to such gain to the company. Section 172 provides that if a company contravenes any of the provisions of chapter XI (sections 149 to 171), for which no specific punishment is provided, the company and every officer of the company who is in default shall be punishable with minimum fine of Rs.50000/- which may extend to Rs.five lacs. Draft Rules 11.11 to 11.15 provide for procedure for Notice of Candidate to be appointed as Director, Notice of Resignation of Directors, Maintenance of Register of Directors, KMP etc.

### 5.11.3 Meetings

Board meetings are meetings at the highest level, i.e. a meeting where board members or their representatives are present. A company is not an actual entity but a legal one so it cannot take actions and make decisions. The board of directors act as agents through which the company takes actions as well as makes decisions.

Notes

**Board Meetings :** The board of directors is the supreme authority in a company and they have the powers to take all major actions and decisions for the company. The board is also responsible for managing the affairs of the whole company. For the effective functioning and management, it is imperative that board meetings be held at frequent intervals. For this, Section 173 of Companies Act, 2013 provides :

In the case of a Public Limited Company, the first board meeting has to be held within the first 30 days, since the incorporation date. Additionally, a minimum of 4 board meetings must be held in a span of one year. Also, there cannot be a gap of more than 120 days between two meetings.

In the case of small companies or one person company, at least two meetings must be conducted, one in each half of the financial year. Additionally, the gap between the two meetings must be at least 90 days. In a situation where the meeting is held at a short notice, at least one independent director must be attending the meeting.

**Notice of Board Meeting :** The notice of Board Meeting refers to a document that is sent to all directors of the company. This document informs the members about the venue, date, time, and agenda of the meeting. All types of companies are required to give notice at least 7 days before the actual day of the meeting.

**Quorum for the Board Meeting :** The quorum for the Board Meeting refers to the minimum number of members of the Board to conduct a valid Board Meeting. According to Section 174 of Companies Act, 2013, the minimum number of members of the board required for a meeting is 1/3rd of a total number of directors.

At any rate, a minimum of two directors must be present. However, in the case of One Person Company, the rules of Section 174, do not apply.

**Participation in Board Meeting :** All directors are encouraged to actively attend board meetings and in case that's not possible at least attend the meetings through a video conference. This is so that all directors can take part in the decision-making process.

**Right Convening Authority :** The board meeting must be held under the direction of proper authority. Usually, the company secretary (CS) is there to authorize the board meeting. In case the company secretary is unavailable, the predetermined authorized person shall act as the authority to conduct the board meeting.

**Adequate Quorum :** The proper requirements of the quorum or the minimum number of Directors required to conduct a Board meeting must be present for it to be considered a valid board meeting.

**Proper Notice :** Proper notice is one of the major requirements to be fulfilled when planning a board meeting. Formal notice has to be served to all members before conducting a board meeting.

**Proper Presiding Officer :** The meeting must always be conducted in the presence of a chairman of the board.

**Proper Agenda :** Every board meeting has a set agenda that must be followed. The agenda refers to the topic of discussion of the board meeting. No other business, which is not mentioned in the meeting must be considered.

### 5.11.4 Winding Up

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Since we believe in Going Concern Assumption, as we want our business to flourish more & more, but at some point of time due to several reasons one has to close down his business and that stage is known as winding up of a company. It is the last stage of company in which its existence for past several years is dissolved and all its assets are used to pay off the creditors, shareholders and other liabilities.

As per section 270 of the Companies Act 2013, the procedure for winding up of a company can be initiated either :

(a) By the tribunal or,

(b) Voluntary.

**I. Winding up of a company by a tribunal :**

As per Companies Act 1956, a company can be wound up by a tribunal on the basis of the following reasons :

1. Suspension of the business for one year from the date of incorporation or suspension of business for whole year.
2. Reduction in number of minimum members as specified in the act (2 in case of private company and 7 in case of public company).

