



**Global Shiksha institute in Collaboration with  
Singhania University**

## **LEGAL ASPECTS OF BUSINESS**

**COURSE: MBA/EMBA  
FIRST SEMESTER**



## **PROGRAM NAME: MBA/EMBA**

### **LEGAL ASPECTS OF BUSINESS**

- Unit 1:** The Indian Contract Act, 1872;
- Unit 2:** Offer & Acceptance;
- Unit 3:** Consideration
- Unit 4:** Capacity of Parties;
- Unit 5:** Free Consent
- Unit 6:** Legality of Object & Consideration and Void Agreements
- Unit 7:** Contingent Contracts; Performance of Contracts
- Unit 8:** Discharge of Contracts
- Unit 9:** Remedies for Breach of Contract
- Unit 10:** Quasi-Contracts
- Unit 11:** Contract of Indemnity & Guarantee
- Unit 12:** Contract of Bailment & Pledge
- Unit 13:** Contract of Agency
- Unit 14:** Contract of Sale of Goods
- Unit 15:** Negotiable Instruments
- Unit 16:** Holder in due course; Cheques & Drafts
- Unit 17:** Discharge of Negotiable Instruments
- Unit 18:** Introduction of Consumer Protection Act, 1986
- Unit 19:** Information Technology Act, 2003
- Unit 20:** Introduction of the Company Law
- Unit 21:** Promoters of a Company
- Unit 22:** Memorandum of a Company
- Unit 23:** Article of Association & Prospectus
- Unit 24:** Powers, Duties & Liabilities of Directors
- Unit 25:** Winding up of Companies

## **EMB-I09 - LEGAL ASPECTS OF BUSINESS**

This course will help the students to explore, recognize and analyse the multiple paradoxes related to the study and application of human resource as an asset in an organization. This course will help the students to understand the basic nature, functions, activities, operations and complexities of human resource management in the corporate realm.

### **Objectives:**

- To introduce conceptual and theoretical foundations of human resource management.
- To aware the importance of human and recognize as an asset in an organization.
- To acquire the skills of interaction and execution of managerial duties with the help of human resources.
- To understand the values and utilities of human resources in an competitive environment.

### **BLOCK I:**

Unit 1: The Indian Contract Act, 1872;

Unit 2: Offer & Acceptance; Consideration; Capacity of parties; Free Consent; Legality of object

& consideration and Void Agreements.

Unit 3: Contingent Contracts & Performance of Contracts.

Unit 4: Discharge of Contracts & Quasi-Contracts

Unit 4: Remedies for Breach of Contract.

### **BLOCK II:**

Unit 1 : Contracts of Indemnity

Unit 2 : Guarantee

Unit 3: Bailment and Pledge.

### **BLOCK III:**

Unit 1: Contract of Agency

Unit 2: Contract of Sale of Goods

Unit 3: Negotiable Instruments.

### **BLOCK IV:**

Unit 1: Consumer Protection Act, 1986

Unit 2: Information Technology Act, 2003.

**BLOCK V :**

Unit 1: Introduction of Companies Act

Unit 2: Kinds of Companies

Unit 3: Article of Association, Article of Memorandum & Prospectus

Unit 4: Promoters, Mergers & Amalgamations

Unit 5: Winding up of Companies.

**RECOMMENDED TEXT BOOKS**

- K.C.GARG., V.K.SAREEN, MUKESH SHARMA & R.C.CHAWLA  
- “MERCANTILE LAW [INCORPORATING LATEST AMENDMENTS IN  
COMPANY LAW, ECONOMIC LAWS AND OTHER LAWS”
- N.D.KAPOOR - “MERCANTILE LAW”
- THULSYAN SINGH - “LEGAL ASPECTS OF BUSINESS”
- AKILESHWAR PATHEK - “LEGAL ASPECTS OF BUSINESS”



## UNIT 1:

### THE INDIAN CONTRACT ACT, 1872

#### Structure

- 1.1 Objectives
- 1.2 Introduction
- 1.3 The Indian Contract Act 1872
- 1.4 Essential Elements of a Valid Contract
- 1.5 Classification of Contract
- 1.6 Some Useful Books
- 1.7 Answer to Check Your Progress Exercise

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#### 1.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a contract
- Understand the essentials of contract.
- Describe the differences between the void, voidable and null void contracts.
- Implementing the formalities in forming a contract

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#### 1.2 INTRODUCTION

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Taking a seat in a bus, putting a coin in the slot of a weighing machine, going to a restaurant and taking snacks all are contracts: We do not even realize that we are making a contract. People engaged in trade, commerce and industry carry on business by entering into contracts. The law relating to contracts is to be found in the Indian contracts Act 1872. It contains principles, subject to which parties may create right and duties for themselves and the law will uphold their rights and duties.

The sale of goods is the most common of all commercial contracts. Knowledge of its main principles is of the utmost importance to all classes of the community. The law relating to contained in the sale of Goods act, 1930. Contracts for the sale of goods are subject to the

general legal principles applicable to all contracts, such as offer and its acceptance, the capacity of the parties, free and real consent, consideration, and legality of the object

There are certain documents, which are freely used, in commercial transactions and monetary dealings. These documents, if they satisfy certain conditions, are known as “negotiable instruments”. The word “for consideration” and “instrument” means a “written document by which a right is created in favour of some person.” Thus a negotiable instrument is a document 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 complexities of modern business are such that it is not possible for any man to transact all his business by himself. He cannot personally attend to all matters in which it is necessary for him to be brought into legal relations with other people. Of necessity he has to depend on the services of other persons in order to run day-to-day business affairs. Such other persons are called agents.

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### 1.3 THE INDIAN CONTRACT ACT 1872

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#### What is a contract?

- **Contract:** An agreement enforceable by law (sec 2 (b))
- **Agreement:** Every promise and every set of promises forming consideration for each other (sec 2 e)
- **Promise:** When the person to whom the proposal is made signifies his ascent thereto, the proposal is said to be accepted. A proposal when accepted then it is a promise.
- **Agreement:** Accepted proposal. The two elements are (i) offer or a proposal and (ii) An acceptance of that offer or proposal.

The contract act is the law of those agreements, which create obligations, and in case of a breach of a promise by other party to the agreement; the other has a legal remedy. There are some agreements, which are not enforceable in a law court. Such agreements do not give rise to contractual obligations then it will not be a contract.

#### Example:

- A invited B for a dinner in a restaurant. B accepts the invitation. On the appointed day, B goes to the restaurant. A does not turn up or A is there but refuses to entertain B. B has no remedy against A. In case A is present but B fails to turn up, A has no remedy against B.
- A promises his son a pocket allowance of Rs. 500 a month. In case A fails or refuses to give his son the promised amount, his son has no remedy against A.
- A contract is an agreement but an agreement is not necessarily a contract.

#### What obligations are contractual in nature?

A legal obligation having its source in an agreement only will give rise to contract.

**Example:**

- A agrees to sell his car to B for Rs. 50,000. The agreement gives rise to a legal obligation on the part of A to deliver the car to B. On the part of B to pay Rs. 50,000 to A. The agreement is a contract. If A does not deliver the car, then B can go to a court of law and file a suit against A for non-performance of the promise on the part of A. On the other hand if A has already given the delivery of the car and B refuses to make the payment of price, A can go to a court of law and file a suit against B for non-performance of promise.

Agreements to do an unlawful, immoral or illegal act for example smuggling or murdering a person cannot be enforceable by law. Certain agreements have been declared void or unenforceable under the Indian contracts act. An agreement to betting (wagering agreement), an agreement in restraint of trade, an agreement to do an impossible advertisement. An obligation which does not have its origin in an agreement does not give rise to a contract. Some of such obligations are tort or civil wrongs, quasi contract, judgment of courts, Relation between husband and wife, Relation between trustee and location. These obligations are not contractual in nature but are enforceable in a court of law.

**Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss : What is a contract & What obligations are contractual in nature.**

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**1.4 ESSENTIAL ELEMENTS OF A VALID CONTRACT**

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**ESSENTIAL ELEMENTS OF A VALID CONTRACT**

- Agreement
- Intention to create legal relationship
- Free and Genuine consent
- Parties competent to contract
- Lawful consideration
- Lawful Orient
- Agreements not declared void or illegal
- Certainty of meaning
- Possibility of performance
- Necessary legal formalities

### 1. Agreement- [Offer and Acceptance]

- Party making the offer - Offeror
- Party to whom the offer is made – Offeree
- There are two parties to an agreement
- They both must be thinking of the same thing in the same sense
- There must be *Consensus – ad – idem*

#### Example:

- Where 'A' owns two cars X and Y wish to sell his car "X" for Rs. 30,000. B an acquaintance of 'A' does not know that 'A' owns car 'X' also. He thinks that 'A' owns only car 'Y' and is offering to sell the same for the stated price. He gives him acceptance to buy the same. There is no contract because the contracting parties have not agreed on the same thing at the same time. 'A' is offering to sell his car 'B' and 'B' is agreeing to buy the car 'Y'. There is no consensus – ad idem.

### 2. Intention to create Legal Relationship:

An agreement of a purely social or domestic nature is not a contract. A husband agreed to pay Dollar 30 to his wife every month while he was abroad. As he failed to pay the promised amount his wife sued him for the recovery of the amount. It was a social agreement and the parties did not intend to create any legal relations.

#### Example: 1

- one of the clauses included in an agreement. This arrangement is not a formal legal agreement and shall not be subject to legal jurisdiction in the law courts. Held: that this agreement was not a legally binding contract as the parties intended not to have legal consequences.

#### Example 2.

- An agreement contained a clause that "shall not give rise to any legal relationships or be legally enforceable, but binding in honour only". Held: The agreement did not give rise to legal relations and therefore was not a contract. (Jones V verton's Pools Ltd (1938) 2 AIR.

#### Example 3.

- An aged couple (C and his wife) held out a promise by correspondence to their niece and her husband (Mrs. and Mr. P.) that C would sell them a portion of his estate in his will, if Mrs. P and Mr. P would sell their cottage and come to live with the aged couple and to share the household and other expenses. The young couple sold their cottage and started living with the aged couple and to share the household and other expenses. The two couples subsequently quarreled and the aged couple repudiated the agreement by requiring the young couple to stay somewhere else. The young couple filed a suit against the aged couple for the breach of promise. Held: That there was intention to create legal relations and the young couple could recover damages.

### 3. Free and genuine consent:

The consent of the parties to the agreement must be free and genuine. The consent of the parties should not be obtained by misrepresentation, fraud, undue influence, Coercion or mistake. If the consent is obtained by any of these flaws, then contract is not valid.

### 4. Partial competent to contract:

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



### **5. Lawful consideration:**

Each party of an agreement must give or promise something and receive something or a promise in return. Consideration is the price for which the promise of the other is sought. However the price need not be in terms of money.

### **6. Lawful object:**

The object of the agreement must be lawful and not one which the law disapproves.

### **7. Agreement not declared illegal or void:**

There are certain agreements which have been expressly declared illegal or void by the law. In such cases, even if the agreement possesses all the elements of a valid agreement, the agreement will not be enforceable by law.

### **8. Certainty of meaning: -**

The meaning of the agreement must be certain or must be capable of being made certain. Otherwise the agreement will not be enforceable by laws. For e.g. 'A' agreed to sell 10 meters of cloth. There is nothing to show, what type of cloth was intended. The agreement is not enforceable for want of certainty of meaning.

### **9. Possibility of performance:**

The terms of the agreement should be capable of performance. An agreement to do an act impossible in itself cannot be enforced. For instance A agrees with B to discover treasure by magic. The agreement cannot be enforced.

### **10. Necessary Legal formalities:**

A contract may be in oral or in writing. If however, a particular type of contract is required by law to be in writing, it must comply with necessary formalities as to writing, registration and attestation if necessary. If these legal formalities are not carried out, then the contract is not enforceable by law.

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

*1. Discuss the Essential elements of a valid contract.*

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## 1.5 CLASSIFICATION OF CONTRACT

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Contracts are classified as follows:

**I - Terms of validity or enforceability**

**II - Mode of formation**

**III- Performance**

**I - Terms of validity or enforceability**

- VALID
- VOIDABLE
- VOID
- ILLEGAL
- UNENFORCEABLE

**II - Mode of formation**

- EXPRESS
- IMPLIED
- QUASI - CONTRACTS

**III – Performance**

- EXECUTED
- EXECUTORY
- UNI-LATERAL
- BI-LATERAL

For the sake of convenience we can classify contracts according to their (1) Validity, (2) Formation and (3) Performance. Let us examine them in detail.

### CLASSIFICATION OF CONTRACTS TO VALIDITY :

When we closely analyse the definition of a contract, it is found that the contract is based on agreement. An agreement enforceable at law is a contract. To make the agreement enforceable at law, the essentials stipulated in Sec.10 of the Indian Contract Act are to be complied with. If anyone of the element is missing then the contract may either be void, voidable, illegal, or unenforceable.

**Void agreements:** "An agreement not enforceable by law is said to be void Sec 2(g). A void agreement has no legal effect. It confers no rights on any person and creates no obligations.

**Example:**

An agreement made by a minor, agreements without consideration [except certain cases] certain agreements against public policy: that are void from the beginning.

### **a. Void Contract:**

There are certain agreements which are valid in the beginning and subsequently it becomes void due to impossibility of performance, change of law or other reasons. When it becomes void the agreement ceases to have legal effect. This we call as void contract.

#### **Example:**

A contract to export coffee to USSR. It may subsequently become void if the exporting country bans the product from being exported.

### **b. Illegal agreement:**

An illegal agreement is one which is against a law in force in India.

Example: An agreement to commit murder, theft or cheating.

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### **c. Voidable Contract:**

A voidable contract is one which can be avoided by some of the parties to the agreement. Until it is avoided, it is a good contract. An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract."- Sec. 2(1)

#### **Examples of voidable contracts:**

Contracts brought about by coercion, under undue influence, misrepresentation etc.

#### **Illustration:**

'P' threatens 'Q' to enter into a contract for the sale of Q's landed property to 'P'. This contract can be avoided by 'Q'. 'P' cannot enforce the contract. But 'Q', if he so desires, can enforce it against 'P'.

### **d. Unenforceable Agreement:**

The term unenforceable agreement is used in English law. It means an agreement which cannot be forced in a court of law by one or both of the parties, because of some technical definition, e.g. want of registration or non-payment of requisite stamp duty or for want of written form.

#### **Difference between void and voidable contract**

<b>Void</b>	<b>Voidable</b>
<ul style="list-style-type: none"><li>▪ Not enforceable by law</li><li>▪ It has no legally binding effect</li><li>▪ In a void contract, the defects are incurable.</li><li>▪ A third party who purchased goods which had been the subject of a void contract will not acquire good title.</li></ul>	<ul style="list-style-type: none"><li>▪ Enforceable by law at the option of one of the parties to the contract.</li><li>▪ It continues to be legal unless avoided by the party.</li><li>▪ In a voidable contract, the defect is curable.</li><li>▪ But in voidable contract third party will acquire good title.</li></ul>

#### Difference between void contract and illegal contract

Void	Illegal
<ul style="list-style-type: none"> <li>▪ All void contracts are not necessarily illegal.</li> <li>▪ All collateral contracts to a void contract are not void</li> <li>▪ Ground for the voidness has to be proved.</li> </ul>	<ul style="list-style-type: none"> <li>▪ All illegal contracts are void</li> <li>▪ But all collateral contracts to a illegal contract are void</li> <li>▪ Court will, of its own motion, in case of an illegal contract, refuse to enforce it, even though the illegality has not been pleaded.</li> </ul>

#### e. Valid Contract:

An agreement enforceable at law is a valid contract. An agreement becomes a contract when all the essentials of a valid contract stipulated in Sec. 10 are complied with.

#### CLASSIFICATION ON THE BASIS OF FORMATION:

A contract may be created in three different methods:

- It may be in writing.
- It may be made orally, and
- It may be inferred from the circumstances of the case.

*Contracts can be classified according to the mode of their formation as*

- (i) Express,
- (ii) Implied and
- (iii) Quasi contracts.

#### a. Express Contracts:

Fact of the agreement can be proved by words written or spoken which express the intention of the parties. Thus contracts in writing and oral (by spoken words) can be collectively called "express contracts."

#### b. Implied contracts:

Tacit or inferred contracts/agreements would be inferred from conduct of the parties and the general circumstances of each case.

Example: Mr. A takes a public bus or enters into a restaurant for a Cup of coffee or obtains a ticket from an automatic machine.

#### c. Quasi Contract:

Unlike other contracts, the *quasi-contract* does not fulfill such requirements and in that strict sense, is not a contract at all. It rests on the ground of equity that. "A person shall

not be allowed to enrich himself unjustly at the expense of another." In such a contract rights and obligations arise not by any agreement between the parties but by operation of law.

**Example:** 'A' a shopkeeper supplied groceries to 'B' by mistake. 'B' used the items as his own. 'B' is bound to pay.

In the above case there is no consensus, no offer, no acceptance, still the law implies a contract. This is known as quasi-contract.

### **CLASSIFICATION ACCORDING TO PERFORMANCE :**

Contracts can again be classified depending upon the extent to which it has been performed i.e. Executed and Executory contracts. An executed contract is one wherein both the parties have performed their obligations under the contract.

**Example:**

'A' agrees to sell his motorbike to 'B' for Rs. 20,000. In this situation 'A' has given the motorbike and got the money from 'B'. When both the parties perform their part of the obligation under the contract the contract is said to be executed.

An executory contract is one where both the parties are yet to perform their Obligations. Thus in the above example, if 'A' has not yet delivered his motorbike and 'B' has not paid the price, the contract is executed as to 'A' and executory as to 'B'. Another classification of contracts on the basis of performance is as follows:

#### ***a. Unilateral or one-sided and Bilateral or two sided contract:***

Unilateral or one-sided contract, one party to the contract has performed his part even at the time of its formation and an obligation is outstanding only against the other.

**Example:**

The promise to give a reward to the person who finds out a lost thing forms a unilateral contract when the thing is actually found out. It creates an one-sided obligation.

In the Bilateral contract at the time of its formation, there are two outstanding obligations.

**Example:**

'A' promises to paint a picture in one month in return for which 'B' promises to pay Rs.1000. Here, there are two promises and each party is a promisor in respect of one promise and a promisee in respect of the other, and as such each can hold the other liable for the breach of his promise.

### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss the classification of contract.**

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**1.6 SOME USEFUL BOOKS**

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- **K.C.Garg., V.K.Sareen, Mukesh Sharma & R.C.Chawla**  
- “Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws and other Laws”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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**1.7 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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**Check Your Progress – 1**

1. See section 1.3

**Check Your Progress – 2**

1. See Section 1.4

**Check Your Progress – 3**

1. See Section 1.5

## UNIT 2:

### OFFER & ACCEPTANCE

#### Structure

- 2.1 Objectives
- 2.2 Introduction – Offer
- 2.3 Introduction – Acceptance
- 2.4 Some Useful Books
- 2.5 Answer to Check Your Progress Exercise

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#### 2.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a offer & acceptance
- Understand the essentials elements of offer & acceptance.
- Describe the differences between the specific & general offer.
- Termination of an offer.

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#### 2.2 INTRODUCTION - OFFER

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##### OFFER / PROPOSAL :

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

- A offers to sell his book to B. A is making an offer to do something i.e. to sell his book. It is a positive rescind on the part of the proposer.
- A offers not to file a suit against B, if the latter pays A the amount of Rs. 200 outstanding. Here the act of A is a negative one i.e. he is offering to abstain from filing a suit.

##### HOW AN OFFER IS MADE: -

- By any act or omission
- By Act – By words (written or oral) – In person or over telephone etc.
- By Conduct – By positive acts or signs – silence cannot amount to offer by conduct.
- By omission – Includes such conduct or forbearance on ones part (not the other person takes it as his willingness or absent)

**Example :**

- a. A proposes by letter to sell a house to B at a certain price. This is an offer by an act by written words (i.e. letter). This is also an express offer
- b. "A" proposes over telephone to sell a house to B at a certain price. This is an offer by an act (by oral words). This is an express offer.
- c. "A" owns a motor boat for taking people from Mumbai to Goa. The boat is in the waters at the Gateway of India. This is an offer by conduct to take passengers from Mumbai to Goa. He had not spoken or calls passengers. The very fact that this motor boat is in the water near Gateway of India, this signifies his willingness to do an act with a view to obtain the consent of the other. This is an example of an implied offer.
- d. "A" filed a suit against if the latter pays "A" the amount of Rs. 200 outstanding. This is an offer by abstinence or omission to do something.

**SPECIFIC AND GENERAL OFFER :**

An offer can be made either to a definite person or a group of persons or to the public at large.

**Specific Offer**

- May be excepted by the person or groups of persons to whom the offer has been made

**General Offer**

- May be excepted by any one by complying with the terms of the offer

**Castil is carbolic smoke ball co.:**

The patent medicine company advertised that it would give a reward of \$100 to any one who contracted influenza after using the smoke balls of the company for a certain period according to the printed directions. Mrs. Castil purchased the advertised smoke ball and contracted influenza in spite of using the smoke ball according to the printed instructions. She claimed the reward of \$100. The claim was resisted by the company on the ground that the offer was not made to law and in any case she had not communicated her acceptance of the offer. She filed a suit for the recovery of the reward.

Held:- She could recover the reward as she had accepted the offer by complying with the terms of the offer.