But with the introduction of new Companies Act 2013, these above stated grounds for winding up have been deleted and some new situations for winding up have been inserted. As per new Companies Act 2013, a company can be wound up by a tribunal in the below mentioned circumstances :

1. When the company is unable to pay its debts.
2. If the company has by special resolution resolved that the company be wound up by the tribunal.
3. If the company has acted against the interest of the integrity or morality of India, security of the state, or has spoiled any kind of friendly relations with foreign or neighboring countries.
4. If the company has not filled its financial statements or annual returns for preceding 5 consecutive financial years.
5. If the tribunal by any means finds that it is just & equitable that the company should be wound up.
6. If the company in any way is indulged in fraudulent activities or any other unlawful business, or any person or management connected with the formation of company is found guilty of fraud, or any kind of misconduct.

**II. Filing of winding up petition :** Section 272 provides that a winding up petition is to be filed in the prescribed form no 1, 2 or 3 whichever is applicable and it is to be submitted in 3 sets. The petition for compulsory winding up can be presented by the following persons:

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- The company
- The creditors ; or
- Any contributory or contributories
- By the central or state govt.
- By the registrar of any person authorized by central govt. for that purpose

At the time of filing petition, it shall be accompanied with the statement of Affairs in form no 4. That petition shall state the facts up to a specific date which shall not more than 15 days prior to the date of making the statement. After preparing the statement it shall be certified by a Practicing Chartered Accountant. This petition shall be advertised in not less than 14 days before the date fixed for hearing in both of the newspapers English and any other regional language.

**III. Final Order And Its Content :** The tribunal after hearing the petition has the power to dismiss it or to make an interim order as it think appropriate or it can appoint the provisional liquidator of the company till the passing of winding up order. An order for winding up is given in form 11.

**IV. Voluntary winding up of a company :** The company can be wound up voluntarily by the mutual decision of members of the company, if :

- The company passes a Special Resolution stating about the winding up of the company.
- The company in its general meeting passes a resolution for winding up as a result of expiry of the period of its duration as fixed by its Articles of Association or at the occurrence of any such event where the articles provide for dissolution of company.

**V. Procedure for voluntary winding up :**

1. Conduct a board meeting with 2 Directors and thereby pass a resolution with a declaration given by directors that they are of the opinion that company has no debt or it will be able to pay its debt after utilizing all the proceeds from sale of its assets.
2. Issues notices in writing for calling of a General Meeting proposing the resolution along with the explanatory statement.
3. In General Meeting pass the ordinary resolution for the purpose of winding up by ordinary majority or special resolution by 3/4th majority. The winding up shall be started from the date of passing the resolution.
4. Conduct a meeting of creditors after passing the resolution, if majority creditors are of the opinion that winding up of the company is beneficial for all parties then company can be wound up voluntarily.
5. Within 10 days of passing the resolution, file a notice with the registrar for appointment of liquidator.
6. Within 14 days of passing such resolution, give a notice of the resolution in the official gazette and also advertise in a newspaper.

7. Within 30 days of General meeting, file certified copies of ordinary or special resolution passed in general meeting.
8. Wind up the affairs of the company and prepare the liquidators account and get the same audited.
9. Conduct a General Meeting of the company.
10. In that General Meeting pass a special resolution for disposal of books and all necessary documents of the company, when the affairs of the company are totally wound up and it is about to dissolve.
11. Within 15 days of final General Meeting of the company, submit a copy of accounts and file an application to the tribunal for passing an order for dissolution.
12. If the tribunal is of the opinion that the accounts are in order and all the necessary compliances have been fulfilled, the tribunal shall pass an order for dissolving the company within 60 days of receiving such application.
13. The appointed liquidator would then file a copy of order with the registrar.
14. After receiving the order passed by tribunal, the registrar then publish a notice in the official Gazette declaring that the company is dissolved.

Notes

**Case Name: M/s Meters and Instruments Private Limited &Anr. v. Kanchan Mehta**

In this case, the Two-Judge Bench of Supreme Court made some key observations regarding dishonor of cheque cases and also issued directions for speedy disposal of cheque cases under Section 138 of NI Act.

Use of modern technology for speedy disposal of cases– The Court took into consideration the use of modern technologies for enabling speedy disposal of cases under Section 138 of NI Act and noted that the use of modern technology needs to be considered not only for paperless Courts but also to reduce overcrowding of Courts. There appears to need to consider categories of cases that can be partly or entirely concluded "online" without the physical presence of the parties by simplifying procedures where seriously disputed questions are not required to be adjudicated. Traffic challans may perhaps be one such category. At least some number of Section 138 cases can be decided online. If a complaint with affidavits and documents can be filed online, process issued online and accused pays the specified amount online, it may obviate the need for the personal appearance of the complainant or the accused. Only if the accused contests, need for the appearance of parties may arise which may be through Counsel and wherever viable, video conferencing can be used. Personal appearances can be dispensed with on suitable self-operating conditions.

## 5.12 SUMMARY

A negotiable instrument is a piece of paper which entitles a person to a sum of money and which is transferable from one person to another by mere delivery or by endorsement and delivery. The characteristics of a negotiable

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instrument are easy negotiability, transferee gets good title, transferee gets a right to sue in his own name and certain presumptions which apply to all negotiable instruments. There are two types fo negotiable instruments (a) Recognised by statue: Promissory notes, Bill of exchange and cheques and (b) Recognised by usage: Hundis, Bill of lading, Share warrant, Dividend warrant, Railway receipts, Delivery orders etc. The parties to bill of exchange are drawer, drawee, acceptor, payee, indorser, indorsee, holder, drawee in case of need and acceptor for honour. The parties to a promissory note are maker, payee, holder, indorser and indorsee while parties to cheque are drawer, drawee, payee, holder, indorser and indorsee. Negotiation of an instrument is a process by which the ownership of the instrument is transferred by one person to another. There are two methods of negotiation: by mere delivery and by endorsement. In its literal sense, the term 'indorsement' means writing on an instrument but in its technical sense, under the Negotiable Instrument Act, it means the writing of a person's name on the face or back of a negotiable instrument or on a slip of paper annexed thereto, for the purpose of negotiation. A bill may be dishonoured by non-acceptance (since only bills require acceptance) or by non-payment, while a promissory note and cheque may be dishonoured by non-payment only. Noting means recording of the fact of dishonour by a notary public on the bill or paper or bothpartly. Protest is a formal notarial certificate attesting the dishonour of the bill. The term 'discharge' in relation to negotiable instrument is used in two senses, viz., (a) discharge of one or more parties from liability thereon, and (b) discharge of the instrument. Legislation being the part of the government and companies being the most important part of economy to earn revenue for the country, they are taking initiative to make the company law simpler. But, being a responsible citizen of India, one should be aware of the post-registration compliance which is equally important for a corporation because in any case, penal action will be taken by the authorities for the non-compliance. Therefore, the promoters should be well aware of the next steps to be taken for the company. It is always recommended to ask the help of professionals for reducing chances of being non-compliant. This article has tried to consolidate all the basic knowledge and the documents required to incorporate a company under the Companies Act, 2013. The advantages and disadvantages have also been highlighted. Since every coin has two sides, therefore incorporation also has both pros and cons. The legislature of india have been very effective in bringing out changes that are required in the said Act. The only change required for the incorporation is that in the technological world, the procedure of incorporation should be made online so that the complexity is reduced and time is saved of the members involved.

## 5.13 EXERCISE

1. Define the term 'negotiable instrument'. What are its essential characteristics.
2. What is a bill of exchange ? How does it differ from a promissory note.
3. Define cheque distinguish between a cheque and a bill of exchange.
4. Discuss the presumption in respect of a negotiable instrument.
5. Explain the privileges granted to a holder in due course. ❑❑❑