**ESSENTIAL REQUIREMENTS OF A VALID OFFER:**

- The offer must be made with a view to obtain acceptance
- The offer must be made with a view to create legal valuation
- The terms of offer must be definite, unambiguous and certain or capable of being made certain. The terms of the offer must not be loose, vague or ambiguous.  
**Ex.1.** "A" offer to sell B a "hundred quintals of oil". There is nothing whatever to show what kind of oil was intended. The offer is not capable of being accepted for want of certainty.  
**Ex.2.** "A" who is a dealer in coconut oil only offers to sell to B 'one hundred quintal of oil'. The nature of A's trade offers an indication of the meaning of the words and this is a valid offer.
- An offer must be distinguished from a) mere declaration of intention or (b) an invitation to offer or to treat.
- The offer must be communicated to the offeror.
- The offer must not contain a term of non-compliance of which may be assumed to amount to acceptance.  
**Ex.** A tells B that he will offer to sell his dog to B for Rs. 4500; if B do not send his reply, A shall assume that B have accepted the offer. Then the offer is not a valid one.
- A tender is an offer as it is in response to an invitation to offer.



- The special terms forming part of the offer must be duly brought to the notice of the offeree at the time of the offer is made.

The terms may be brought to his notice either by drawing his attention to them specifically or by inferring that of ordinary prudence could find them by exercising ordinary intelligence. If the conditions are contained in a document, which is delivered after the contract is complete, then the offeree is not bound by them.

When two parties make identical offers to each other, in ignorance of each others offer, the offer are known as cross offer and neither of the two can be called an acceptance of the other and therefore there is no contract.

### **TERMINATION OR LAPSE OF AN OFFER:-**

- The offer lapses after stipulated or reasonable time
- An offer lapses by neither the deal completes or insanity of the offeror for the offeree before acceptance.
- An offer terminates when rejected by the offeree
- An offer terminates when revoked by the offeror before acceptance
- An offer terminates by not being accepted in the mode prescribed or if no mode is prescribed in some usual and reasonable manner.
- A conditional offer terminates when the condition is not accepted by the offeree
- An offer terminates by counter offer by the offeree.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss how an offer is made.**

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## 2. Discuss what are the essential requirements of a valid offer & Termination of an offer.

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### 2.3 INTRODUCTION - ACCEPTANCE

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#### ACCEPTANCE:

- Acceptance - Act of giving consent to the proposal
- How Made - Express - oral or written
  - Implied (Castile Vs Carbolic smoke Ball Co.)
- Who can accept - Specific offer – Only by the person to whom it is
  - General offer – By anyone complying with the terms of the offer (Castile Vs Carbolic smoke Ball Co.)

#### ESSENTIALS OF A VALID ACCEPTANCE :

- Acceptance must be absolute and unqualified
- 2. It must be communicated
- 3. It must be according to the mode prescribed
- It must be given within the time specified or within reasonable time
- It must be in response to offer
- It must be made before the offer takes
- It must be given by the person to whom the offer is made.

#### COMMUNICATION OF OFFER, ACCEPTANCE AND REVOCATION :

- Offer must be communicated to the offeree and the acceptance must be communicated to the offeror.
- Revocation of offer by the offeree to the offeror and revocation of the acceptance by the offeree to the offeror must be communicated.
- Communicative of the proposal is complete when it comes to the knowledge of the person to whom it is made.
- Completion of communication of aspects has two accepting they are: (i) as against the propose and (ii) as against the acceptor

### **The communication of acceptance is complete**

- (i) As against the proposer when it is put into a couple of transmission to him so as to be out of the power of the acceptor
- (ii) As against the acceptor when it comes to the knowledge to the proposer.

### **The communication of a revocation (of an offer or an acceptance) is complete**

- (i) as against the person who make it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it.
- (ii) As against the person to whom it is made when it comes to his knowledge.
- (iii) A proposal may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the essentials of a valid acceptance.**

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#### **2. Discuss the communication of offer, acceptance and revocation :**

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## 2.4 SOME USEFUL BOOKS

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- **K.C.Garg., V.K.Sareen, Mukesh Sharma & R.C.Chawla**  
- “Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws and other Laws”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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## 2.5 ANSWER TO CHECK YOUR PROGRESS EXERCISE

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### Check Your Progress – 1

1. See section 2.2

### Check Your Progress – 2

1. See Section 2.3



## UNIT 3: CONSIDERATION

### Structure

- 3.1 Objectives
- 3.2 Introduction of Consideration
- 3.3 Essentials of Valid Consideration
- 3.4. Consideration No Contract
- 3.5 Some Useful Books
- 3.6 Answer to Check Your Progress Exercise

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### 3.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a consideration
- Understand the essentials elements of valid consideration.
- Describe the term of 'consideration no contract.

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### 3.2 INTRODUCTION

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#### MEANING :

Consideration is an essential element in a contract. It is the sign and symbol of every bargain subject to certain exceptions. An agreement made without consideration is void. Consideration is the necessary evidence required by law of the intention' of the parties to effect their legal relations.

All contracts require consideration to support them: Consideration means the valuable considerations (i.e) the price paid for the other party's promise. Contract results where one party promises to do in exchange for something in return. Consideration is otherwise known as "something in return." In a nutshell consideration is the price paid by the promisee for the obligation of the promissory.

#### Example

(i) 'P' agrees to sell his land for Rs.2.00.000 to 'Q'. For 'P's promise. the consideration is Rs.2.00.000. For 'Q's promise, the consideration is the house.

(ii) 'X' promises not to file a suit against 'Y' if 'Y' pays him Rs. 10.000 on a particular date. 'X's act of not filing a case against 'Y' is the consideration for 'Y' and Rs.10, 000 is the consideration for 'X'. If there is no consideration there is no contract.

## DEFINITION :

Sec. 2(d) of Contract Act defines consideration as follows:

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

## TYPES OF CONSIDERATION

Past consideration  
Present Consideration and  
Future consideration.

### Past Consideration:

When the consideration of one party was given before the date of the promise. it is said to be past.

#### For Example :

X' does some work for 'Y' in the month of January and 'Y' promised him to pay some money during February. The consideration of 'X' is past consideration. Under English law past consideration will make the contract invalid. But under Indian law a past consideration is good consideration because the definition of consideration in Sec. 2(d) includes the words "has done or abstained from doing."

### Present Consideration:

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

### Future Consideration:

When the consideration is to move at a future date it is called future consideration or executory consideration.

## Check Your Progress – 1

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### 1. Discuss the meaning of consideration.

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## 2. Discuss the definition of consideration.

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## 3. Discuss the types of consideration.

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### 3.3 ESSENTIALS OF VALID CONSIDERATION

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- **Consideration Must Move at the Desire of the Promisor:**

The act done or loss suffered by the promisee must have been done or suffered at the desire of the promisor. An act done without any request is a voluntary act and does not come within the definition of consideration.

**Example:** The collector of a district asked 'D' to spend money on the improvement of a market and he did so. 'D' cannot demand payment from the shopkeepers using the market for having improved the market. *Durga Prasad Vs Baldeo*.

- **It must be a real consideration:**

The consideration must have some value in the eyes of law. It must not be illusory. The impossible acts or non-existing goods cannot support a contract. A contribution to charity is without consideration. A Promise to pay an existing debt within due date if the creditor gives a discount is without consideration and the discount cannot be enforce.

- **Public Duty:**

"Where the promisee is already under an existing Public duty an express promise to perform or performance of that duty will not amount to Consideration.

**Example:** A contract to pay a sum to a witness who has already received some money to appear at a trial is invalid.

- **Promise to a Stranger:**

A Promise made to a stranger to perform an existing contract, is enforceable because the promisor undertakes a obligation upon himself which can be enforced by the stranger.

**Example:** 'X' wrote to his nephew 'B'. promising to pay him an annuity of 150 pounds in consideration of his marrying 'C'. 'B' was already engaged to marry 'C'. *Held* the fulfilment of B's contract with 'C' was consideration to support X's promise to pay the annuity. *Shadwell Vs Shadwell*.

▪ ***Consideration need not be adequate:***

Sec. 25 provides that "An agreement to which the consent of the party is freely given is not void merely because the consideration is inadequate." Law requires the presence of consideration but, does not inquire into the adequacy.

**Example:** 'P' agrees to sell a house worth Rs. 5,00,000 for Rs. 1,00,000. P's consent to the agreement was freely given. The agreement is valid in spite of inadequate consideration.

▪ ***The consideration must not be illegal, immoral or opposed to public Policy:***

If the consideration of the object of the agreement is illegal, immoral or opposed to public Policy, the agreement to contract is invalid.

**Example:** 'X' agreed to Pay Rs. 50,000 to 'Y' if he kills 'C'.

▪ ***The consideration may be past, present and future***

▪ ***The consideration may move from the Promisee or from any other Person:***

A person has given some properties to his wife 'C' directing her at the same time to pay an annual allowance to his brother 'R'. 'C' also entered into an agreement with 'R' promising him to pay the allowance. This agreement can be enforced by 'R' even-though no part of consideration received by 'C' moved from 'R'.

**Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss the essentials of consideration.**

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**3.4 CONSIDERATION NO CONTRACT**

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**EXCEPTIONS TO THIS RULE?**

A Promise without consideration is a gratuitous undertaking and cannot create a legal obligation. Under Roman law an agreement without consideration was called a '*nudum Pactum*' and was unenforceable. Under English law simple contracts must be supported by consideration but special contracts require no consideration. Under Indian law, the presence of consideration is, as a rule essential to the validity of contracts.



- (i) The agreement is made by a written document
- (ii) The demand is registered according to the law relating to registration in force at that time.
- (iii) The agreement is made on account of natural love and affection.
- (iv) The Parties to the agreement stand in a near relation to each other.

**Examples:**

An agreement entered into by a husband with his wife during quarrels and disagreement, whereby the husband promised to give some property to his wife. The agreement is void because, under the circumstances, there is no natural love and affection between the parties.

**Voluntary Compensation:**

Sec. 25(2) applies when there is a voluntary act by one party and there is a subsequent promise (by the party benefitted) to pay compensation to the former. The term 'voluntary' Signifies that the act was done, "otherwise than at the desire of the promisor". This kind of promise without any consideration is valid.

**Example:**

'D' finds B's baggage and gives it to him. 'B' promises to give 'D' Rs. 100. This is a valid contract.

**Time-barred debt:**

'A's promise to pay, wholly or in part, a debt which is barred by the law of limitation can be enforced if the promise is in writing and is signed by the debtor or his authorised agent. Sec. 25(3).)

**Example:**

'D' owes 'B' Rs. 10,000 but the debt is barred by the Limitation. 'D' signs a written promise to pay 'n' Rs. 5000 on account of tile debt. This is a contract.

**Agency:** No consideration is required to create an agency. (Sec.185).

**Completed Gift:**

According to Sec. 25 'No consideration No contract' rule does not apply to completed gifts). If a person transfers certain property to another by a written and registered deed according to the provisions of Transfer of property Act, he cannot subsequently claim back that property on the ground of lack of consideration.

Can a person who is stranger to consideration sue upon it? Normally, the rule is that the consideration must move from the promisee and the party to a contract can sue. In other words, a stranger to a consideration cannot sue.

**Example:**

Suppose 'A', a doctor, agrees to treat 'B', but as 'A' will not accept payment, 'B' promises 'C' (A's son) that he will pay him Rs. 5,000, 'C' cannot maintain a suit on the promise because he is a stranger to the consideration and the fact of C being the son of A will not alter the position.

Under Indian law consideration may move from the "Promisee or any other Person". So it is clear that the consideration can move from any person. There are certain differences between the rights of a stranger to a contract and stranger to consideration. A stranger to contract i.e. one who is not a party to it, cannot file a suit to enforce it. A contract between 'P' and 'Q' cannot be enforced by 'R'.

But a stranger to consideration can sue to enforce it provided he is a party to the contract. A contract between 'P', 'Q' and 'R' whereby 'P' pays money to 'g' -for delivering goods to 'R' can be enforced by 'R' although he did not pay any part of the consideration.

### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss what are the exceptions in consideration.**

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### **3.5 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

### **3.6 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

#### **Check Your Progress – 1**

1. See section 3.2

#### **Check Your Progress – 2**

1. See Section 3.3

#### **Check Your Progress – 3**

1. See Section 3.4

## UNIT 4:

# CAPACITY OF PARTIES

### Structure

- 4.1 Objectives
- 4.2 Introduction
- 4.3 Some Useful Books
- 4.4 Answer to Check Your Progress Exercise

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### 4.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a capacity of parties
- Understand the meaning of Minor.
- Describe the legal rules regarding Minor Agreement.

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### 4.2 INTRODUCTION

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#### CAPACITY DEFINED:

According to Sec. 10, an agreement becomes a contract if it is entered into between the parties who are competent to contract. 'Capacity' referred to here, means competence of the parties to enter into a valid contract. Capacity includes physical and mental capacity.

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

From this definition we come to the conclusion that the following are not competent to contract:

- A person who has not attained the age of majority.
- A person who is of unsound mind, e.g. lunatic or an insane person.
- Any other person who has been disqualified from contracting under any law, e.g. a person who has been adjudicated an insolvent.

## **MINOR:**

Under Section 3 of the Indian Majority Act, 1875, a minor is one who has not completed eighteenth year of age. It may be stated here that a minor whose property has been entrusted to a guardian by a court, attains the age of majority when he completes twenty one years of age. In England, minority continues up-to the completion of 21<sup>st</sup> year.

## **THE LEGAL RULES REGARDING MINOR'S AGREEMENT :**

- **Minor's Agreement is Void-ab-initio: (void from the very beginning):**

Today an agreement with or by minor is void and inoperative. Formerly, the position was not clear. The Indian Contract Act, does not expressly state whether a contract made by a minor is void or voidable. Sec. 11 of the Act simply states that a minor is not competent to contract. Following the English law, it was held formerly that a minor's contract was voidable but not void. The issue came up again in the case of *Mohori Bibi Vs Dharmadas Chose*.

In this case, a minor executed an agreement for Rs.20, 000 and received Rs. 8,000 from a mortgagee by way of earnest money. He sued for setting aside the mortgage. The lender wanted refund of the sum which he had actually paid. Held an agreement by a minor was absolutely void and therefore, the question of refunding the money did not arise. Had the agreement been only voidable, the benefit received would have been refunded under Sections 64 and 65 of the Act.

- **A Minor can be a Promisee or a Beneficiary:**

During his minority, a minor cannot bind himself by a contract. But there is nothing in the contract act which prevents him from making the other party to the contract to be bound to the minor. Thus, a minor is incapable of making mortgage, or a promissory note. But he is capable of becoming a mortgagee, a payee or endorsee. He can derive benefit under the contract.

- **A Minor's Agreement cannot be Ratified by the Minor on his attaining Majority:**

A minor cannot ratify the agreement on attaining the age of majority as the original agreement is totally void from the beginning, and, therefore, validity cannot be given to it later or)

**Example:**

*Indira Ramasamy V Anthiappa Chettiar*. 'A', a minor makes a promissory note in favour of 'B'. On attaining majority, he makes out a fresh promissory note in place of the old one. Neither the original nor the fresh promissory note is valid.

- **If a Minor has Received any Benefit Under a Void Contract he Cannot be Asked to Refund the Same:**

We have already mentioned the facts in Mohiri Bibi's case. In that case, the lender could not recover the money paid to the minor. Also the property mortgaged by the minor in favour of the lender could not be sold by the latter for the realisation of his loan.

- **A Minor is Always Allowed to Plead Minority:**

He is not prevented from this right even where he had procured a loan or entered into some other contract by falsely representing that he was of full age. Thus, a minor who has deceived the other party to the agreement by representing himself as of full age is not prevented from later asserting that he was a minor at the time he entered into agreement.

**Examples:**

Leslie V Shiell'S', a minor, borrowed £ 400 from L, a money lender, by fraudulently misrepresenting that he was of full age. On default by 'S', 'L' sued for return of £ 400 and damages for the crime. Held, 'L' could not recover £ 400, and his claim for damages also failed. Even on equitable grounds, the minor could not be asked to refund £ 400, as the money was not traceable as the minor had already spent it.

In the case of a fraudulent misrepresentation of his age by the minor, inducing the other party to enter into a contract, if money could be traced the court may award compensation to that other party under Sections 30 and 33 of the Specific Relief Act, 1963.

- **A Minor Cannot be a Partner in a Partnership Firm:**

He cannot become a partner but 'for the benefit of the partnership with the consent of all the partners he can be admitted as a partner. Other partners cannot file a case against the minor partner if the latter commits any offence.)

- **A Minor's Estate is Liable to a Person Who Supplies Necessaries of Life to a Minor:**

However there is no personal liability on a minor for the necessaries of life supplied). The term 'necessaries' is not defined in the Indian Contract Act 1872. But the English Sale of Goods Act defines necessaries as "goods suitable to the condition in life of the minor and to his actual requirements at the time of sale and delivery".

From the above definition it is very clear that in order to entitle the supplier to be reimbursed from the minor's estate, the following conditions must be fulfilled:

1. The goods are 'necessaries' for that particular minor having regard to his status.

**For example,** Purchase 'of a car may be a necessity for a particular minor and may not hold good for the other person.

2. The minor needs the goods both at the time of sale and delivery.

**Example:**

Nash V Inman: I. a minor, was studying B.C.S., in a college. He ordered 11 fancy coats for about £45 with N, the tailor. The tailor sued I for the price. I's father proved that his son had already a number of coats and had clothes suitable to his condition in life when the clothes made by the tailor were delivered. Held the coats supplied by the tailor were not necessities and, therefore tailor cannot get the price.

The minor's estate is liable not only for the necessary goods but also for the necessary services rendered to him. The lending of money to a minor for the purpose of defending a suit on behalf of a minor in which his property is in jeopardy or for defending him in prosecution, or for saving his property from sale in execution of decree is deemed to be a service rendered to the minor. Other examples of necessary services rendered to a minor are: Provision of education, medical and legal advice, provision of a house on rent to a minor for the purpose of living and continuing his studies.

- Minor's parents' or guardians are not liable to a minor's creditors for the breach of contract by the minor, whether the contract is for necessities or not. But the parents are liable where the minor is acting as an agent of the parents or the guardian.
- A minor can act as an agent and bind his principal by his acts without incurring any personal liability.

▪ **No Specific Performance:**

An agreement by a minor being void, the court can never direct specific performance of such an agreement by him.

▪ **No Insolvency:**

A minor cannot be declared insolvent even though there are dues payable from the properties of the minor.

▪ **A Company Shares of a Minor:**

A minor cannot apply for and be a member of a company. If a minor has, by mistake been recorded as a member, the company can rescind the transaction and remove the name from the register. But where a minor was made a member and, after attaining majority, he received and accepted dividends, he will be stopped from denying that he is a member. *Fazalbhoy V The Credit Bank of India.*

'A' threatens to kill 'B' if he does not transfer all his property in 'A's favour for a very low price, The agreement is voidable for being the result of coercion. It is not necessary that coercion must have been exercised against the promisor only, it may be directed at any person.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the meaning of capacity of parties.**

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#### **2. Discuss the legal rules regarding the minors agreement.**

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### **4.3 SOME USEFUL BOOKS**

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### **4.4 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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#### **Check Your Progress – 1**

1. See section 4.2

## UNIT 5:

### FREE CONSENT

#### Structure

- 5.1 Objectives
- 5.2 Introduction – Free Consent
- 5.3. Coercion
- 5.4. Undue Influence
- 5.5. Fraud
- 5.6 Misrepresentation
- 5.7. Mistake
- 5.3 Some Useful Books
- 5.4 Answer to Check Your Progress Exercise

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#### 5.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a Free consent
- Understand the consent is not free if it is caused by Coercion, Undue influence, Fraud, Misrepresentation and Mistake.

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#### 5.2 INTRODUCTION

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##### DEFINITION OF FREE CONSENT:

An agreement is valid only when it is the result of free consent of all the parties to it. Sec. 13 of the Act defines the meaning of the term 'consent' and Sec. 14 of the Act specifies under what circumstances consent is "free".

Sec. 13 "Two or more persons are said to consent when they agree upon the same thing in the same sense." Consent involves a union of the wills and an accord in the minds of the parties. When the parties agree upon the same thing in the same sense, they have consensus-ad-idem for a valid contract the parties must have "Identity of mind." Sec.14. this section lays down that consent is not free if it is caused by



- Coercion,
- Undue influence,
- Fraud.
- Misrepresentation and
- Mistake

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### 5.3 COERCION

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#### DEFINITION:

Coercion is defined by Sec.15 of the Act as follows: “Coercion is (1) the committing or threatening to commit, any act forbidden by the Indian Penal Code, or (2) Unlawful or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

#### Examples:

- A Hindu widow is forced to adopt ‘X’ under threat that her husband’s dead body would not be allowed to be removed unless she adopts ‘X’. The adoption is voidable as having been induced by coercion.
- ‘A’ threatens to kill ‘B’ if he does not transfer all his property in ‘A’s favour for a very low price. The agreement is voidable for being the result of coercion.

It is not necessary that coercion must have been exercised against the promisor only, it may be directed at any person.

#### Examples :

- ‘A’ threatens to beat ‘B’ (C’s Son) if ‘C’ does not let his house to ‘A’, The agreement is caused by coercion though ‘X’ is a stranger to the transaction,
- ‘X’ threatens to kill ‘Y’ if he does not sell his house to ‘B’ at a very low price. The agreement is caused by coercion though ‘X’ is a stranger to the transaction.

Further, it is immaterial whether the Indian penal code is or is not in force in the place where the coercion is employed.

#### Example:

- ‘A’. on board an English ship on the high seas, causes ‘B’ to enter .’ into an agreement by an act amounting to criminal .intimidation under the Indian penal code. ‘A’ afterwards sues ‘B’ for breach. of contract at Calcutta. ‘A’ has employed coercion, although his act is not an offence by the law of England, and although the Indian penal code was not in force at the time or place where the act was done.

#### THREAT TO COMMIT SUICIDE - IS IT COERCION?

As per Section 15 "Committing or threatening to commit any act forbidden by the Indian penal code is coercion." As the act of suicide is forbidden by the IPC a threat to commit suicide must be treated as coercion.

## **DURESS:**

The English equal of coercion is Duress. Duress has been defined as causing, or threatening to cause, bodily violence or imprisonment, with a view to obtain the consent of the other party to the contract. Duress differs from coercion on the following points:

- 'Coercion' can be employed against any person whereas 'duress' can be employed only against the other party to the contract .or members of his family.
- 'Coercion' may be employed by any person, and not necessarily by the promisee. 'Duress' can be employed only by the party to the contract or his agent.
- 'Coercion' is wider in its scope and includes unlawful detention of goods also. 'Duress' on the other hand does not include unlawful detention of goods. Only bodily violence or imprisonment is duress.

## **CONSEQUENCES OF COERCION:**

- Sec.19: When consent to an agreement is caused coercion the agreement is a contract voidable at the option of the party whose consent was so obtained. In other words, the affected party can have the contract cancelled or if he so desires to insist on its performance by the other party.
- Sec. 72: A person to whom money has been paid or anything delivered under coercion must repay or return it.

### **Example:**

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

## **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss about the coercion.**

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## **5.4 UNDUE INFLUENCE**

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### **DEFINITION:**

A contract is said to be induced by undue influence where,

- (i) One of the parties is in a position to dominate the will of the other, and
  - (ii) He uses the position to obtain an unfair advantage over the other, Sec.16(1) Sec 16
- (2) provides that undue influence may be presumed to exist in the following cases:

(i) Where one party holds a real or apparent authority over the other or where he stands in a fiduciary relationship to the other. Fiduciary relationship means a relationship of mutual trust and confidence. Such a relationship is supposed to exist in the following cases - father and son; guardian and ward; solicitor and client; doctor and patient; saint and disciple; trustee and beneficiary etc.

(ii) Where a party makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress.

**Example:**

'F' having advanced money to his son 'B' during his minority, upon B's coming of age obtains by misuse of parental influence, a bond from B for a greater amount than the sum advanced. 'F' employs undue influence.

**CONSEQUENCES OF UNDUE INFLUENCE:**

An agreement caused by undue influence is a contract voidable at the option of the party whose consent was obtained by undue influence (Sec. 19A)

**Example:**

'A', a money-lender advances Rs. 100 to 'B' an agriculturist and by undue influence induces 'B' to execute a bond for Rs. 200 with interest at 6 percent per month. The court may set the bond aside, ordering 'B' to repay Rs.100 with such interest as may seem just.

**Burden of Proof (Sec:16(3)):**

If a party is proved to be in a position to dominate the will of another and the transaction appears on the face of it or on the evidence adduced to be unconscionable, the burden of proving that the contract was not induced by undue influence, lies on the party who was in a position to dominate the will of the other.

**Undue Influence is suspected in the following cases:**

1. Inadequacy of consideration
2. Fiduciary relationship between the parties.

Inequality between the parties as regards age, intelligence, social, social status, etc.  
Absence of independent advisors for the weaker party.

**Unconscionable bargains:**

Unconscionable bargain is one which is against the conscience of reasonable persons and what shocks the public. If excessive profit is made it will also fall within this term.

**High rates of Interest:**

It is usual for money lenders to charge 'High rates of interest' from needy borrowers, can the court presume the existence of undue influence in such cases?

**Illustration:**

'A' applies to a banker for a loan at a time when there is an acute shortage in the money market. The banker declines to sanction the loan at the prevailing rate of interest. 'A' accepts the loan for a very high interest rate. Held, this is a transaction in the ordinary course of business and the contract is not induced by undue influence.

So a transaction will not be set aside merely because the rate of Interest is high. But if the rate is so high that the court feels it is unconscionable, the burden of proving that there was no undue influence lies on the creditor.

In India, in most of the states, there are Moneylender's Acts which lay down the maximum rates of interest which can be charged. Also, under Usurious Loans Act of 1918, the court has discretionary powers to reduce rates of interest whenever they appear to be unconscionable.

**Example:**

A poor Hindu widow was badly in need of money for her maintenance. A money lender availed of the opportunity of her predicament and persuaded her to make an agreement to pay 100% interest. The court reduced the interest.

**Pardanishin Women:**

Women who observe the custom of Parda i.e. seclusion from contact with people outside her own family, are peculiarly susceptible to undue influence. Therefore, Indian courts have held, that a contract made by or with a pardanishin lady may be set aside by her unless the other party to the contract satisfies the court that the terms of the contract were fully explained to her and that she understood their implications.

**DIFFERENCE BETWEEN UNDUE INFLUENCE AND COERCION:**

- In both undue influence and coercion. One party is under the influence.
- In Coercion the influence arises from committing or threatening to commit an offence punishable under the IPC or detaining or threatening to detain property unlawfully.
- In undue influence, the influence arises from the domination of the will of one person over another.
- Cases of coercion are mostly cases of the use of physical forces. But in undue influence it is a question of mental pressure.

**Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

## 1. Discuss about the Undue-influence.

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### 5.5 MISREPRESENTATION

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#### DEFINITION:

Representation is a statement or assertion made by one party to the other, before or at the time of the contract, regarding some fact relating to it. Misrepresentation arises when the representation made is inaccurate and is not due to any desire to defraud the other party. There is no intention to deceive.

Section 18 of the Contract Act classifies cases of misrepresentation into three groups as follows :

- The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true.

#### Example:

'X' learns from 'A' that 'Y' would be director of a company to be formed. 'X' tells this to 'B' in order to induce him to purchase shares of that company and 'B' does so. This is misrepresentation by 'X' though he believed in the truthfulness of the statement and there was no intent to deceive as the information was derived not from 'Y' but from 'A' and was mere hearsay.

- Any breach of duty which, without an intent to deceive, gives an advantage to the person committing it, or anyone claiming under him by misleading another to his prejudice or to the prejudice of anyone claiming under him. Under this heading would fall cases where a party is under a duty to disclose certain facts and does not do so and thereby misleads the other party. In English law such cases are known as cases of "constructive fraud".
- Causing however, innocently, a party to an agreement to make a mistake as to the substance of a thing which is the subject of the agreement.

#### CONSEQUENCE OF MISREPRESENTATION:

In cases of misrepresentation the party aggrieved can, avoid the agreement, or insist that the contract be performed and that he be put in the position in which he would have been if the representation made had been true.

**Example:**

'A' informs 'B' that his estate is free from encumbrance. 'B' thereupon buys the estate, In fact, unknown to 'A', the estate is subject to mortgage. 'B' may either avoid the contract or may insist on its being carried out and the mortgage debt be redeemed.

In case of misrepresentation the aggrieved claim compensation or damages from the other person. This however, is subject to certain exceptions these are:

**Breach of Warranty of authority by an agent:**

Where an agent believes that he has the authority to represent his principal while in fact he has no such authority, the agent is liable for damages even though he is only guilty of innocent misrepresentation.

**Misstatement in Prospectus:**

The directors of a company are liable for damages under Sec. 62 of the Companies Act, 1956 for innocent misrepresentation made in the prospectus.

**Negligent representation:**

Made by one person to another between whom confidential relationship exists.

However, if the aggrieved party whose consent was caused by misrepresentation had the means of discovering the truth with ordinary diligence, he has no remedy.

**Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss about the Misrepresentation.**

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**5.6 FRAUD**

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**DEFINITION:**

The term 'fraud' includes an acts committed by a person with a view to deceive another person. To “deceive” induce a man to believe that a thing is true which, is false”.

Sec. 17 of the Contract Act states that 'Fraud' means and includes any of the following acts committed by a party to a contract (or with his connivance or by his agent) with intent to deceive another party thereto or his agent; or to induce him to enter into a contract.

**False Statement :**

The suggestion as to a fact that which is not true by one who does not believe it to be true. "If a false statement is intentionally made it is fraud".

**The Active Concealment:**

The active concealment of fact by one having knowledge or belief of the fact. "Mere non-disclosure is not fraud where the party is not under any duty to disclose all facts. But active concealment is fraud.

**Examples :**

- 'B' having discovered a vein of ore on the estate of 'A', decided to conceal the existence of ore from, 'A'. With 'A's Ignorance, 'B' contracted with 'A' to buy the estate at an under value. The contract is voidable at the option of 'A'.
- "A" sells by auction to 'B' a horse which 'A' knows to be unsound. 'A' says nothing to 'B' about the horse's unsoundness, This is not and because 'A' is under no duty to disclose the fact to 'B', But If between 'A' and 'B' there exists a fiduciary relationship (If 'B' is 'A's daughter) here arises the duty to disclose and non-disclosure amounts to fraud.

**Intentional non-performance:**

"A promise made without any intention of performing it" (e.g. Purchase of goods without any intention of paying for them) is fraud.

**Fraudulent act or omission :**

"Any such act or omission as the law specially declares to be fraudulent". This clause refers to provisions in certain acts which make it obligatory to disclose relevant facts. e.g. under Sec. 55 of the Transfer of Property Act, the seller of immovable property is bound to disclose to the buyer all material defects. Failure to do so amounts to fraud.

**From the analysis of the above we can say that for fraud to exist there must be:**

- A representation or assertion, and it must be false.
- The representation or assertion must be of a fact.

**Example:**

'A' a seller of a horse says that the horse is a "Beauty" and is worth Rs. 5000. It is merely 'A's opinion. It is not a matter of fact. The representation or statement must have been made with a knowledge of its falsity or without belief in its truth or recklessly.

**Example:**

A company issue a prospectus giving false information about the un bounded wealth of Nevada. A share broker who took shares on the faith of such an information wanted to avoid the contract, Held he could do so since the false representation in the prospectus amounted to fraud.

- The representation must have been made with the intention of including the other party to act upon it.
- The representation must in fact be to deceive.

**Example:**

'A' by misrepresentation leads 'B' erroneously to believe that 500 kilos of indigo are made annually at 'A's' factory, 'B' examines the accounts of the factory, which shows that only 400 kilos have been made. After this 'B' buys the factory. The contract is not voidable on account of 'A's' misrepresentation.

- The party subjected to fraud must have suffered some loss.

### **CAN SILENCE BE FRAUDULENT?**

- The general rule is that mere silence is not fraud.

**Example:**

'H' sold to 'W' some pigs which were to his knowledge suffering from swine fever. The pigs were sold "With all faults" and 'H' did not disclose the fever to 'W'. Held, there was no fraud. '

- Silence is fraudulent "if the circumstances of the case are such that regard being had to them, it is the duty of the person keeping silence to speak." Whenever there is a duty to disclose, silence amounts to fraud.
- Silence is fraudulent where the circumstances are such. Silence is in itself equivalent to speech'.

### **CONSEQUENCES OF FRAUD**

A party who has been induced to enter into an agreement by fraud has the following remedies open to him: (Section 19)

- He can avoid the performance of the contract.
- He can insist that the contract shall be performed and that he shall be put in the position in which he would have been if the representation made had been true.
- The aggrieved party can sue for damages.

### **DISTINCTION BETWEEN FRAUD & MIS-REPRESENTATION :**

- In case of fraud the party making a false representation makes it with the intention to deceive the other party to enter into a contract. Misrepresentation on the other hand is innocent i.e. without any intention to deceive or to gain an advantage.
- In case of fraud, the aggrieved party can sue the person who made the false statement, for, damages. But in case of misrepresentation except in certain cases, the only remedy is rescission and restitution.
- In case of fraud the person who made the false statement cannot argue that the aggrieved person had the means of discovering the truth or could have done so with ordinary diligence.



### **Check Your Progress – 4**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about the Fraud.**

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### **5.7 MISTAKE**

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#### **Definition:**

Mistake may be defined as an erroneous belief concerning consent cannot be said to be 'free' when an agreement is entered into under a mistake, Mistake is of two kinds:

- Mistake of law
- Mistake of Fact

#### **MISTAKE OF LAW:**

Mistake on a point of Indian law does not affect the contract. Mistake on a part of law in force in a foreign country is to be treated as mistake of fact.

#### **Example:**

'A' and 'B' make a contract based on the erroneous belief that a 'particular debt is barred by the Indian law of limitation. This is a valid contract. The reason is that every man is presumed to know the law of his own country and if he does not he must suffer the consequence of such lack of knowledge. But if in the above case, the mistake is related to the law of limitation of a foreign country, the agreement could have been avoided (Sec. 20).

#### **MISTAKE OF FACT:**

An agreement induced by mistake of fact is void, Mistake of fact may be,

- a bilateral mistake
- a unilateral mistake

#### **Bilateral Mistake:**

When both the parties to the agreement are under a mistake of fact essential to the agreement. The mistake is called a bilateral mistake of fact and the agreement is void (Sec.20), for the application of Sec.20 the following two conditions are to be fulfilled.

- i) The mistake must be mutual
- ii) The mistake must relate to a matter of fact essential to the agreement.

**Examples:**

- 'A' agrees to buy from 'B' a horse. It turns out that, the horse was dead at the time of bargain, though neither party was aware of fact. The agreement is void.
- 'A' agrees to sell to 'B' a specific cargo of goods supposed to be on its way from England to Bombay. It turns out that, before the day of the bargain, the ship carrying the cargo has been washed away and the goods lost. Neither party was aware of the fact. The agreement is void.

Mistake so as to render the agreement void, must relate to some essential matter. Some typical cases of mistake invalidating the agreement are given below:

**Mistake as to the subject matter:*****(a) Mistake as to the Existence of Subject-matter:***

If both the parties believe that the subject-matter of the contract to be in existence, which in fact at the time of the contract is non-existent, the contract is void.

**Example:**

'A' agreed to purchase 'B's car which was lying in 'B's garage. Unknown to either party the car and the garage were, completely destroyed by fire a day earlier. The agreement is void.

***(b). Mistake as to identity of the subject-matter:***

Where the parties agree upon different things, i.e. One party intends to deal in one thing and the other intends to deal in another.

**Example:**

'A' who owns three cars of different colours, offers to sell his white colour car for Rs.1,00,000. 'B' accepts the offer thinking 'A' is selling his green colour car. There is a mistake as to the Identity of the subject - matter and hence no contract.

***(c) Mistake as to Title to the subject matter:***

Where the parties believe that the seller is the thing which he purports to sell, but in fact, h has no title to it, the contract is void on the ground of mistake.

**Example:**

A person took a lease of a fishery which, unknown to either party already belonged to him. Held, the lease was void.

***(d) Mistake as to the quality of the Subject-matter:***

If the subject matter is something different from what the parties thought it to be, the agreement is void.

**Example:**

Table napkins were sold at an auction by a description, "with the crest of Charles I and the authentic property of that monarch." in fact napkins were Georgian. Held, the agreement was void as there was a mistake as to the quality of the subject-matter.

***(e) Mistake as to the quantity of the subject-matter:*****Example:**

'P' wrote to 'H' enquiring the price of rifles and suggested that he might buy as many as 50. On receipt of the information, he telegraphed "Send three rifles". But because of the mistake of the telegraph authorities the message transmitted was "send the rifles". 'H' despatched 50 rifles. Held, 'there was no contract between the parties. However, 'p' could be held liable to pay for. three rifles on the basis of an implied contract.

***(f) Mistake as to the price of subject matter:***

Where a contract of lease of a house was agreed to at a lease of \$ 230 but in written agreement the figure \$130 was inserted by mistake, the contract was held to be void. But an erroneous opinion as to the value of the subject matter of the agreement is not to be deemed a mistake as to a matter of fact.

**Example:**

'A' buys an article thinking it is worth Rs. 10,000 while it is actually worth Rs.500 only. The agreement cannot be avoided on the ground of mistake,

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

If both the parties believe that an agreement is capable of being performed when in fact this is not the case" The agreement in such a case is void on the ground of impossibility.

***Impossibility may be,***

**(i) Physical impossibility:**

Example: A contract for the hire of a room for Witnessing the coronation procession of Edward VII was held to be void because, unknown to the parties the procession had already been cancelled.

**(ii) Legal Impossibility:**

A contract is void if it provides that something be done which cannot as matter of law, be done.

**Unilateral Mistake:**

In case of unilateral mistake i.e. where only one party to a contract is under a mistake, the contract, generally speaking is not invalid. Sec. 22 reads, "A contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact."

**TO THE ABOVE RULE, THERE ARE CERTAIN EXCEPTIONS:**

**(a) Where the unilateral mistake is as to the nature of the contract:**

A contract is void when one of the parties to it does not intend to enter into it, but through the fault of another and without any fault of his own makes a mistake as to the nature of the contract.

**Example:**

An old illiterate man was made to sign a bill of exchange by means of a false representation that it was a guarantee. Held, the contract was void.

**(b) Mistake as to quality of the promise:**

An auction was held for the sale of some lots of hemp (quality natural fibre) and some lots of tow (broken inferior fibre). Mr. B thinking that hemp was being sold. Bid for a lot of tow for an amount which was not proportioned to it, and was only fair price for hemp. Held, contract could be avoided.

**(c) Mistake as to the identity of the person contracted with:**

Where 'A' intends to contract with 'B' but by mistake enters into a contract with 'C' believing him to be 'B', the Contract is void on the grounds of mistake.

**Example :**

Mr. 'X' of Blenkarn. by imitating the signature of a reputed firm called Blenkiron and Co. Induced another firm 'Y' to supply goods to him on credit. The goods were then sold to 'X' of Blenkarn. Held. there was no contract between 'X' of Blenkarn and 'Y' because 'Y' never intended to supply to Blenkarn. Therefore 'X' of Blenkarn obtained no title to the goods. But if the goods are sold for cash then that is a valid contract.

**CONSEQUENCES OF MISTAKE:**

Mistakes render a contract void ab initio as such in case of a contract which is yet to be performed the party complaining of the mistake may avoid it. i.e. need not perform it. If the contract is executed, the party who received any advantage must restore it or make compensation for it, as soon as the contract is discovered to be void.

**Check Your Progress – 5**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss the meaning of Mistake.**

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**2. Discuss different kinds of mistake.**

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### **5.3 SOME USEFUL BOOKS**

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### **5.4 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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#### **Check Your Progress – 1**

1. See section 5.3

#### **Check Your Progress – 2**

1. See section 5.4

#### **Check Your Progress – 3**

1. See section 5.5

#### **Check Your Progress – 4**

1. See section 5.6

#### **Check Your Progress – 5**

1. See section 5.7



## UNIT 6:

# LEGALITY OF OBJECT AND CONSIDERATION

### Structure

- 6.1 Objectives
- 6.2 Introduction
- 6.3 Agreements opposed to public policy
- 6.4 Some Useful Books
- 6.5 Answer to Check Your Progress Exercise

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### 6.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a Legality of object and consideration.
- Understand when the legality of object and consideration becomes unlawful.
- Describe the agreements opposed to public policy.

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### 6.2 INTRODUCTION

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According to Section 23 of the Indian Contract Act, **an agreement of which the object or consideration is unlawful is void**. 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 things

- Consideration for the agreement ;
- Object for the agreement; and
- Agreement.

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

***The object of a contract must be lawful. It becomes unlawful if:***

- (i) It is forbidden by law,
- (ii) It is such that if allowed, it would defeat the provision of law,
- (iii) It is fraudulent,
- (iv) It causes injury to a person or his property,
- (v) It is of immoral nature,
- (vi) If the court regards it as opposed to public policy.

### **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. It is forbidden by law, if the legislature penalises it or prohibits it. It is illegal and cannot become valid even if the parties act according to such agreement. Section 26, 27, 28 and 30 of the Contract Act deal with cases where the consideration or object of an agreement is considered unlawful.

An act or an undertaking is forbidden by law:

- (a) When it is punishable by criminal law of the country or.
- (b) When it is prohibited by special legislation or regulations made by a competent authority under powers derived from the legislature.

#### **Example:**

An agreement to pay consideration to a tenant to induce him to vacate premises governed by the Rent Restriction Act is illegal & cannot be enforced because such an act is forbidden by the Act.

### **2. 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. 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.

#### **Example:**

A's estate is sold for arrears of revenue under the provision' of an Act of the legislature by which the defaulter is prohibited from purchasing the estate. B, upon an understanding with A becomes the purchaser, and agrees to convey the estate to A upon receiving from him the price which B has paid. The agreement is void, as it renders the transaction, in effect a purchase by the defaulter and would so defeat the object of the

An agreement between husband and wife to live separately is invalid as being opposed to Hindu law.

### **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.

**Example:**

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

#### **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.

**Examples:**

- A asks an editor of a newspaper to publish a defamatory article against B and promises to pay Rs. 4000 for the work. The agreement is void as it involves injury to the person of B and therefore, a suit cannot be brought to recover Rs. 4000 by the editor.
- A debtor who owed Rs 100 executed a bond by which he was required to put forth manual labour until the amount was repaid and in case of default, he had to pay exorbitant interest. The court held that the contract contained in the bond is indistinguishable from slavery and as such, the contract involved injury to the person of the debtor.

#### **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.

**Examples:**

- A agrees to let her daughter to B for concubinage. The agreement is void because it is immoral.
- P advanced money to D a married woman to enable her to obtain a divorce from her husband and D agreed to marry her as soon as she obtained a divorce. It was held that P was not entitled to recover back the amount as the agreement had for its object the divorce of D from her husband.

#### **6. If the court regards it as being 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. 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. 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. Public policy is not capable of exact definition and courts do not generally go beyond the decided cases on the subject.

#### **Agreements for which object or consideration is unlawful in part (Section 24).**

Where consideration and object of an agreement is unlawful in part, and Unlawful part cannot be separated from the lawful 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 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.



## **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss the legality of object & consideration.**

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## **6.3 AGREEMENTS OPPOSED TO PUBLIC POLICY**

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### **▪ Trading with enemy**

Trading with enemy is clearly against public policy in so far as it helps the enemy to the detriment of the country. Besides, it is against national honour to indulge in such acts in times of national emergency. But where a contract is made during peace times and then war breaks out, one of the two things may result. Either the contract is suspended or it stands dissolved depending upon the intention of the parties.

### **▪ Stifling prosecutions**

It is in public interest that criminals should be prosecuted and punished. An agreement to stifle a prosecution i.e. to prevent proceedings already instituted from running their normal course or to compromise a prosecution is illegal and void. It is not open to the parties to take the administration of justice out of the hands of the authorities and themselves determine what should be done. Thus, a promise executed as consideration for compounding charge of grievous hurt is void. But an agreement for compounding of a compoundable offence is not void.

#### **Example:**

A mortgage was executed by the respondent as a part of the consideration and in return the bank promised to withdraw criminal proceedings instituted by it against the mortgagor's husband. The bond was held invalid.

But where a compromise agreement is made before any complaint is filed, it would not amount to stifling prosecution, even if it is implemented after the filing of a complaint which is then withdrawn.

#### **Example:**

A bank found that the goods in a godown, which was pledged to it against a loan, were either fraudulently overvalued or withdrawn in collusion with bank officials. The borrower agreed to make up for the deficiency by hypothecating more property. Some delay having taken place in the hypothecation, the bank filed a complaint which was withdrawn after the hypothecation was completed. It was held that the agreement was valid.

Similarly, withdrawal of a suit for judicial separation on promise of separate maintenance was not considered against public policy. Further, the withdrawal of

prosecution with good motive, for example for providing relief to the victims of a disaster was not considered to be against public policy by the Supreme Court. [Union Carbide Corporation v Union of India (1991) AIR 1992 SC 248].

▪ **Maintenance and Champerty**

Maintenance may be defined as an agreement whereby a person promises to maintain a suit in which he has no interest. 'Champerty' is an agreement whereby a person agrees to assist another in litigation in-exchange of a promise to hand over a portion of the proceeds of the action. The principles of English law on maintenance and champerty are not applicable to India. In England both kinds of agreements are illegal and unenforceable. In India, agreements to share the subject matter of litigation if recovered are not in themselves opposed to public policy unless they are extortionate and unconscionable. Thus, an agreement by a chartered accountant with his client to charge fees on the basis of percentage of the benefit received by the client in Income tax proceedings is void. The agreement for supplying funds by way of 'maintenance' or Champerty is valid; unless :

- It is unreasonable so as to be unjust to the other party or,
- It is made by a malicious motive like that of gambling, in litigation or oppressing other party by encouraging unrighteous Suits, and not with the bonafide object of assisting a claim believed to be just.

▪ **Traffic relating to public offices**

Agreements concerning the sale of public offices are bad as they promote corruption; . Section 6(f) of the Transfer of Property Act provides that a public office cannot be transferred more than the salary of a public officer.

**Example:**

A paid B, a public servant a certain amount inducing him to retire from service, thus paving the way for A to be appointed in his place. The agreement was held to be void.

▪ **Agreements tending to create interest opposed to duty**

An agreement which tends to create an interest in favour of a person which would conflict with his duty is illegal on the ground that it is opposed to public policy. It is the essence of public policy that a servant must not be deterred from doing his duty. Thus an agreement by a person in Government service for the purchase of land situated within his circle is illegal as opposed to public policy.

**Example:**

A agrees to pay B, the lieutenant colonel in the army, Rs. 50,000 if he will assist her brother to desert the army. The object of the agreement is opposed to public policy and agreement is void and illegal.

- **Marriage brocage agreements**

A marriage brocage agreement is an agreement whereby a person promises for reward to procure the marriage of another. Such agreements are void being against public policy. Thus, if A pays B, a stranger a certain sum of money to procure a wife for him, he cannot enforce the agreement as it is clearly against public policy.

**Example:**

A proposed the marriage of his widow niece to B and offered to give her gold and jewels and land. The marriage took place, but A refused to fulfill the rest of his promise. The agreement was held to be not enforceable.

- **Agreements tending to create monopolies**

An agreement to .create monopoly is void as opposed to public policy. There can be monopoly rights given to one' person to the exclusion of others, in matters, like selling of vegetables.

- **Agreements to influence elections to public offices**

Any agreement with voters tending to influence them by improper means and agreement with third persons to influence voters by indirect means are all invalid. Similarly an agreement between rival candidates that one shall withdraw in consideration of a promise by the other to appoint him to office is void.

**Example:**

A promises B, the owner of a newspaper Rs. 500 in consideration of the publication by B, in his newspaper of false statements in regard to a candidate for election. B published them. The agreement is valid as opposed to public policy.

- **Agreement in restraint of personal liberty**

A, contract which restricts the liberty of an individual is illegal.

**Example:**

A borrowed money from a moneylender and agreed that he would not without the lender's written consent leave his job, borrow money, dispose of his property or move from house. It was held that the contract was illegal as it unduly restricted the liberty of A [Harwood v. Miller's Timber and

- **Agreements interfering with marital duties**

Agreements which interfere with the performance of marital duties are void as being opposed to public policy. Thus an agreement to lend money to a woman in consideration of her getting a divorce and marrying the lender is void.

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss the Agreements opposed to public policy.**

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**6.3 SOME USEFUL BOOKS**

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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**6.4 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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**Check Your Progress – 1**

1. See section 6.2

**Check Your Progress – 2**

1. See section 6.3



# UNIT 7:

## VOID AGREEMENTS

### Structure

- 7.1 Objectives
- 7.2 Introduction
- 7.3 Wagering Agreement
- 7.4 Contingent Contract
- 7.5 Some Useful Books
- 7.6 Answer to Check Your Progress Exercise

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### 7.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a Void Agreements.
- Understand the Wagering Agreements.
- Describe the Contingent contract.

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### 7.2 INTRODUCTION

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The contract act specifically declares certain agreements to be void. A void agreement is one which is not enforceable by law [Sec-2 (g)]. Such an agreement does not give rise to any legal consequences and is totally void from the very inception.

The different kinds of void agreements under the Contract Act 1872 are given below

- Agreements made by incompetent persons. (Sec. 11)
- Agreements made where there is a mutual mistake as to a matter of fact (Sec. 20)
- Agreements made where there is a mistake as to any law in force in India (Sec. 21)
- Agreements of which consideration or object is unlawful.
- Agreements of which consideration or object is partly unlawful (Sec. 24)
- Agreements without consideration (Sec. 25)
- Agreements in restraint of marriage (Sec. 27)
- Agreements in restraint of trade (Sec. 27)
- Agreements in restraint of legal proceedings (Sec. 28)

- Agreements the meanings of which are uncertain or not capable of being made certain (Sec. 29)
- Agreements by way of wager (Sec. 30)
- Agreements contingent on the happening of an event (Sec. 32)
- Agreements contingent on the impossible events (Sec. 36) Agreements to do an Impossible Act (Sec. 56]

In case of reciprocal promises to do things legal and also to do other things illegal, the first set of promises is a contract, but the second set of reciprocal promises is a void agreement (Sec. 57)

It may be stated here that the agreement from 1 to 13 are void ab-initio, i.e. from the very inception) while the remaining 14 to 15 become void by subsequent events.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Void Agreements.**

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### **7.3 WAGERING AGREEMENT**

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#### **DEFINITION OF WAGER:**

"A contract between two parties to the effect that if a given event is determined in one way, one of them shall pay a sum of money to the other and in the contrary event the other shall pay to the former." It is a promise to give money or money's worth upon the determination or ascertainment of an uncertain event.

#### **Example:**

'A' and 'B' may wager regarding an uncertain event as to whether it would rain or not on a particular day. 'A' promising to pay 'B' Rs.100 if it rains and 'B' promising Rs.100 if it does not rain. Such agreements are void and are not enforceable at law. No suit can be initiated for recovering anything alleged to be won on any wager (Sec. 30)

**Essential Elements of a Wager:**

- Intention of both the parties to the wagering contract is to gamble.
- The gain of one party is the loss or the other party.
- Neither party should have any interest in the happening or non-happening of the event other than the sum he will win or lose.
- The event on the happening of which the amount is to be paid is uncertain.
- The mind of the parties to the agreement may be uncertain in regard to the fact.
- The event on which the betting is placed should not necessarily be unlawful.

**The Following Contracts are not Wager:**

- A crossword competition involving a good measure of skill for its successful solution.
- Games of skill e.g. picture puzzles or athletic competitions.
- A subscription towards any prize or sum of money of the value of Rs. 500 or above to be awarded to any winner of a horse race.
- Share market transactions.
- Contracts of insurance is not a contract of wager because of the following reasons:
  - In case of Insurance the assured has an insurable interest in the subject-matter.
  - Both the parties are interested in protection of the subject matter.
  - Except life insurance, the other contracts of insurance is
  - d contract of indemnity.
  - It is beneficial to the public.
  - It is based on scientific and actual calculation of risks.

**Effects of Wagering Agreements:**

Wagering agreements have been expressly declared to be void in India. In the states of Maharashtra and Gujarat they have been declared to be illegal. No suit can be initiated for recovering anything alleged to be won on any wager.

Since the wagering agreements are void, transactions are void, transactions collateral to them are not affected. So excepting in the states of Maharashtra and Gujarat collateral transactions are valid.

**Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

## 1. Discuss the Wagering Agreements.

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## 7.4 CONTINGENT CONTRACT

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### DEFINITION:

[Sec. 31]: A Contingent Contract, is a contract to do or not to do something, if some event, collateral to such contract does or does not happen.

#### Example:

'A' contracts to pay 'B' Rs. 10,000 if B's house is burnt. This is a Contingent.

### ESSENTIALS OF A CONTINGENT CONTRACT:

- The performance of a contingent contract is made dependent upon the happening or non-happening of some event.
- The event on which the performance is made to depend is an event collateral to the contract, i.e It does not form part of the reciprocal promises which constitute the contract.
- The contingency is uncertain, If the contingency is bound to happen the contract is due to be performed in any case and is not therefore a contingent contract.

#### Examples

- Life Insurance, indemnity and guarantee are examples of contingent contract.
- where 'A' agrees to deliver 100 bags of rice and 'B' agrees to pay the price only, afterwards, the contract is a conditional contract and not contingent, because the event on which B's obligation is made to depend is a part of the promise itself and not a collateral event.
- The contingent event should not be the mere will of the promisor.

#### Example:

- 'A' promises to pay 'B' Rs.1000. If he so choose, it is not a contingent contract.
- If the event is within the promisor's will but not merely his will, it may be a contingent contract.

### RULES REGARDING ENFORCEMENT OF CONTINGENT CONTRACTS :

- **Contracts contingent upon the happening of a future uncertain event** cannot be enforced by law unless and until that event has happened. And if the event becomes impossible such contract becomes void (sec.32)

#### Examples:

- (i) "A' makes a contract with 'B' to buy 'B's horse if 'A' survives 'C', This contract cannot be enforced by law unless 'C' dies in A's life time.



(ii) 'A' contracts to pay 'S' a sum of money when 'B' marries 'C', 'C' dies without being married to 'B', The contract becomes void.

- **Contracts contingent upon the non-happening of an uncertain future event** can be enforced when the happening of that event becomes impossible, and not before (Sec. 33)

**Example:**

'A' agrees to pay 'S' a sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

- **When the event to be deemed is impossible**

**Example:**

'A' agrees to pay 'B' a sum of money if 'B' marries 'C', 'C' marries 'D', The marriage of 'B' to 'C' must now be considered impossible although it is possible that 'D' may die and that 'C' may afterwards marry 'B'.

- **(a). The happening of an event within a fixed time:**

Contract is contingent upon the happening of an event within a fixed time, become void at the expiration of the fixed time, such event has not happened or if before fixed time, such event has not happened or if before the fixed time, such event becomes impossible.

- **(b) The non-happening of an event within a fixed time:**

**Example,** 'A' promises to pay 'B' a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year or is burnt within the year.

- **Impossible event:**

Contingent agreements to do or not to do anything the impossibility of the event is known or not to the parties to the agreement at the time when it is made (sec.36)

### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Contingent Agreement.**

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## 2. Discuss the essential elements of Contingent Agreement.

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### 7.5 SOME USEFUL BOOKS

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### 7.6 ANSWER TO CHECK YOUR PROGRESS EXERCISE

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#### Check Your Progress – 1

1. See section 7.2

#### Check Your Progress – 2

1. See section 7.3

#### Check Your Progress – 3

1. See section 7.3

## UNIT 8:

### PERFORMANCE OF CONTRACT

#### Structure

- 8.1 Objectives
- 8.2 Introduction
- 8.3 Offer of Performance (or) Tender
- 8.4 Time & Place of Performance
- 8.5 Performance of Reciprocal Promises
- 8.6 Appropriation of Payments
- 8.7 Assignments of Contract
- 8.8 Some Useful Books
- 8.9 Answer to Check Your Progress Exercise

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#### 8.1 OBJECTIVES

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After studying this unit you should be able to:

- Define the Offer of Performance, Time and Place of Performance.
- Understand the Performance of Reciprocal Promises.
- Describe the Appropriation of payments & Assignments of contract.

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#### 8.2 INTRODUCTION

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Every contract creates a legal obligation which continues till the contract has been performed or otherwise discharged. Performance of the contract is, in fact, the most natural and usual mode of extinction of an obligation. Performance of a contract consists in doing or causing to be done what the Promisor has promised to do. Section 37 of the Act provides that the parties to a contract must either

- (i) perform their respective promises or
- (ii) offer to perform the same, unless
- (iii) such performance is dispensed with or
- (iv) excused under the provisions of this Act, or of any other law.

**A contract is said to be performed, when parties make:**

- **Actual performance.**

When a party has done what he undertook to do there is nothing left for him to do. Then he is said to have performed his obligation. The performance of the contract in order to be complete must, however, be made in accordance with the terms of the contract.

- **Attempted performance or offer to perform.**

Sometimes it so happens that the promisor offers to perform his obligation under the contract but the promisee does not accept. This is known as attempted performance or tender.

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### **8.3 OFFER OF PERFORMANCE (OR) TENDER**

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Where the promisor has made an offer of performance and the offer has been refused, the promisor is not responsible for non-performance. Offer of performance is also known as tender. The motive of the party 'tendering to perform' is to perform it. Thus a valid tender of performance is considered to be the performance of a promise and it discharges a party from his obligation under a contract. If the offeror produces goods of the correct quality and quantity, the rejection of his offer discharges him from further liability. If a debtor tenders money due under a debt, the effect of such a tender is to stop the running of interest on the amount payable but the debt is not discharged.

#### **ESSENTIALS OF A VALID TENDER :**

In order that a tender should be valid and adequate, it must fulfill the following conditions which are laid down in section 38.

- **It must be unconditional.**

Where a tender or offer of performance is conditional, the other party is under no obligation to accept it. A person is not bound to accept a tender of railway receipt that is made, subject to demurrage. But a tender with a request for a receipt is valid.

**Example:**

P sent a single cheque for two items, only one of which was due at the time, while the other was payable after sometime. The cheque being one and indivisible could be accepted as whole or not at all. It was held that the promisee was within his right in rejecting cheque.

- **It must be made at a proper time and place.**

When the contract provides that tender should be made at a particular place and time, it should be so done. If the place is not mentioned, the rule is that the debtor must find the creditor. Where no time is fixed then it is valid to make the tender at any

reasonable time. What is proper time and place is a question of fact depending on the circumstances of each case. However, a tender before due date is not valid.

**Example :**

A owes B Rs. 1000 payable on 1st June with interest. B offers to pay on 1st May the amount with interest up-to 1st may. It is not a valid tender as it is not made at the appointed time.

- **A person to whom the tender is made must be given a reasonable opportunity of inspection of goods or articles.**

The inspection is to satisfy oneself as to whether the thing offered is what was promised. There is no valid tender where goods are locked in a box and the other party is not allowed to open it. The usual place of inspection is the place of delivery. A tender made at such a late hour of the due date that the buyer had hardly the time to inspect it, is not good in law.

**Example:**

A contracts to deliver to B at his warehouse on the 1st March 1996, 100 bales of cotton of a particular quality. In order to make a valid offer of performance, A must bring the cotton to B's warehouse' on the appointed day under such circumstances that B may have a reasonable opportunity of satisfying himself that the thing offered is cotton of the quality contracted for and that there are 100 bales.

- **The tender must be whole and not of the part.**

Tender in part is no tender. A creditor need not accept a smaller sum than that what he is entitled to. A tender by instalments is invalid unless the contract so provides. A tender of a lesser amount does not stop the running of interest loan the entire amount.

- **The tender must be in the proper form.**

Tender of money should be in the current coins. A person is not bound to accept a cheque. A tender by cheque is valid when the person to whom it is tendered is willing to accept such payment.

- **The tender must be made to a proper person.**

Tender made to a stranger would be invalid. It should be made to the promisee or his duly authorised agent.

- **Tender for the delivery of goods must be for the quantity and quality as stipulated in the contract.**

The party making the tender must always be ready and willing to fulfill the obligation whenever called upon. If the tender is of cash payment, actual cash must be available in readiness for payment. But a man cannot be said to be able and willing if he has neither possession of nor control over the goods he had promised to deliver. A mere

offer by post to pay the amount is not a valid tender. There is no readiness and willingness in this case to pay the money then and there.

- A tender made to one of the several joint promisees has the same legal consequences as a tender to all of them. In other words payment or tender can be legally made to even one of the joint promisees. But the joint promisees must be all joint in status. Thus a payment to a partner is deemed to be a payment to the partnership firm.

### **Effect of refusal to accept offer of performance (Section 38)**

Where a promisor has made an offer of performance to the promisee and the offer has not been accepted:

- (a) the promisor is not responsible for the non-performance; nor
- (b) does he thereby lose his rights under the contract .

### **CONTRACTS WHICH NEED NOT BE PERFORMED**

Sections 62 to 67 of the Contract Act deal with contracts which need not be performed relevant provisions are as under :

- If the parties to a contract agree to novation, rescission or alteration, the original contract need not be performed. (Section 62).
- The promisee may dispense with or remit performance by the promisor in whole or in part or may extend the time for the performance or may accept any satisfaction in lieu thereof. (Section 63);
- When a voidable contract is rescinded, the other party need not perform his promise. (Section 64).
- Where the failure of performance has been caused by the promisee's neglect or refusal, the promisor will be excused. (Section 67).

### **BY WHOM CONTRACTS MUST BE PERFORMED**

- **By the promisor.**

As a general rule, a contract may be performed by the promisor, either personally or through any other competent person. But where personal considerations are the foundation of the contract, it has to be performed by the promisor himself and in case of his death or disablement, a contract will be discharged and the other party would be freed from liability.

**Example:** It promises to paint a picture for B. The promise must be performed by it himself.

▪ **By the agent:**

Where personal skill is not necessary and the work could be done by anyone, the promisor or his representative may employ a competent person to perform it. Thus a contract to sell goods can be assigned by the seller to his agent.

▪ **By the representative:**

In the event of the death of the promisor before performance, their representatives are bound by the promises, unless personal considerations are the foundation of the contract. The legal representatives of the deceased promisor cannot be required to perform c;ontract involving personal skill and action. On the death of a person, the benefits and burdens of his contracts pass to the legal representatives as part of his estate.

**Examples:**

- (a) A promises to deliver goods to B on a certain day on payment of Rs. 1000. A dies before that day. A's representatives are bound to deliver the goods to B, and B is bound to pay Rs. 1000 to A's representatives.  
(b) A promises to paint a picture for B, by a certain day at a certain price. A dies before the day. The contract cannot be enforced either by A's representative or by B.

▪ **By third person.**

If the promisee accepts performance of the promise from a third party, there is a discharge of the contract. Once the third party performs the contract, and that is accepted by the promisee there is an end of the matter and the promisor is thereby discharged. (Section 41). Thus, where a person has accepted a part payment from a third person in full satisfaction of his claim, he cannot later on sue the debtor for the balance.

## **WHO CAN DEMAND PERFORMANCE ?**

It is only the promisee or his agent who can demand performance of the promise under a contract. It is immaterial whether the promise is for the benefit of the promisee or for the benefit of some other person. In the case of the death of the promisee, his legal representatives can demand performance. In certain cases a third person who is not a party to the contract can also demand performance.

**Example:**

A promises B to sell his house to C for Rs. 20,000. A does not perform the contract. C cannot sue A. It is only B who can enforce the promise against A.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### 1. Discuss the essentials of Valid Tender.

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### 2. Discuss By whom the contract must be performed.

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## 8.4 TIME & PLACE OF PERFORMANCE

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It is for the parties to a contract to decide the time and place for the performance of the contract. Sections 46 to 50 of the Indian Contract Act lay down certain rules in this regard which are as follows:

- Where a contract does not specify any time for performance, and the promise is not supposed to ask for performance, the promisor must perform it within a reasonable time. What is a reasonable time is a question of the fact (Sec 46). Failure to perform the contract within a reasonable time entitles the other party to put an end to the contract. Thus, where ornaments were borrowed for a wedding ceremony, detaining them after the wedding did not amount to performance within a reasonable time.
- When a contract is to be performed on a particular day, without any application of the promisee being required, the promisor may perform contract on that particular day during the usual hours of the business on such day and at the place at which promise ought to be performed.

**Example:**

A promises to deliver goods at B's warehouse on the first January. On that day A brings the goods to B's warehouse, but after the usual hour for closing it, and they are not received. A has not performed his promise.

- In the above two cases, the promisor undertakes to perform the promise without application by the promisee. But where the promise has to be performed on a certain day but the promisor had not undertaken to perform it without application by the promisee, the promisee is bound to apply for performance at a proper time place and



within the usual hours of business. What is a proper time and place is a question of fact. (Sec 48).

**Example,** in case of a deposit it is the duty of the depositor to go to the banker and make a demand for money. It is not the duty of the banker to seek out his creditor.

- When a promise is to be performed without application by the promisee, and no place is fixed for the performance of it, it is the duty of the promisor to apply to the promisee to appoint a reasonable place for the performance of the promise, and to perform it at such place (Section 49).

**Example:**

A undertakes to deliver a thousand maunds of jute to B on a fixed day. A must apply to B to appoint a reasonable place for the purpose of receiving it and must deliver to him at such place.

- A Contract should be performed in the manner and at the time prescribed in the contract. (Section 50). A promisor is discharged from liability if he performs the promise in a manner or at a time prescribed or sanctioned by the promisee.

**Examples:**

- A desires B who owes him Rs. 100 to send him a note for Rs. 100 by post. The debt is discharged as soon as B puts into the post a letter containing the note duly addressed to A.
- B owes A 2,000 rupees. A desires B to pay the amount to A's account with a banker. B who also has an account with C Bank, orders the amount to be transferred to A's credit and this is done by the banker. Afterwards, and before A knows of the transfer, the bank C fails. There has been a good payment by B.
- A owes B Rs. 2,000. B accepts some of A's goods in reduction of the debt. The delivery of the goods operates as a part payment.

## TIME AS THE ESSENCE OF THE CONTRACT

A party may promise to perform his obligation by a specified time. This gives the other party a right to expect that it shall be performed by that time. But if the promisor fails to do so, can the promisee rescind the contract? This question can be answered by deciding whether in such a case time was or was not the essence of the contract.

The expression 'time is of the essence of the contract' means that one who does not perform in full own promised performance within the time specified in the contract cannot maintain any action for the enforcement of a return of promise. It means that the time agreed for the performance of a contract must be strictly observed. Section 55 of the Indian Contract Act deals with this subject and may for the sake of the convenience be studied under the following three heads.

- **When time is of the essence of the contract**

Where time is of the essence of a contract and a party who is bound to perform his promise within the time fixed fails to do so, the contract becomes voidable at the option of the other party. An intention to make time as the essence of the contract must be expressed in a very clear language. The law is well settled that merely because of the specification of time on or before which a contract is to be performed, would not make time the essence of the contract. Time is an essence of the contract if the parties intend it to be so.

**Example:**

D agreed to sell and deliver 6 bales of cotton to P on 12th July, 1974. But he failed to deliver the cotton by that time. The contract was voidable at the option of P.

Time is always considered to be the essence of the contract in the following cases :

- (a) Where the parties have so expressly provided.
- (b) Where delay operates as an injury.
- (c) Where the nature and necessity of contract requires it to be so construed, as for example, where a party asks for extension of time for performance.

- **When time is not of the essence of the contract**

Where time is not of the essence of the contract and the promisor fails to perform it within the specified time, the promisee is not entitled to avoid the contract. But he would be entitled to compensation from the promisor for any loss occasioned to him by such failure. In a contract for the sale of land or immovable property it would normally be presumed that time is not of the essence of the contract. But the renewal of a lease is something different from the sale of immovable property.

**Example:**

The lessee of a petrol pump had apply for the renewal of the lease within a time. contract. The lessee was late by 10 days in his application for renewal. The landlord refused to renew. It was held that the time so fixed was of the essence of the bargain

- **Acceptance of performance out of time**

Where the promisee accepts performance of a promise at any time other than that agreed" the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise unless at the time of such acceptance he gives notice to the promisor of his intention so to do. When two or more persons make a joint promise, the promisee is entitled, in the absence of an agreement to the contrary, to compel anyone or more of such joint promisors to perform the whole of such promise. In other words the liability of joint promisors is joint and several. (Section 43). Thus, in a suit against the firm the plaintiff is entitled to proceed against the firm itself or against all the partners or against such partners as he wishes to sue. If one promisor makes payment in full or otherwise satisfies the entire obligation, the

promisee's right against all others who are bound for the same performance is extinguished. Where one of several joint promisors has performed the promise, he is entitled in the absence of a contract to the contrary to claim equal contribution from the other joint promisors. A person who discharges a joint liability can seek contribution from the persons who are co-promisors. If a joint promisor makes default in such contribution the remaining joint promisors must share the loss equally.

**Examples:**

- A, B and C jointly promise to pay D Rs. 1000. D may compel either A, or B or C to pay him Rs. 3000.
- A, B and C jointly promise to pay D the sum of Rs. 3000. C is compelled to pay the whole. A is insolvent but his assets are sufficient to pay one half of his debts. C is entitled to receive Rs. 500 from A's estate and Rs. 1250 from B.

Explanation to section 43 provides that as soon as a surety makes any payment to the creditor, he can, recover it from the principal debtor. The right of contribution exists between, co-sureties as well:

**Example:**

- A, B and C, are under a joint promise to pay D Rs. 3000. A and B being only sureties for C, fails to pay A and B are compelled to pay the whole sum. They are entitled to recover it from C.

A release of one of joint promisors by the promisee does not discharge the other joint promisors. This release does not release such joint promisors from responsibility to the other joint promisors or joint promisors. Section 44 is a departure from the rule in English law. Under the English law a release of one joint promisor operates as a release of all joint promisors.

**Example:**

A, B and C are under a joint promise to pay X Rs. 3000. X may release C from liability; but A and B remain liable to pay to X. C is not released from the responsibility to A and B. If X recovers the amount from A and B, they have a right of rateable contribution from C.

**Section 45 deals with the devolution of joint rights.**

Where there are joint promisees, the benefit of the will see devolves on the representatives of the deceased promisee. In other words in Case of a promise to two or more persons jointly, such persons jointly and on the death of anyone or all of them, the survivors or, the representatives of deceased promisees jointly are the only persons who are entitled to claim performance of the promise. All the joint promisees must join together to claim performance of the promise. If some only join their suit is liable to be dismissed under section 45.

**Example:**

*A in consideration of 5000 rupees lent to him by B and C, promises B and C jointly to repay them that sum with interest on a day specified. The right to claim performance rests with B's representatives jointly with C during C's life and after the death of C with the representatives of B and C jointly.*

## **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss “Time is as essence of the Contract”.**

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## **8.5 PERFORMANCE OF RECIPROCAL PROMISES**

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"Promises which form the consideration or part of the consideration for each other are called reciprocal promises." A promise against a promise is a good consideration. Where one party gives a promise in consideration of the other party's promise, both the promises are called reciprocal promises. In case of bilateral contracts, each party is not only a promisor but a promisee also. Where the contract consists of mutual promises there is an obligation on each party to perform his own promise and to accept performance of the other's promise. Where there are mutual promises between A and B to marry, A's promise consideration for B's and for B's promise is a consideration for A's.

### **RULES AS REGARD TO THE PERFORMANCE OF RECIPROCAL PROMISES ARE AS UNDER:**

#### **▪ Simultaneous reciprocal promises (Section 51)**

Where two promises are to be performed simultaneously, they are known as mutual and concurrent. Section 51 provides that in case of reciprocal promises, to be performed simultaneously, a promisor need not to Perform 112 (perform his part unless the other side is also ready and willing to perform his part. In a contract of sale for cash on delivery, delivery of the goods and payment of price are concurrent conditions. Cash must be paid in exchange for and simultaneously with the delivery of the goods.

#### **Example:**

A and B contract that A shall deliver goods to B at a price to be paid by instalments, the first instalment to be paid on delivery. A need not deliver unless B is ready and willing to pay the first instalment on delivery. B need not pay the first instalment unless A is ready and willing to deliver the goods on payment of the first instalment.

- **Conditional reciprocal promises**

There are three rules in this regard

(a) Where the order in which reciprocal promises are to be performed is expressly fixed, they shall be performed in that order; when the order is not so fixed they shall be performed in their natural order. (Section 52). The order in which reciprocal promises are to be performed is often a question of construction of a document. The construction depends upon' the intention of parties when the contract was made.

**Example:**

A and B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before B's promise to pay for it.

(b) Where one party prevents the other from performing his promise, the contract becomes voidable at the option of the party so prevented and he is entitled to compensation from the other party of the loss. (Section 53)

**Example:**

A and B contract that B shall execute certain work for a thousand rupees. B is ready and willing to execute the work accordingly, but A prevents him from doing so. The contract is voidable at the option of B, and if he elects to rescind it, he is entitled to recover from A compensation for any loss which he has incurred by its non-performance.

(c) Where in case of reciprocal promises, the nature of the promise is such that one of them cannot be performed or its performance cannot be claimed till the other is performed; and the promisor of the last mentioned promise fails to perform his promise, such promisor cannot claim performance from the other party. He must also make compensation to the other party for his own non performance of the contract. (Section 54).

**Example:**

A contracts with B to execute certain builder's work for a fixed price, B supplying the timber necessary for the work. B refuses to supply any timber and the work cannot be executed. A need not execute the work and B is bound to make compensation to A for any loss caused to him by the non performance of the contract.

- **Reciprocal promises one legal and the other illegal**

When a contract consists of two parts, one part legal and the other illegal and the legal part is separable from the illegal one, then the court will enforce the legal part. However" if the legal part is inseparable from the illegal part the whole contract is void. (Sec 57)

**Example:**

A and B agree that A shall sell a house for 10,000 rupees but that if B uses it as a gambling house, he shall pay A 50,000 rupees for it. The first set of reciprocal promises namely to sell the house and to pay 10,000 rupees for it is a contract. The second set is for an unlawful object namely that B may use the house as a gambling house and is a void agreement.

- **Alternative promise one branch being illegal**

In the case of an alternative promise one branch of which is legal and the other illegal, the legal branch alone can be enforced. (Section 58).

**Example:**

A and B agree that A shall pay B 1000 rupees for which B shall afterwards deliver to A either rice or smuggled opium. This is a valid contract to deliver rice and a void agreement as to the opium.

**Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss the performance of Reciprocal promises.**

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**8.6 APPROPRIATION OF PAYMENTS**

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Where there are several debts owing by one person to another and a certain payment is made by the debtor which is insufficient to satisfy all the debts, a question arises as, "to which of the debts is the payment to be appropriated." The creditor would like to appropriate the payment towards a debt which he is not likely to recover. Appropriation is a right given to the debtor for his benefit. The debtor has a right to instruct the creditor to which account the money so paid is to be appropriated and the creditor is bound by those instructions. But a difficulty arises when no such instructions are given by the debtor.....

▪ **Appropriation by debtor. (Section 59)**

Where a debtor owes more than one debt to his creditor and pays him a sum of money which is insufficient to discharge the entire debt, the debtor has a right to appropriate it either expressly or by implication towards any debt due to his creditor. Section 59 deals with those cases where there are several distinct debts and it does not apply where there is only one debt. The debtor has the privilege to choose which debt he will pay and if the creditor accepts the payment he must apply it as directed.

**Example:**

- A owes to B among other debts the sum of 567 rupees. B writes to A and demands payment of this sum. A sends to B 567 rupees. This payment is to be applied to the discharge of the debt of which B had demanded payment.

Where the debtor does not make any express direction, the intention of appropriation may be inferred from the nature of the transaction or the circumstances of the case. Thus, where in response to a letter of demand the demanded sum is sent, the

circumstances imply that the payment is to be applied to the discharge of that particular debt in respect of which demand was made.

**Example:**

- A owes B, among other debts, Rs. 1,000 upon a promissory note which falls due on the first June.
- He owes B no other debt of the amount. On the first June, A pays to B 1000 rupees. The payment is to be applied to the discharge of the promissory note.

▪ **Appropriation by creditor. (Section 60)**

If at the time of paying the money the debtor gives no express or implied direction as to which particular debt the payment was to satisfy, the creditor has got the option to appropriate the amounts towards the satisfaction of any legally due debt, even though such debt may be time barred. It is not open to the creditor to appropriate a payment towards the adjustment of an illegal or disputed debt. The debt besides being lawful must also be actually due and payable to him by the debtor. The creditor is entitled to appropriate payments in the manner least disadvantageous to himself. He may even insist upon appropriation in the chronological order in which the debts stand. Appropriation once made is binding on the creditor and cannot be subsequently altered by him to suit his convenience.

**Examples:**

A owes several debts to B, one of them of Rs. 5,000 is time barred. A sends Rs. 10,000 to B without indicating to which debt the amount is to be appropriated. B may appropriate Rs. 5000 against the time barred debt if he so chooses.

▪ **Appropriation by law. (Section 61)**

Where neither party makes an appropriation, the payment shall be applied towards one debt after another in the order of time notwithstanding that some of them are barred by limitation. Where all the debts are of equal standing, the payments will be distributed between all the debts proportionately. Thus in the case of running accounts, the payment would go towards the earlier items in the account. It is the first item in the debit side of the account that is discharged or reduced by the first item on the credit side.

**Example:**

A owes two debts of Rs. 2000 each which are time barred and another debt of Rs. 4,000 to B. A sends Rs. 2000. Neither party makes any appropriation. Rs. 2000 would be appropriated rateably against the two debts of Rs. 2000 each which are time barred i.e., Rs. 1000 would be appropriated against each debt.

• **Principal and interest:**

When both principal and interest are due, the debtor can specify that a particular payment made by him is to be appropriated to the principal, the interest remaining due. If the creditor accepts the payment, he will have to accept the debtor's

appropriation. If, however, a payment has been made without expressly stating whether it is towards interest or principal, payment is to be applied towards interest first, and then to principal.

#### **Check Your Progress – 4**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Appropriation of payments.**

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### **8.7 ASSIGNMENT OF CONTRACTS**

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The word 'assignment' means transfer. Assignment of contract stands for transfer of contractual rights or liabilities by a party to the contract to some other person, who is not a party. On assignment, an assignee can bring an action on his own initiative (without making the assignor a party to the suit) against the other party to the contract. The Indian Contract Act has no specific provision dealing with assignment of contracts. But the law on the subject is well settled. Assignment may take place (a) by an act of parties; (b) by operation of law.

**The rules regarding assignment are as follows.**

- Contracts involving personal skill or taste, for example, a contract to paint a picture or a contract to marry cannot be assigned.
- The obligations or liabilities under a contract cannot be assigned except with the consent of the promisee. For example, a debtor cannot assign his liability without the consent of the creditor.
- The rights and benefits under a contract are assignable unless the contract is of a personal nature. Thus the creditor can assign his rights to anyone he likes without reference to the debtor.
- Assignment by operation of law takes place in cases of death or insolvency. Upon the death of a party to the contract, his rights and liabilities devolve upon his heirs and legal representatives. In case of insolvency, the rights and liabilities of the person concerned pass to the official Assignee or the Official Receiver as the case may be.



### **Check Your Progress – 5**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the assignment of contracts.**

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### **8.8 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### **8.9 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

#### **Check Your Progress – 1**

1. See section 8.3

#### **Check Your Progress – 2**

1. See section 8.4

#### **Check Your Progress – 3**

1. See section 8.5

#### **Check Your Progress – 4**

1. See section 8.6

#### **Check Your Progress – 5**

1. See section 8.7

# UNIT 9:

## DISCHARGE OF CONTRACT

### Structure

- 9.1 Objectives
- 9.2 Introduction
- 9.3 Some Useful Books
- 9.4 Answer to Check Your Progress Exercise

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### 9.1 OBJECTIVES

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After studying this unit you should be able to:

- Understand the Discharge of Contract.

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### 9.2 INTRODUCTION

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Discharge of contract means termination of the contractual relationship between the parties. A contract is said to be discharged when it ceases to operate, i.e., when the rights and obligations created by it comes to an end. In some cases, other rights and obligations may arise as a result of discharge of contract, but they are altogether independent of the original contract.

A contract may be discharged:

1. by performance
2. by agreement of consent.
3. by impossibility.
4. by lapse of time.
5. by operation of law.
6. by breach of contract.

The above said contract discharge methods have been explained below:

#### ▪ BY PERFORMANCE

Performance means, the doing of that which is required by a contract. Discharge by performance takes place, when the parties fulfill their obligations arising under the contract within the time and in the manner prescribed. In such a case, the parties are discharged and the contract comes to an end. If only one party performs the promise then it is considered that only one is discharged. He gets a right against the other party who is guilty of breach.

The Performance of a contract is usually operated in two modes. 1. Actual performance- when both the parties performed their promises, the contract is discharged. Performance should be complete, precise according to the terms of the agreement. 2. Attempted performances (or) tender are not actual performance but it's only an offer to perform the obligation under the contract.

▪ **BY AGREEMENT OF CONSENT.**

The contract makes a contractual obligation, which is discharged by agreement, which may be expressed or implied. The various cases of discharge of a contract by mutual agreement are dealt within sections 62 and 63 as discussed below:

- a. Novation-* it takes place when (i) a new contract is substituted for an existing one between the same parties, or (ii) a contract between two parties is rescinded in consideration of a new contract being entered into on the same terms between one of the parties and a third party.

**Example:**

A owes B Rs 10,000/. A enters into an agreement with B and gives B a mortgage of his (A's) estate for Rs 5000/ in place of the debt of Rs.10, 000/. This is a new contract, which extinguishes the old one.

Novation should take place before expiry of the time of the performance of the original contract.

- b. Rescission-* Rescission of a contract takes place when all or some of the terms of the contract are cancelled. It may occur: (i) by mutual consent of the parties, or (ii) where one party fails in the performance of his obligation. In such a case, the other party may rescind the contract without prejudice to his right to claim compensation for the breach of contract.

**Example:**

A promises to supply certain goods to B six months after date. By that time, the goods go out of fashion. A and B may rescind the contract.

- c. Alteration-* Alteration of a contract may take place when one or more of the terms of the contract is / or altered by the mutual consent of the parties to the contract. In such a case, the old contract is discharged.

**Example:**

A enters into a contract with B for the supply of 100 bales of cotton at his godown no.1 by the first of the next month. A and B may alter the terms of the contract by mutual consent.

- d. Remission-* Remission means acceptance of a lesser fulfillment of the promise made i.e., acceptance of a lesser sum than, what was contracted for, in discharge of the whole of the debt. It is not necessary that there must be some consideration for the remission of the part of the debt [Harichand Madangopal Vs State of Punjab, A.I.R. (1973 S.C.381)].

**Example:**

A owes B Rs.5000/. A pays to B and B accepts, in satisfaction of the whole debt, Rs.2000/ paid at the time and place at which Rs. 5000/ were payable. The whole debt is discharged.

- e. Waive--* waiver takes place, when the parties to the contract agree that they shall no longer be bound by the contract. This amounts to a mutual abandonment of rights by the parties to the contract. Consideration is not necessary for waiver.
- f. Merge--* Merger takes place in an inferior right accruing to a party under a contract merges into a superior right accruing to the same party under the same or some other contract.

**Example:**

P holds a property under a lease. He later buys the property. His rights as a lessee merged into his rights as an owner.

▪ **BY IMPOSSIBILITY**

If an agreement contains an undertaking to perform impossibility, it is void *ab initio*. It falls into two categories they are:

- (i) Impossibility existing at the time of agreement. The facts of impossibility may be (i) known to the parties, also called as absolute impossibility. (ii) Unknown to the parties by the ignorance or any other reason.
- (ii) Impossibility arising subsequent to the formation of contract. It is also called as post contractual or supervening impossibility like destruction of subject matter, non-existence or non-occurrence of a particular state of things, death or incapacity for personal service, change of law or stepping in of a person with statutory authority or outbreak of war.
- (iii) Impossibility of performance- not an excuse- a contract is not discharged on the ground of supervening impossibility like difficulty of performance, commercial impossibility, impossibility due to failure of a third person, strikes, lock-out and civil disturbances, failure of one of the objects.

▪ **BY LAPSE OF TIME**

If the contract is not performed in time, then the contract will be considered as discharged.

▪ **BY OPERATION OF LAW**

This includes discharge – by death, by merger, by insolvency, by unauthorized alteration of the agreement and rights and liabilities become vested in the same person.

▪ **BY BREACH OF CONTRACT**

Breach of contract means a breaking of the obligation, which a contract imposes. It confers a right of action for damages on the injured party. Breach of contract may take

place by (i) actual breach of contract which takes place by the performance is due, during the performance of the contract. (ii) Anticipatory breach of contract.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about the discharge of contract.**

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### **9.3 SOME USEFUL BOOKS**

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### **9.4 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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#### **Check Your Progress – 1**

1. See section 9.2

## UNIT 10:

# REMEDIES FOR BREACH OF CONTRACT

### Structure

- 10.1 Objectives
- 10.2 Introduction
- 10.3 Quasi Contracts
- 10.4 Some Useful Books
- 10.5 Answer to Check Your Progress Exercise

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### 10.1 OBJECTIVES

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After studying this unit you should be able to:

- Define the remedies for breach of Contract.
- Understand the Quasi Contracts.

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### 10.2 INTRODUCTION

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A remedy is the means given by law for the enforcement of a right. When a contract is broken the injured party is entitled to the following remedies according to the law:

- Rescission of the contract
- Suit for damages
- Suit upon *quantum merit*
- Suit for specific performance of the contract
- Suit for injunction

The above said remedies are explained as follows:

#### A. Rescission

When a contract is broken by one party, the other party may sue to treat the contract as a rescinded and refused further performance. In such a case, he is absolved of all his obligations under the contract.

#### Example:

A promises B to supply ten bags of cement on a certain day, B agrees to pay the price after the receipt of the goods. A does not supply the goods. B is discharged from liability to pay the price.

## **B. Damages**

Damages are a monetary compensation allowed to the injured party by the court for the loss or injury suffered by him by the breach of the contract. The object of awarding damages for the breach of a contract is to put the injured party to the same (original) position. This is called the doctrine of restitution. The foundation of modern law of damages both in India and England, is to be found in the judgment in the case of *Hadley Vs Vaxendale*, (1854) 9 EX.341.

**The rules relating to damages may now be considered as follows:**

### **i. Damages arising naturally-ordinary damages**

When the damages are proximate consequence occurred by natural and direct by the usual course of things then it is called as ordinary damages.

### **ii. Damages in contemplation of the parties- special damages**

Any damages arising as other than the reason of normal damage then it will be considered as special damages but special damages cannot be claimed as a matter of right.

### **iii. Vindictive or exemplary damages**

This damage can be given away as compensation for the loss suffered, and not by way of punishment for wrong inflicted, but in case of breach of a promise to dishonor of a cheque by a banker wrongfully when he possesses sufficient funds to the credit of the customer, the court may award exemplary damages.

### **iv. Nominal damages**

Even though the injured party has not in fact suffered any loss by reason of the breach of a contract, the damages recoverable by him are nominal. These damages merely acknowledge that the plaintiff has proved his case and won. [Brace Vs Calder (1895) 2 Q.B.253]

### **v. Damages for loss of reputation**

### **vi. Damages for inconvenience and discomfort**

### **vii. Mitigation of damages**

### **viii. Difficulty of assessment**

Although damages, which are incapable of assessment, cannot be recovered the fact that they are difficult to assess with certainty or precision does not prevent the aggrieved party from recovering them.

### **ix. Costs of decree**

In addition to the damages, the aggrieved party is entitled to get the cost of getting the decree for damages. The cost of suit for damages is in the discretion of the court.

### **x. Damages agreed upon in advance in case of breach**

If a sum is named in a contract as the amount to be paid in case of its breach, or if the contract contains any other stipulation by way of a penalty for failure to perform the obligations, the aggrieved party is entitled to receive from the party, who has broken the contract, a reasonable compensation not exceeding the amount so named.

### **C. Quantum merit**

It means “as much as earned”. This claim arises when one party partly performs, has become discharged by the breach of the contract by the other party.

### **D. Specific Performance**

In certain cases of breach of a contract, damages are not adequate remedy. In such cases the court may direct the party in breach to carry out his promise according to the terms of the contract. In some cases specific performance will not be granted where (i) damages are an adequate remedy (ii) the contract is not certain (iii) the contract in its nature revocable (iv) the contract is made by the trustees in breach of their trust (v) the contract is of a personal nature (vi) the contract is made up by a company in excess of its power as laid down in its memorandum of association (vii) the court cannot supervise the carrying out procedure.

### **E. Injunction**

Where a party is in breach of a negative term of a contract, the court may issue an order, restraint him from doing what he promised not to do. Such an order of the court is known as injunction.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the remedies for breach of contract.**

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## 10.3 QUASI CONTRACT

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Sometimes obligations are created by law whereby an obligation is imposed on a party and an action is allowed to be brought by another party. These obligations are known as Quasi-contracts.

- A supplied B a minor and / or the wife and children of B with necessities suitable to his / their condition in life. A is entitled to be reimbursed from B's property
- A is a tradesman; leaves goods at B's house by mistake B treats the goods as his own. B is bound to pay A for them.

### Kinds of Quasi Contract

#### 1. Supply of necessities

If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another with necessities suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.

**Example;**

A supplies B, a lunatic, with necessities suitable to his condition in life. A is entitled to be reimbursed from B's property.

#### 2. Payment by an interested person

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

**Example;**

P left his carriage on D's premises. D's landlord seized the carriage as distress for rent. P paid the rent to obtain the release of his carriage.

Held: P could recover the amount from D.

#### 3. Obligation to pay for non-gratuitous acts

When a person lawfully does anything for or delivers or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or restore, the thing so done or delivered.

**Example:**

A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. Then B is bound to pay for them to A.

#### 4. Responsibility of Finder of goods

A person, who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee. He is bound to take as much care of the goods as a man of ordinary prudence would, under similar circumstances, should take care as of his own goods of the same bulk, quality and value.

**Examples:**

F picks up a diamond on the floor of S's shop. He hands it over to S to keep it till true owner is found out. No one appears to claim it for quite some weeks in spite of the wide advertisements in the newspapers. F claims the diamond from S who refuses to return. S is bound to return the diamond to F, who is entitled to retain the diamond against the whole world except the true owner.

**5. Mistake or coercion**

A person to whom money has been paid, or anything delivered, by mistake or under coercion, must repay or return it to the person who paid it by mistake or under coercion.

**Examples:**

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

**Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss the kinds of Quasi contract.**

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**10.4 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

**10.5 ANSWER TO CHECK YOUR PROGRESS EXERCISE****Check Your Progress – 1**

1. See section 10.2

**Check Your Progress – 2**

1. See section 10.

## UNIT 11:

# CONTRACT OF INDEMNITY & GUARANTEE

### Structure

11.1 Objectives

11.2 Contract of Indemnity

11.3 Contract of Guarantee

11.4 Some Useful Books

11.5 Answer to Check Your Progress Exercise

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### 11.1 OBJECTIVES

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After studying this unit you should be able to:

- Define the contract of Guarantee & Indemnity.
- Understand the essentials of valid Guarantee.
- Describe the rights & liabilities of Surety.

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### 11.2 CONTRACTS OF INDEMNITY

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#### Definition:

Sec.124 of the contract Act defines a Contract of indemnity as a contract by which one party promises to save the other party from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person.

#### Example:

'A' contracts to indemnify 'B' against the consequences of any proceedings which 'C' may take against 'B' in respect of a certain sum or 1000 rupees. This is a contract of indemnity.

In the above example, 'A' is called the Indemnifier and 'B' the Indemnity-Holder or Indemnified.

*There are a few requisites for a valid contract of indemnity. They are:*

- A contract of indemnity must satisfy all the essentials of a contract.
- A contract of indemnity may arise either,  
(i) by an express promise or

(ii) by operation of law. E.g., the duty of a principal to indemnify an agent from consequences of all lawful acts done by him as an agent. Similarly, on a transfer of shares, the transferee, in law, undertakes to indemnify the transferor against all future loss.

- Under contract of indemnity loss to promisee is essential. Under promisee has suffered a loss, he cannot hold the promisor liable on the contract of indemnity.
- As per Indian Contract Act, the loss must have been caused either by the conduct of the promisor or any other person. But this any other person does not include promisee and an act of God such as accidents, death, disability, destruction by fire, cyclone, etc.
- As the Indian Contract Act is not exhaustive. at present Indian courts are following English law which covers promises to save a harmless person from loss caused by events such as accidents, death, disability, destruction by fire, cyclone etc.

#### **Rights of Indemnity-holder or Indemnified:**

The Indemnity-holder is entitled to recover from the promisor:

- All damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
- All costs of suit which he may have to pay to a third party, [provided he acted prudently or with the authority of the indemnifier]
- All sums which he may have paid upon compromise of such suit, (provided such compromise was prudent and was authorised by the indemnifier).

#### **Rights of Indemnifier:**

- The Act makes no mention of the rights of an indemnified. It has been held in *Aswant Singhji V. Secretary of Bombay State's case*, that, the indemnifier enjoys rights similar to the rights of a surety under section 141, i.e., he becomes entitled to the benefit of all the securities which the creditor has against the principal debtor, whether he was aware of them or not.

#### **Check Your Progress – 1**

Note:

1. Give your answer in the space given below.
2. Check your answers with those given at the end of the unit.

## 1. Discuss the contract of Indemnity.

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### 11.3 CONTRACT OF GUARANTEE

#### Definition (Section - 126):

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

#### Example:

'P' lends Rs.50, 000 to 'Q' and 'R' promises to 'P' that if 'Q' does not pay the money 'R' will make the payment to 'P'. This is a contract of guarantee.

The person who gives the guarantee is called the "Surety" - It is 'R' in the above example. The person for whom the guarantee is given is called the "Principal Debtor" - It is 'g' in the example. The person to whom the guarantee is given is called the "Creditor". It is 'P' in the example. In a contract of guarantee there are three parties namely, the creditor, the principal debtor and the surety.

#### Kinds of Guarantees:

A contract of guarantee may either be oral or in writing (Sec.126J, though a creditor should always prefer to put in writing to avoid any disputes regarding the terms etc. In case of an oral agreement the existence of the agreement itself is very difficult to prove.

From the point of view of the scope of guarantee a contract of guarantee may either be specific or continuing.

#### ▪ Specific Guarantee:

A guarantee is a 'specific guarantee', if it is intended to be applicable to a particular debt and comes to an end on its repayment. A specific guarantee once given is irrevocable.

#### Example:

'A' guarantees the repayment of a loan of Rs. 1,00,000 to 'B' by 'C' (a banker). The guarantee in this case is a specific guarantee:

#### ▪ Continuing Guarantee:

"A guarantee which, extend, to a series of transactions is called a continuing guarantee".

**Example:**

Mr. 'P' guarantees payment to Mr. 'B', a tea-dealer, to the amount of Rs. 1000 for any tea he may from time to time supply to Mr.'C'. Mr.'B' supplies Mr.'C' with tea to the value of Rs.1000 and Mr.'C' pays Mr.'B' for it. Afterwards Mr. 'B' supplies Mr.'C' with tea to the value of Rs.2000. Mr.'C' fails to pay. The guarantee given by Mr.'P' was a continuing guarantee, and he is liable to Mr.'P' to the extent of Rs.1000.

**A continuing guarantee is revoked under the following circumstances:**

- By notice of revocation by the surety.
- By the death of the surety, the estate of the surety is liable for an transactions entered into prior to the death of the surety. It is not necessary that the creditor must have notice of the death.
- By variation in contract.
- Creditor's act of omission.
- Novation.
- By discharge of principal debtor.

**Essentials of a valid contract of guarantee:**

All the three parties [i.e., the principal debtor, the creditor and the surety] must agree to make such a contract. A contract of guarantee may be oral.

The surety must make a clear promise that if the principal debtor does not perform his promise, he (surety) will perform that promise. So, the liability of the surety is secondary, i.e., "the creditor must first proceed against the principal debtor and if the latter does not perform the promise, then only, he can proceed against the surety.

There must be consideration between creditors and the surety to make the contract enforceable.

The liability of the surety must be legally enforceable.

**RIGHTS AND LIABILITIES OF SURETY:**

Rights of a surety can be discussed under three sub-divisions, namely,

- a) As against the Principal debtor
- b) As against the creditors and
- c) As against the co- sureties.

### **(A) RIGHTS AGAINST THE PRINCIPAL DEBTOR:**

(i) **Right of subrogation:** After paying the amount due to the creditor, the surety is subrogated to the right of the creditor. i.e., he has the same rights as those of the creditor and he can therefore, sue the principal debtor to exercise those rights.

(ii) **Right to demand securities from the creditor:** The surety is entitled to the benefit of securities which the principal debtor had given to the creditor, after he has performed the promise or paid the debt to the creditor.

(iii) **Right of indemnity:** The surety is entitled to be indemnified against all payments properly made by him. The surety is entitled to receive only that amount which he had paid rightfully to the creditor.

(iv) **Right to be relieved earlier:** A Surety can, even before making any payment, compel the debtor to relieve him from liability by paying off the debt. Provided the liability is an ascertained and subsisting one.

### **(B) RIGHT AGAINST THE CREDITOR:**

(i). In case of fidelity guarantee, Le., guarantee regarding good conduct, honesty etc. of the principal debtor, the surety can ask the creditor or the employer to dispense with the services of the principal debtor or the employee in case the latter is proved to be dishonest or has committed any act of dishonesty.

(ii). After the debt has become due and before the surety is called upon to pay, the surety may ask the creditor to sue the debtor and collect the amount. But the surety must undertake to indemnify the creditor any risk, delay or expense, resulting from such a suit. In no circumstances the surety can compel the creditor to sue the principal debtor before suing him (surety).

(iii). The surety can, after payment of the debt or performance of the promise of the principal debtor, recover all the securities which the creditor had either before or after the contract of guarantee was entered into [Sec. 141]. It is immaterial whether the surety was aware of such securities or not. He is entitled to all of them.

### **(C) RIGHT AGAINST THE CO-SURETIES**

(i). Where there are two or more sureties for the same debt either jointly or severally and, whether under the same or different contracts and, sureties were aware of such debts and if one of them is called upon to pay the debt of the principal debtor to the creditor, then such a

surety is entitled to recover the excess of the amount over and above his share which he had to pay from his co-sureties, in equal amount.

(ii). If the sureties agreed to stand as sureties in different amounts for the same debt, in case the principal debtor commits default and one of the co-sureties is asked to clear the debt, he is entitled to recover the amount from the co-sureties but not exceeding the amount which he had agreed originally to pay in the event of the default by the principal debtor.

### **Liabilities of a Surety:**

Unless the contract provides otherwise, the liability of the surety is co extensive with that of the principal debtor. In other words, the surety is liable for all those amounts, the principal debtor is liable for.

#### **Example:**

'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.

The liability of a surety is called as secondary or contingent as his liability arises only on default by the principal debtor. But as soon as the principal debtor defaults, the liability of the surety begins and is co-extensive of the principal debtor, i.e., the surety will be liable for all those sums for which the principal debtor is liable.

The creditor may file a suit against the surety without suing the principal debtor. Further, where the creditor holds securities from the principal debtor for his debt, the creditor need not first exhaust his remedies against the securities before suing the surety unless the contract specifically so provides. The creditor is not bound to give notice of the default to the surety, unless it is expressly provided for.

### **WHEN A SURETY IS DISCHARGED FROM LIABILITY:**

The liability of a surety under contract of guarantee comes to an end under any one of the following circumstances:

#### **Notice of Revocation:**

In case of a continuing guarantee, a notice by the surety to the creditor stating that he will not be responsible, will revoke his liability as regards all future transactions. He will remain liable for all transactions entered into prior to the date of the notice [Sec. 130].

#### **(ii) Death of Surety:**

In case of continuing guarantee the death of a surety discharges him from all liabilities as regards transactions after his death unless there is a contract to the contrary [Sec. 131]



**(iii) Variation of Contract:**

Any variance, made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance [Sec. 133].

**Example:**

'C' contracts to lend Rs. 10,000 on the 1st March. 'A' guarantees repayment. 'C' pays Rs. 10,000 to 'B' on the 1st January. 'A' is discharged from his liability, as the contract has been varied in as much as 'C' might sue 'B' for the money before 1st March.

**(iv) 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.

**(v) Arrangement with 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 [Sec. 135].

**(vi) By Creditor's Act or Omission Impairing Surety's Eventual Remedy [Sec:139]:**

If the creditor act which is inconsistent with the right of the surety, or omits to do any act which is his duty to the surety, and the eventual remedy of surety himself against the principal debtor is thereby impaired, the surety is discharged.

**(vii) Loss of Security:**

If the creditor loses or parts with any security given to him by the principal debtor at the time the contract to guarantee was entered into, the surety is discharged to the extent of the value of the security, unless the surety consented to the release of such security [Sec. 141].

**Check Your Progress – 1**

Note:

1. Give your answer in the space given below.
2. Check your answers with those given at the end of the unit.

**1. Discuss the kinds of Guarantee.**

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## 2. Discuss rights & liabilities of Surety.

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## 3. Discuss when Surety is discharged from liability.

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### 11.4 SOME USEFUL BOOKS

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### 11.5 ANSWER TO CHECK YOUR PROGRESS EXERCISE

#### Check Your Progress – 1

1. See section 11.2

#### Check Your Progress – 2

1. See section 11.3

## UNIT 12:

# CONTRACT OF BAILMENT & PLEDGE

### Structure

- 12.1 Objectives
- 12.2 Introduction
- 12.3 Different kinds of Bailment
- 12.4 Duties & Liabilities of the Bailor
- 12.5 Duties & Liabilities of the Bailee
- 12.6 Particular & General Lien
- 12.7 Finder of Goods
- 12.8 Contract of Pledge (or) Pawn
- 12.9 Some Useful Books
- 12.10 Answer to Check Your Progress Exercise

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### 12.1 OBJECTIVES

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After studying this unit you should be able to:

- Define the contract of Bailment & different kinds of Bailment.
- Understand the duties & Liabilities of Bailor and Bailee.
- Describe particular & General Lien.
- Explain about Termination of Contract of Bailment.

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### 12.2 INTRODUCTION

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#### Definition of Bailment (Section 148) :

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". The transaction is called "Bailment".

**Example :**

- 'P' lends his book to 'g'.
- 'P' delivers a pen to 'g' for repair.
- 'P' gives 'g' his watch as security for a loan.
- In all these cases 'P' is the bailor and 'g' is the bailee.

**Requisites of a valid contract of Bailment :**

▪ **Contract:**

Bailment is the result of a contract between the owner of the goods and the other to whom they are delivered temporarily with condition that they shall be returned or disposed of according to the discretion of the person delivering them, Sometimes the bailment arises from implied contract i.e., finder of goods.

▪ **Delivery of goods:**

The delivery of goods is made to convert the transaction into a contract of bailment. Sometimes, if the goods are already in possession of a person who agrees to hold them on behalf of the owner, a contract of bailment is thereby entered into although the goods were never delivered. In this case it is called constructive delivery. If the key of the go-down where the goods are lying is given to the buyer, It will also amount to constructive delivery of goods. The goods are not delivered permanently but are returnable or disposed of according to the directions of the person delivering them.

▪ **Purpose:**

The goods are delivered to another person for some specific purpose. The bailee will have to complete the purpose for which it is given to him before returning it to the bailor.

▪ **Ownership:**

In bailment the bailor continues to be the owner of the goods. Therefore bailment does not cause any change of ownership.

▪ **Movable goods:**

Bailment is concerned with only movable goods. Money is not included in the category of movable goods i.e., a deposit of money is not bailment. The relationship between depositor and the bank is that of borrower and the lender.

▪ **Possession:**

A person already in possession of the goods becomes a bailee by a subsequent agreements, express (or) implied.

**Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

## 1. Discuss requisites of valid contract of Bailment.

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### 12.3 DIFFERENT KINDS OF BAILMENT

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#### Bailment may be classified into

- Voidable Bailment
- Gratuitous Bailment and
- Bailment for Reward.

#### (a) Voidable Bailment :

A contract of bailment is voidable 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.

##### **Example:**

'A' lends to 'B', on hire, a horse for his riding. 'B' drives the horse in his carriage. This contract can be terminated at the option of A'.

#### (b) Gratuitous Bailment:

A gratuitous bailment is one when the goods are delivered to another without any charge or consideration on the condition that they shall be returned to the bailor. In such cases, the following points must be considered:

- The bailor may at any time ask the bailee to return the goods even though they might have been bailed for a specific time or purpose [Sec. 159].
- The bailor must indemnify the gratuitous bailee, if the bailee is asked to return the goods before the expiry of the specified period or before the fulfillment of the purpose, for which the goods were bailed provided the bailee in such a case suffers a loss greater than the benefit which he has derived from the gratuitous bailment for the goods (Sec. 159).
- A gratuitous bailment is terminated by the death either of the bailee or of the bailor [Sec. 162).

#### (c ) Bailment for Reward:

A bailment for reward is one where either the bailor or the bailee is entitled to a remuneration.

##### **Example:**

Motorcar let out for hire; goods given to a carrier for carriage for a price: articles given to a person for being repaired for a remuneration etc.

Bailment can also take from any one of the following:

- a. Deposit
- b. Gratuitous
- c. Hire
- d. Pledge
- e. Carriage
- f. Given to complete a work

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss different kinds of Bailment.**

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### **12.4 DUTIES & LIABILITIES OF THE BAILOR**

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#### **(a). 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 risk, and if he does not make full disclosure, he is responsible for damage arising to the bailee directly from such faults (Sec.150].
- In case of bailment for reward (or) non-gratuitous bailment, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed".

#### **Example:**

'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. '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.

#### **(b). To repay expenses to the bailee:**

- In case of gratuitous bailment all ordinary expenses are to be borne by the bailee while extraordinary expenses are to be borne by the bailor and if the bailee has incurred such expenses, the bailor must repay to the bailee all such expenses. On the other-hand, in the case of non-gratuitous bailment, the bailor must repay even the ordinary expenses incurred by the bailee [Sec. 158].

(c). **To indemnify the bailee :**

- If the bailee has suffered any loss which arose from defective title of the bailor, the bailor has to compensate the bailee [Sec.164]

**Example:**

'A' gives B's car to 'C' for use without B's knowledge or permission. 'B' sues 'C' and receives compensation. 'C' is entitled to recover the losses from 'A'.

- In the case of non-gratuitous bailment, if the bailor demands back the goods bailed before the specified time or the fulfillment of the purpose for which they were bailed, he must indemnify the bailee for any loss which the bailee has suffered.

**Rights of the Bailor**

- To get back the goods after expiry of the time for which they were bailed (or) after the accomplishment of the purpose of bailment.
- To get back the goods from the bailee at any time if it is a gratuitous bailment. Even if the goods are bailed for a specific period the bailee will have to be indemnified for any loss which might be more than the benefit he derived out of the gratuitous bailment and which he might suffer due to early termination of the contract of bailment.
- To terminate the contract of bailment if the bailee is guilty of an act in respect of the bailed goods that is inconsistent with the terms of bailment.
- If the bailee has not been able to recover any compensation from the wrong-doer of the goods bailed, the bailor shall be entitled to proportionate compensation according to the loss suffered by the bailor.
- The bailor may enforce the duties of the bailee..

**Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss Duties & Liabilities of Bailor.**

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## 12.5 DUTIES & LIABILITIES OF THE BAILEE

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**(a). Not to Make Unauthorised Use of Goods:**

The bailee is responsible to the owner if he uses the goods bailed in a manner inconsistent with the conditions of the bailment and asks the bailor to return the goods (sec. 153). If the bailor has suffered any loss on account of any unauthorised use, the bailee must indemnify the bailor [Sec. 160].

**(b). To Return the Goods Bailed [Sec.160] :**

The bailee must return the goods bailed on the expiration of time or accomplishment of the purpose for which the goods were bailed. The goods must be returned to the bailor or disposed of according to his direction. Moreover, the goods must be returned without any demand from the bailor [Sec. 160].

**'Example:**

'A' hires a horse in Calcutta from 'B' to march to Henaras. 'A' rides with lot of care, but marches to Cuttack instead. The horse accidentally falls and is injured. 'B' is liable to make compensation to 'A' for the injury to the horse.

**(c ). Indemnity:**

If the bailee does not return the goods according to the terms of the bailment, the bailee must indemnify the bailor for any loss, destruction or deterioration of the goods from the date of expiry of the time for which the goods were bailed.

**(d). To Take Reasonable Care of the Goods Bailed:**

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 (Sec. 151) In spite of enough care, if the goods are destroyed or spoiled, in the absence of any special contract, the bailee is not liable for the loss (Sec. 152). A bailee is liable for damages caused by negligence of the servants.

**(e). To Deliver any Accretion to the Goods Bailed:**

In the absence of a contract to the contrary, the bailee must return to the bailor any addition or profit accruing from the goods [Sec. 163].

**Example:**

'X' leaves a cow in the custody of 'Y' to be taken care of. The cow has a calf. 'Y' is bound to deliver the calf as well as the cow to 'X'.



**(f). Not to Mix Bailor's Goods With his Own Goods [Sec. 155-157]:**

The bailee must not mix his own goods with these of the bailor without the consent of the bailor. If such mixed goods can be separated, the cost of separation will have to be borne by the bailee. If the goods so mixed cannot be separated, all the damages and the cost of the goods must be paid by the bailee.

**Example:**

'O' bails superior flour worth Rs. 10, 000 to 'B'. Without 'D's consent, 'B' mixes the flour with inferior quality flour of his own, worth only Rs.2000. 'B' must compensate 'O' for the loss.

**(g). To Compensate for Setting up of Adverse Title:**

The bailee must not set up an adverse title to the goods of the bailor. If he does so., he must compensate for the same.

**Rights of the Bailee:**

Generally, the bailee can, by suit, enforce the duties of the bailor.

The bailor is entitled to be rewarded if the goods were bailed to be worked upon by him [Sec. 148]

The bailee has a right to be compensated if he has suffered any loss from the defect in the goods, which the bailor bailed and which he did not disclose [Sec. 150].

The bailee has a right to be compensated if he has suffered any loss from the fact that the bailor was not entitled to bail the goods [Sec. 164]. "If the bailor has no title to the goods', and the bailee, in good faith, delivers them back to or according to directions of the bailor the bailee is not responsible to the owner in respect of such delivery" [Sec. 166].

The bailee is entitled to recover reasonable expenses incurred by him in connection with the goods bailed.

If the bailee is deprived of the goods bailed by a third person, he has a right to sue such a person to recover the goods from him as if the goods belonged to him. If he has incurred any expense in such a case, he can recover the amount from the bailor.

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

The bailee has a right to exercise lien. The right of a person to retain the property of another person till his claim against the other is satisfied is called the right of lien. Lien signifies the right of a person, who is in possession of the goods of another, to retain such

possession until the debt due to him has been discharged. This right is sometimes called a 'Possessory Lien'.

#### **Check Your Progress – 4**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss Duties & Liabilities of Bailee.**

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### **12.6 DUTIES & LIABILITIES OF THE BAILEE**

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This lien may be of two types, namely,

- a. Particular lien
- b. General lien

#### **PARTICULAR LIEN OR SPECIFIC LIEN**

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

##### **Example:**

If 'X' gives a piece of cloth to 'Y', a tailor, for making a suit and if 'X', does not pay the lawful charges to the tailor, the tailor has a right to refuse the delivery of the suit. Unlike general lien, the tailor has no right to retain any other items of cloth of 'X' other than the suit. for the pending charges from 'X'.

The right of 'Particular lien' can be exercised by the bailee under the following circumstances only.

- The particular lien is available only if the service rendered by the bailee is one involving the "exercise of labour and skill" in respect of the goods bailed. There is no lien for custody charges or other charges for work not involving labour or skill.
- The right of lien cannot be exercised until the services have been performed in full. When a bailee has done only a part of the work contracted for. he cannot claim lien for part payment.
- The lien cannot be claimed if there is an agreement to pay the money on a future date.

- The lien can be exercised only so long as the goods are in the possession of the bailee. If possession is lost for any reason the lien is also lost.

#### **Persons entitled to exercise particular lien :**

- The bailee (Sec. 170), e.g., a carrier, mechanics, repairers, tailors watch-makers, etc.
- Unpaid seller of goods under Sec. 47 of the Sale of Goods Act.
- Agents in respect of their claims against their principals under Sec. 221 of Indian Contract Act.
- A partner of a firm, under Sections 46 and 52 of the Partnership Act.
- Finder of the goods under Sec. 168 of the Contract Act.
- Pawnee and pledgee under Sec. 173 of the Contract Act.

#### **GENERAL LIEN:**

Title 'general lien' is a right to retain the goods belonging to another; not only for the discharge of a debt or liability incurred in *connection with those goods* but also for a general balance of account between the owner and the person detaining the goods. Bankers, factors, wharfingers, attorneys of the Highcourts, policy-brokers may, in the absence of a contract to the contrary, exercise, the general lien and retain as a security for a general balance of account any goods bailed to them but no other person has a right to retain as a security for such balance, goods bailed to them, unless there is an express contract to that effect [Sec. 170).

#### **Check Your Progress – 5**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about General & Particular Lien.**

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### **12.7 FINDER OF GOODS**

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Rights and Responsibilities of a person who finds the goods belonging to another and takes them into his custody.

**Responsibility (or) Duties :**

- If the finder of goods takes the goods that he has found into his custody he must try to find out the owner of the goods and incur necessary expenses.
- He must take as much care of the goods found as he would have taken care of his own goods of the same bulk quality and value till he finds the owner. He is considered to be the bailee though no formal contract has been entered into between him and the owner.
- He must incur expenses to preserve the goods, e.g.; if he finds a cow, he must properly feed it to keep it alive.
- If there is an accrual to the goods found, he must return it to the true owner.

**Rights of a Finder of Goods :**

- He can retain the goods till his lawful charges in finding the owner and preserving it are paid to him by the owner.
- If the owner of the lost goods had announced a reward the finder can sue the owner for the reward and he can exercise the right often on the goods till the announced reward is paid to him.
- The finder of the goods may sell them,
  - (i) if the owner of the goods cannot be found after reasonable efforts; or
  - (ii) if the owner refuses to pay the lawful charges
  - (iii) if the goods are in danger of perishing or losing the greater part of their value and
  - (iv) his lawful charges amount to two-third of the value of the goods.

**TERMINATION OF BAILMENT**

A contract of bailment terminates under the following circumstances:

**Expiry of Time:** If the bailment is for a stipulated period, the bailment terminates as soon as the stipulated period expires.

**Fulfillment of Purpose:** If the bailment is for a specific purpose, the bailment terminates as soon as the purpose is fulfilled.

**Act Inconsistent With the Terms:** If the bailee does any act, with regard to the goods bailed, which is inconsistent with the terms of the bailment, the bailment terminates (Sec. 153).

**Goods Lent Gratuitously:** A gratuitous bailment can be terminated anytime. But if premature termination causes any loss to the bailee the bailor must compensate the loss.

**Death:** A gratuitous bailment terminates upon the death of either the bailor or the bailee.

### **Check Your Progress – 6**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about Finder of Goods.**

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## **12.8 CONTRACT OF PLEDGE [OR] PAWN**

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### **Definition:**

The bailment of goods as is security for payment of a debt or performance of a Promise is called pledge or pawn. The bailor in this case is called pledgor or pawnor. The bailee is called the pledgee or the pawnee [Sec. 172).

### **Essentials of a Valid Pledge:**

- There must be a debt or a promise to perform some act.
- Goods are bailed by way of security for the repayment of the debt or the performance of the promise.
- Goods to be pledged must be delivered to the pledge.
- Only movable goods can be pledged.
- Legal possession is necessary in case of pledge and therefore mere physical possession cannot be considered to be a pledge, e.g., a servant cannot pledge the goods belonging to his master because legally he is not the owner of those goods.

### **Rights of Pledge or Pawnee:**

#### **(i).Right of Retainer :**

The pawnee can retain the goods pledged not only for payment of the debt or the performance of the promise, but also for the interest of the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged" {Sec. 173}. The pawnee enjoys only particular lien. If the pawnee makes fresh advances to

the same debtor it will have presumed that the debtor has agreed to create lien or, the goods already pledged for the fresh advance [Sec. 174].

**(ii) Right to Sell:**

The pawnee may sell the goods by giving reasonable notice to the pawnor if the principal debt and the interest is not paid to him even if the pawnor's title to the goods was defective. If the sale results in deficit he can recover the remaining amount by filing a suit against the pawnor.

**(iii). Right to Sue the Pawnor:**

If the pawnor does not repay the debt or perform the promise after the expiry of the period, he may sue the pawnor for the same without losing his right of lien or the right to sell the goods pledged.

**Rights of Pledgor or Pawnor :**

- **Defaulting Pawnor's Right to Redeem:**

A pawnor who has committed default in the payment on the debt (or) in the performance of the promise within the stipulated time may redeem (take back) the goods pledged, before the pawnee has sold the goods by giving a reasonable notice.

- **Presentation and Maintenance :**

The pawnor can enforce the reservation and proper maintenance of the goods pledged.

- **Protection of Debtors :**

The pawnor as a debtor has various rights given to him by statutes enacted for the protection of debtors e.g., Money Lender

**When can a Non-owner Make a Valid Pledge?**

The owner of goods can always make a valid pledge. In the following, cases one who is not an owner can make a valid pledge,

- **Mercantile Agent [Sec. 178]:**

A mercantile agent who is in possession of goods, with the consent of the owner, can make a valid pledge provided the pawnee acts in good faith and has not noticed at the time of the pledge that the pawnor has no authority to pledge.

- **Person in possession of Goods Under Voidable Contract:**

When a person has obtained possession of goods under voidable contract, he can make a valid pledge before the contract has been revoked provided the pawnee acts in good faith and without any notice of any defect in the title of the pawnor.

▪ **Pawnor with a Limited Interest (Sec. 1791:**

A person who has only limited interest in the goods can make a valid pledge to the extent of that interest.

▪ **possession with Co-owner:**

If of several co-owners is in sole possession of the goods with the consent of the other owner, he can make a valid pledge of the goods {Sec. 30(1)] of Sale of Goods Act.

▪ **Seller in possession of Goods After Sale:**

A seller in possession of the goods after the sale, and the buyer to whom the possession had been delivered before payment of the price, may make a valid pledge, provided the pawnee acted in good faith and had no prior notice to this effect.

**Check Your Progress – 7**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss Contract of Pledge or Pawn.**

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**12.9 SOME USEFUL BOOKS**

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyam Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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**12.10 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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**Check Your Progress – 1**

1. See section 12.2

**Check Your Progress – 2**

1. See section 12.3

**Check Your Progress – 3**

1. See section 12.4

**Check Your Progress – 4**

1. See section 12.5

**Check Your Progress – 5**

1. See section 12.6

**Check Your Progress – 6**

1. See section 12.7

**Check Your Progress – 7**

1. See section 12.8





## UNIT 13:

# CONTRACT OF AGENCY

### Structure

- 13.1 Objectives
- 13.2 Introduction
- 13.3 Creation of Agency
- 13.4 Rights & Duties of Principal, Agents & Third Party
- 13.5 Termination
- 13.6 Some Useful Books
- 13.7 Answer to Check Your Progress Exercise

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### 13.1 OBJECTIVES

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After studying this unit you should be able to:

- Define the contract of Agency and classification of agents.
- Understand the rights & duties, of principal, agents & third party.
- Describe the liabilities of principal & agents.
- Explain about Termination of Contract of agency.

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### 13.2 INTRODUCTION

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#### DEFINITION OF AN AGENT: -

Person employed to do any act for another or to represent another in dealings with third person.

A approves B a broker to sell his car on his behalf then

A Principal & B Agent

Relationship between A and B is Agency

Act of an agent is the act of the principal

#### NATURE OF AGENCY

Who can employ an Agent?

A major

Partnership firms

Of sound mind

Company an Artificial person

### Who may be an Agent?

- Person who is capable of contracting

(If the agent happens to be a person incapable of contracting, then the principal cannot hold the agent liable, in case he misconducts or has been negligent in performance of his duties)

- **Agent & Servant:**

Agent is not a sort out – servant may be an agent – Agent may work for several principles at the same time.

### CLASSIFICATION OF AGENT:

#### (A). Agents are classified as:

- **Commercial Agent (or) Mercantile Agent**
- **Non-Commercial Agent (or) Non-Mercantile Agent**

#### Mercantile or Commercial Agent:-

- **Broker**

Agent engaged to buy and / or to sell property or to make bargains and contracts between the engager and a third party for a commission called brokerage.

- **Factor**

Agent who is entrusted with possession of goods with an authority to sell them. He can sell the goods on credit on in his own name. He is also authorized to raise money on their security.

- **Commission Agent**

Agent who is employed to buy or sell goods or transact business.

- **Delcredete Agent**

Agent who's consideration of an extra remuneration called a delcredete commission guarantor the performance of the contract by the other parties.

- **Auctioneer**

Agent appointed to sell goods by auction.

- **Banker**

Buying & selling of securities, Collection of charges, bills, interests, etc.

#### Non Commercial Agent:-

- **Wife:**

If the wife and husband are living together and the wife is booking for necessities she is an agent. When the wife lives a part from the husband, through no fault of hers, the husband is liable to provide her maintenance. If he does not provide for her maintenance, she has implied authority to bind the husband for recessed.

## (B) Delegation of Agent :-

### ▪ Subagent and substituted Agent

General rule is that an agent cannot appoint an agent. However an agent may appoint an agent in the following circumstances.

- a. Whose expressly permitted by the principal
- b. Where the ordinary custom of trade premises delegation
- c. The nature of agency is such that it can be accomplished without the appointment of sub agent.
- d. Where the nature of the job assigned to the agent purely clerical and does not involve the exercise of discretion
- e. In an unfrozen emergency

### ▪ Sub Agent

- a. Person employed by acting under the control of the original agent in the business of the agency.
- b. There is no priority of contact between the subagent and the principal.

### ▪ Substituted Agent:

- a. Where an agent appoints or names other person for being appointed as an agent in his person, such person is called a substituted agent.

#### **Example:**

A directs B, his solicitor to sell his house 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.

## **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss the Definition & Nature of Contract of Agency.**

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### **1. Discuss the Classifications of Contract of Agency.**

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### 13.3 DIFFERENT KINDS OF BAILMENT

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**AGENCY CAN BE CREATED IN THE FOLLOWING WAYS AS MENTIONED BELOW:**

- Creation of an Agency**
- 1) By an express agreement
  - 2) By Implication
  - 3) By ratification.

Consideration is not essential to create an agency

**[A] Express Agency**

The authority of an agent may be expressed by the following forms:

- Word of Mouth (Oral)
- By writing-usual form of written of agency – Power of Attorney are stamped paper.

**[B] Implied Agency**

Implied agency is possible by the below said method:

- From conduct, situation or relationship of parties.

**Agents authority and liability of principal and third party**

The implied agency arises when the principal conducts himself towards the person alleged to be the agent or the third parties in such a manner, as if the principal had concerned to the appointment of that person as agent. It includes:

**a) Agency by Estoppels**

When a person has by his conduct or statements induced others to believe that a certain person is his agent; he is estoppels from subsequently denying it. Estoppels arise when you are precluded from denying the truth of anything which you have represented as a fact, although it is not a fact.

**b) Agency by holding out**

P allows his servant A to buy goods for him as credit from C and pays for them regularly. On the occasion, P pays his servant cash to purchase the goods. The servant purchases the goods on credit, pocketing the money. C can recover the price from P since through previous dealings P has held out his servants A as his agent.

**c) Agency of Necessity**

When somebody is forced to act on behalf of a particular person.

**Example,** two master of a ship which is in distress or requires heavy and urgent repairs can pledge the ship or cargo (without express or implied authority) and raise money in order to execute the voyage. He will be considered at the agent of the owner by necessity.

### [C] Agency by ratification

When an agent does an act for his principal but without knowledge or authority or while he exceeds the given authority, the principal is not held bound by the transaction. Principal if he so desires can ratify the act of the agent. Agency in such a case owner into existence from the moment the agent first acted.

#### **Requisites of a valid ratification**

- Agent must contract as agent
- Principal must have been in existence at the time the agent originally acted
- Principal must also be competent of contracting at the time of contract as well as at the time of ratification
- Ratification must be done within a reasonable time
- The act to be ratified must be a lawful one
- Principal should have full knowledge of facts
- Ratification must be of a contract as a whole
- Principal must have authority to ratify
- Ratification cannot be made so as to subject a third party to damage or terminate any right or interest of a third person.

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit. ..

#### **1. Discuss Creation of Contract of Agency.**

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### **13.4 RIGHTS & DUTIES OF PRINCIPAL, AGENT & OTHER PARTY**

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#### **RIGHTS AND DUTIES OF PRINCIPAL, AGENTS & THIRD PARTY :**

##### **[A] Rights of an agent**

- Right to receive agreed or reasonable remuneration

- Right to retain moneys of the principal towards advances made or expenses properly included by him
- Right of lien to retain properties of the principal for the amount due to himself for commission, disbursements or services rendered.
- Right of stoppage- in transit -in case
  - (i) Where he purchase goods with his own funds or by incurring personal liability
  - (ii) Where he holds himself liable for the price of the goods sold, for example delcredete agent

#### **[B] Principal's duties to agent**

- To indemnify the agent against the consequences of all lawful acts does by such agent in exercise of authority conferred upon him.
- Liable to indemnify an agent against the consequences of an act done it, good faith, though it causes an inquiry to the right if third persons.
- The principal is not liable for acts, which are criminal in nature though done by the agent at the instance of the principal.
- The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.

#### **[C] Duties of agent**

- To conduct the business of agency to the principle's directions and not to deviate even for the benefit of the principal
- To conduct the business with the diligence and skill generally possessed by persons engaged in similar business
- To render proper accounts
- In case of difficulty to communicate with the principal
- Not to make any secret profits
- Not to deal on his own account
- Not entitled to remuneration for business misconduct
- An agent should not disclose confidential information
- When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to taken behalf of the representatives of his late principal, all reasonable states for the protection and preservation of the interests entrusted to him.

## LIABILITY OF PRINCIPAL OR AGENTS TORTS

### [A] Liability of principal to third persons

- Contracts entered into through an agent and obligations arising from acts done by an agent may be enforced in the same manner and will have the same legal consequence as contracts had been entered into and the acts done by the principal in person.
- Liable for the acts of the agents falling within actual authority, apparent or ostensible authority.
- Principal will be liable even for misrepresentations made or frauds constituted, by an agent for his benefits.

### [B] Personal liability of an agent

- Where acting for a foreign principal
- Where acting for a principal whose name is does not disclose
- Where the principal cannot be sued e.g. minor
- Where he acts without authority or exceeds authority
- Where he agrees to be personally bound
- Where he signs a negotiable instrument in his own name
- Where he is a factor or an auctioneer
- Where he is guilty of fraud or misrepresentations in matters outside his authority.
- Where trade or custom makes him personally liable
- Where agency is one coupled with interest

### Check Your Progress – 3

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### 1. Discuss Rights & Duties Principal, Agents & Third Party.

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## 13.5 TERMINATION OF AGENCY

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The various modes of termination of agency as mentioned below:

by revocation by the principal

on expiry of fixed period of time  
on the performance of the specific purpose  
In the event of insanity or death of the principal or agent  
on destination of the subject – matter of agency  
In the event of insolvency of the principal  
by renunciation of agency by the agent.

#### **Check Your Progress – 4**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss Termination of Agency.**

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#### **13.6 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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#### **13.7 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

##### **Check Your Progress – 1**

1. See section 13.2

##### **Check Your Progress – 2**

1. See section 13.3

##### **Check Your Progress – 3**

1. See section 13.4

##### **Check Your Progress – 4**

1. See section 13.5



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## UNIT 14: SALE OF GOODS ACT 1930

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### Structure

- 14.1 Objectives
- 14.2 Sales Contract
- 14.3 Transfer of Title & Risk of loss
- 14.4 Warranties in Sales Contract
- 14.5 Performance of Sales Contract
- 14.6 Conditional Sales & Rights of an unpaid seller
- 14.7 Some Useful Books
- 14.8 Answer to Check Your Progress Exercise

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### 14.1 OBJECTIVES

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After studying this unit you should be able to:

- Define Sale of Goods Act definition and the differentiation of sale & agreement to sell.
- Understand transfer of title & risk of loss.
- Describe the warranties in sales & performance of contract.
- Explain the conditional sales & rights of unpaid seller.

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### 14.2 THE SALE OF GOODS ACT 1930

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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. There may be a contract of sale between one part-owner and another. A contract of sale may be absolute or conditional. The term '**contract of sale**' is a generic term and includes both a *sale* and an *agreement to sell*

### DEFINITIONS

#### Sale:

- A contract of sale of goods is a contract whereby the seller transfer or agrees to transfer the property in goods to the buyer for price.
- There must be at least the parties
- Transfer or agreement to transfer the ownership of goods
- Subject matter: Goods
- Consideration: Price
- May be absolute or conditional
- All other essentials of a valid contract must be present

**Example for Sale:**

A sells his Yamaha Motor Bicycle to B for Rs.10, 000 Ownership has been transferred from A to B.

**Agreement to Sell:**

- A agrees to sell certain goods to B. The goods are on the way from London to Mumbai in a ship. Property of the goods will pass to the buyer when the goods came to the port; the agreement is subject to the condition that the ship arrives in port with the goods.

**SALE AND HIRE PURCHASE DISTINGUISHED:**

Hire Purchase – Agreement for hire with an option to purchase. Hirer will become owner of the good on the payment of last installment of hire charges. Owner can terminate the contract.

**Installment sale & Hire Purchase are different** – H.P – Hirer has option to purchase. In Installment sale – Buyer has bought or agreed to buy the goods.

**Differences between sale and agreement to sell**

Sale	Agreement To Sell
<ul style="list-style-type: none"> <li>▪ Executed Contract</li> </ul>	<ul style="list-style-type: none"> <li>▪ Executory Contract</li> </ul>
<ul style="list-style-type: none"> <li>▪ Seller can sue the buyer for price of goods.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Seller can only sue for damages with reference to the price that was payable at a stated date.</li> </ul>
<ul style="list-style-type: none"> <li>▪ In case of loss of goods, the loss will fall on the buyer, even if goods are in possession of seller. Risk is associated with ownership.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Loss to be owned by the seller even if goods are in possession of the buyer.</li> </ul>
<ul style="list-style-type: none"> <li>▪ In case buyer pays the price &amp; the seller thereafter becomes an insolvent, the buyer can claim the goods from official receiver or assignee.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Buyer cannot claim the goods.</li> </ul>
<ul style="list-style-type: none"> <li>▪ Buyer recovers in solvent without paying the price; the seller will have to deliver the goods to official assignee or receiver except where he has lien on the goods.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Seller can refuse to deliver the goods to the official assignee or receiver.</li> </ul>

**What is called as goods?****Goods :-**

Every kind of moveable property other than auctionable claims & money

- Money itself (legal tender) cannot be the subject for sale

- Foreign Currency may however be bought or sold

#### **Auctionable Claim:**

Things which a person cannot make use of, but which can be claimed by him by means of legal action of a debt.

#### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Definition Sale of Contract.**

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#### **2. Differentiate Sale & Agreement to sell.**

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### **14.3 TRANSFER OF TITLE & RISK OF LOSS**

#### **TRANSFER OF PROPERTY :-**

Transfer of property in goods from the seller to the buyer is the main object of a contract of sale. The term property in goods must be distinguished from possession of goods. Property in goods means the ownership of goods, whereas possession of goods refers to the custody or control of goods. An article may belong to A, although it may not be in his possession. B may be in possession of that article though he is not its owner. It is important to know the precise moment of time at which the property in goods passes from the seller to the buyer for the following reasons:

- ***Risk follows ownership***

Unless otherwise agreed, risk follows ownership whether delivery has been made or not and whether price has been made or not.

- ***Action against third parties***

When the goods are in any way damaged or destroyed by the action of third parties, it is only the owner of the goods who can take action against them.

- ***Insolvency of the seller or the buyer***

In the event of insolvency of either the seller or the buyer, the question whether the official receiver or assignee can take over the goods or not depends on whether the property in the goods has passed from the seller to the buyer.

▪ ***Suit for price***

The seller can sue for the price, unless otherwise agreed only if the goods have become the property of the buyer.

**PASSING OF PROPERTY :-**

The primary rules for ascertaining, when the property in goods passes to the buyer is as follows;

***i) Goods must be ascertained***

When there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained.

***ii) Intention of the parties***

Where there is a contract for the sale of specific or ascertained of goods, the property in them passes to the buyer at the time when the parties intend it to pass.

**TRANSFER OF PROPERTY BASED ON THE CLASSIFICATION OF GOODS:**

**[A]. Existing Specific and ascertained :**

The rules relating to transfer of property in specific goods are as follows:

***i) Passing of property at the time of contract***

Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made.

***ii) Passing of property delayed beyond the date of the contract***

***a) Goods not in a deliverable state:***

Where there is a contract for the sale of specific goods not in a deliverable state.

***b) When the price of goods is to be ascertained by weighing:***

Where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof.

**[B]. Generic and un-ascertained :**

When there is a contract for the sale of unascertained goods, the property in the goods does not pass to the buyer until the goods are ascertained. Until goods are ascertained there is merely an agreement to sell.

1. Future Goods

2. Contingent Goods

**Example:**

A owns an India car show room of 50 cars, and agrees to sell any one of them to the contract is for unascertained goods. Since which particular shall become the subject matter of sale is not individualized at the time of the contract of sale.

- An agreement to sell future crops of a particular field implies an agreement to sell future goods.
- A agree to sell to B a certain painting, only if C, its present owner sells it to A. This painting is classified as contingent goods.

#### **[C]. Goods sent on approval or 'on sale or return'**

When goods are delivered to the buyer on approval or 'on sale or return' or other similar terms, the property therein passes to the buyer;

- i) When he signifies his approval or acceptance to the seller.
- ii) When he does any other act adopting the transaction.
- iii) If he does not signify his approval acceptance to the seller but retains the goods without giving notice of rejection, beyond the time fixed for the return of the goods, or if no time has been fixed, beyond a reasonable time.

#### **CONTRACTS INVOLVING SEA ROUTES :**

There are certain special clauses and conditions for the transfer of property through the sea and these are follows;

##### **▪ F.A.S. contracts**

'Free alongside ship'. The property in goods sold under an F.A.S. contract passes from the seller to the buyer when the goods are delivered alongside the ship. The sold goods will be named by the buyer under a contract of carriage. Seller's duties under F.A.S are as follows:

- i) To deliver the goods by alongside the ship
- ii) To notify the buyer immediately that the goods have been delivered alongside the ship
- iii) To pay all charges and to bear all risks from the goods delivered alongside the ship.

##### **▪ F.O.B. contracts**

'Free on board'. Seller sends the goods on a ship at his selling point at his own expense under a contract by sea, to be made by or on behalf of the buyer, for the purpose of transmission to the buyer. Seller's duties under F.O.B are

- i) To deliver the goods on board the ship, the name of the buyer will be documented. When once the goods are put on board the ship, they are at the risk
- ii) To give notice of the shipment to the buyer so as to enable him to protest himself by insurance against loss during the sea transit.

▪ **Buyer's duties under F.O.B-**

- i) To arrange for the contract of affreightment
- ii) To name the ship to which the goods are to be delivered or to authorize the seller to select the ship

▪ **C.I.F. contracts**

It is a contract performed by the delivery of documents representing the goods to the buyer, through a bank.

**PRICE AS INFLUENCING FACTORS IN SALE OF GOODS**

Money consideration for sale of the goods:

- Price may be either fixed by the contract
- May be agreed to be fixed in a manner provided by the contract. e.g., by a value
- May be determined by the course of dealing between the parties

**Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss Transfer of Property.**

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**2. Discuss Transfer of property based on classification of Goods.**

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**3. Discuss Contract in Sea Routes.**

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#### 14.4 WARRENTIES IN SALES CONTRACT

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A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty.

▪ **Condition:**

A condition is a stipulation which is essential to the main purpose of the contract. It goes to the root of the contract.

▪ **Warranty:**

A warranty is a stipulation which is collateral to the main purpose of the contract. It is not of such vital importance as a condition.

#### DIFFERENCE BETWEEN A CONDITION AND WARRANTY :

CONDITION	WARRANTY
A condition is a stipulation (in a contract) which is essential to the main purpose of the contract	A warranty is a stipulation which is only collateral or subsidiary to the main purpose of the contract
A breach of condition gives the aggrieved party a right to sue for damages as well as the right to repudiate the contract	A breach of warranty gives only the right to sue for damages. The contract cannot be repudiated
A breach of condition may be treated as a breach of warranty in certain circumstances	A breach of warranty cannot be treated as a breach of condition

**Example:**

A man buys a particular horse, which is warranted to ride. If the horse turns out to be vicious, the buyer's only remedy is to claim damages. But if instead of buying a particular horse, asks a dealer to supply him with a quiet horse and the horse turn out to be vicious, the stipulation is a condition and the buyer can reject the horse or keep the horse and claim damages.

▪ **Observation**

- A breach of condition can be treated as a breach of warranty under certain conditions.
- A breach of warranty cannot be treated as a breach of condition.
- Express and implied conditions and warranties cannot be treated as a breach of condition.

▪ **Contract of guarantee**

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 for whom the guarantee is given is called as 'principal debts'

- The person to whom the guarantee is given is called the as “creditor”
- Two contracts – Principal contract between the principal debtor and creditor
- Secondary contract between the creditor and the surety.

**Example:**

When A requests B to lend Rs.10, 000 to C, that C will repay the amount within the agreed time and that a C failing to do so, A himself will pay to B, in this case there is a contract of guarantee.

## **EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES :**

In a contract of sale of goods, conditions and warranties may be express or implied. Express conditions and warranties are those, which are expressly provided in the contract. Implied conditions and warranties are those, which the law implies into the contract unless the parties stipulate to the contrary.

### **[A] Express condition:**

If the terms of contract expressly provide for them.

### **[B] Implied conditions**

#### ***a. Condition as to title :***

In a contract of sale, unless the circumstances of the contract are such as to show a different intention, there is an implied condition on the seller that: i) in the case of a sale, he has a right to sell the goods, and ii) in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass

**Example;**

R bought a car from D and used it for four months. D had no title to the car and consequently R had to hand it over to the true owner.

Held: R could recover the price paid. [Rowland v. Divail, (1923) 2 K.B. 500]

#### ***b. Sale by description :***

Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description.

**Example;**

A ship was contracted to be sold as a “copper fastened vessel” to be taken with all faults, without any allowance for any defects whatsoever. The ship turned out to be “partially copper-fastened”.

Held: The buyer was entitled to reject [Sheperd v. Kain, (1821) 5 B & add.240]

#### ***c. In certain cases, conditions as to fitness or quality:***

Normally, in a contract of sale there is no implied condition as to quality or fitness of the goods for a particular purpose. The buyer must examine the goods thoroughly before he buys them in order to satisfy himself that the goods will be suitable for the purpose for which he is buying them.

#### ***d. Goods to be of merchantable quality:***

Where goods are bought by description from a seller who deals in goods of that description, there is an implied condition that the goods are of merchantable quality. This means goods should be such as are commercially saleable under the description by which they are known in the market at their full value.



**Example:**

A manufacturer supplied 600 horns under a contract. The horns were found to be dented, scratched and otherwise and therefore the seller's suit for price was dismissed {Jackson v. Rotax Motor & Cycle Co. (1910) @ k.B.397}

**e. Condition implied by custom:**

An implied condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

**Example:** A bought a set of false teeth from a dentist. The set did not fit into A's mouth.

Held- He could reject the set as the purpose for which anybody would buy it was implicitly known to the seller, i.e., dentist {Dr.Baretto v.T.R.Price, A.I.R. (1939) Nag. 19}

**f. In case of sale by sample:**

- (a) Bulk to correspond with sample
- (b) Buyer to have responsible opportunity to compare the bulk with sample
- (c) Goods to be of merchantable quality

**[C] Implied warranties :**

**The implied warranties in a contract of sale are as follows:**

**a. Warranty of quite possession**

In a contract of sale; unless there is a contrary intention, there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. If the buyer is in any way disturbed in the enjoyment of the goods in consequence of the seller's defective title to sell, he can claim damages from the seller.

**2. Warranty of freedom from encumbrances**

**Check Your Progress –3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss Warranties in Sales Contract.**

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**14.5 PERFORM OF SALES CONTRACT**

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Performance of a contract of sale means as regards, the seller deliver the goods to the buyer, and as regards the buyer, acceptance of the delivery of the goods and payment for them, in accordance with the terms of the contracts of sale.

A contract of sale always involves reciprocal promises, the seller promising to deliver the goods and the buyer promising to accept and pay for them. In the absence of a contract to the contrary they are to be performed simultaneously and each party should be ready and willing to perform his promise before he can call upon the other to perform his promise.

### **Delivery of Goods :**

Delivery means voluntary transfer of possession of goods from one person to another. Delivery of goods sold may be made by doing anything, which one of the parties agrees shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer. Delivery of the goods may be actual, symbolic, or constructive. This is explained as follows:

- ***Actual delivery***

Where the goods are handed over by the seller to the buyer or his duly authorized agent, the delivery is said to be actual. Delivery of goods may also be made by doing anything which has the effect of putting the goods in the possession of the buyer.

- ***Symbolic delivery***

Where the goods are ponderous or bulky and incapable of actual delivery, i.e., haystack in a meadow, the delivery may be symbolic. Handing over of the key of a warehouse to the buyer is symbolic delivery of the goods to the buyer and is as effective as actual delivery, even though there is no change in the possession of the goods.

- ***Constructive delivery***

Where a third person who is in possession of the goods of the seller at the time of the sale acknowledges to the buyer that he holds the goods on his behalf, there take place a delivery by attainment or constructive delivery.

### **Rules as to delivery of goods :**

- Mode of delivery
- Delivery and payment
- Effect of part delivery
- Buyer to apply for delivery
- Place of delivery
- Time of delivery
- Goods in possession of a third party
- Cost of delivery
- Delivery of correct quantity
- Delivery to a carrier or wharfinger

### **Acceptance of delivery :**

Receipt of goods by the buyer does not necessarily result in acceptance of goods by him under, and in performance of the contract of sale. Acceptance is something more receipt or taking possession of the goods by the buyer. It means the final assent by the buyer that he has received the goods under, and in performance of, the contract of sale. If he wrongfully refuses to accept the goods under the contract, he is liable for damages. The buyer is deemed to have accepted the goods,

- a) When he intimates to the seller that he has accepted the goods
- b) When the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller.

### **Rights and duties of the Buyer :**

- **Rights of the buyer- are as follows-**
  - a) Right to have delivery as per contract
  - b) Right to reject the goods
  - c) Right to repudiate
  - d) Right to notice of insurance
  - e) Right to examine
  - f) Rights against the seller for breach of contract
- **Duties of the buyer**
  - a) Duty to accept the goods and pay for them in exchange for possession
  - b) Duty to apply for delivery
  - c) Duty to demand delivery at a reasonable hour
  - d) Duty to accept installment delivery and pay for it
  - e) Duty to take risk of deterioration in the course of transit
  - f) Duty to intimate the seller where he rejects the goods
  - g) Duty to take delivery
  - h) Duty to pay price
  - i) Duty to pay damages for non-acceptance

### **Check Your Progress – 4**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss perform of Sales Contract.**

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## 14.6 CONDITIONAL SALES & RIGHTS OF UNPAID SELLER

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A seller of goods is deemed to be an unpaid seller when:

- The whole of the price has not been paid or tendered
- A bill of exchange or other negotiable instrument has been received as a conditional payment and the condition on which it was received has not been fulfilled by the reason of dishonor of the instrument or other wise.

The following conditions must be fulfilled before a seller of goods can be deemed to be an unpaid seller:

- He must be unpaid and the price is due.
- He must have an immediate right of action for the price
- A bill of exchange or other negotiable instrument was received but the same has been dishonored.

### **Rights of an unpaid seller against the goods**

Where the property in the goods has passed to the buyer, an unpaid seller has the following rights against the goods.

- ***Right to lien:***

A lien is a right to retain possession of goods until payment of the price. It is available to the unpaid seller of the goods, who is in possession of them where-

- a) The goods have been sold without any stipulation as to credit
- b) The goods have been sold on credit, but the term of credit has expired
- c) The buyer becomes insolvent

- ***Right of stoppage in transit***

The right of stoppage in transit is a right of stopping the goods in transit after the unpaid seller has parted with the possession of the goods. He has the further right of resuming possession of the goods as long as they are in the course of transit, and retaining possession until payments or tender of the price. It is available to the unpaid seller-

- a) When the buyer becomes insolvent
- b) When the goods are in transit

- ***Right of resale***

The unpaid seller can resell the goods-

- a) Where the goods are of a perishable nature
- b) Where he gives notice to the buyer of his intention to re-sell the goods and the buyer does not within a reasonable time pay or tender the price.

### **Check Your Progress – 5**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

## 1. Discuss Rights of unpaid seller.

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### 14.7 REMEDIES FOR BREACH OF CONTRACT OF SALE

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#### Remedies for breach of contract of sale :

- **Buyer suits:**

- a) Suit for damages for non-delivery of the goods
- b) Suit for breach of warranty
- C) Suit for damages for repudiation of contract by the seller before due date
- d) Suit for specific performance
- e) Suit for interest

- **Seller's suits**

- a) Suit for price
- b) Suit for damages for non-acceptance of the goods
- C) Suit for damages for repudiation of contract by the buyer before due date
- d) Suit for interest

#### Unascertained or further goods:

- Property in the goods is not transferred to the buyer unless and until the goods are ascertained.
- In the case of sale of unascertained goods or future goods by description, property passed to the buyer, when goods of that description in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the affect of the seller.

#### Sale “as approval” or “Sale or return” basis:

- Where goods are delivered to the buyer “as approval” or a “sale on return” or similar terms, the property passes to the buyer.
- When A signifies his approval or acceptance to the seller B. The seller (B) does any act adopting the transaction e.g., pledges the goods with a third party or B retains the good, without giving notice of rejection, beyond the time fixed for the return of goods or if the time is fixed, beyond a reasonable time.

#### Transfer of title by non-clauses:

Owner only can transfer a good title.

### **Exceptions**

- When effected by a mercantile agent in the ordinary course of business
- When made by a joint owner in possession with the consent of other joint owner.

### **Check Your Progress – 5**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss remedies for breach of contract sale.**

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### **14.8 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### **14.9 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

#### **Check Your Progress – 1**

1. See section 14.2

#### **Check Your Progress – 2**

1. See section 14.3

#### **Check Your Progress – 3**

1. See section 14.4

#### **Check Your Progress – 4**

1. See section 14.5

#### **Check Your Progress – 3**

1. See section 14.6

#### **Check Your Progress – 4**

1. See section 14.7

# UNIT 15:

## NEGOTIABLE INSTRUMENTS

### Structure

- 15.1 Objectives
- 15.2 Introduction
- 15.3 Transfer of Negotiable Instruments & Liabilities of parties
- 15.4 Enforcement of Secondary Liability
- 15.5 Some Useful Books
- 15.6 Answer to Check Your Progress Exercise

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### 15.1 OBJECTIVES

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After studying this unit you should be able to:

- Define nature of negotiable instruments.
- Understand transfer of negotiable instruments.
- Describe the liabilities of negotiable instruments.
- Explain enforcement of secondary liability.

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### 15.2 INTRODUCTION

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Negotiable means transferable from one person to another person. Instrument means  
- Any written document by which a right is created in favor of some person.

#### **The Reserve Bank of India Act, 1934 :**

- Sec 31: No person (other than RBI or the Central Government) can draw, accept, make or issue any bill of exchange or promissory note payable to bearer on demand.
- No person (other than RBI or Central Government) can make or issue any promissory note payable to the bearer of the instrument.

#### **Definition of a Negotiable Instrument :**

A “Negotiable instrument” means a promissory note, bill of exchange or cheque payable either to order to bearer (Section 13)

An instrument may be negotiable either by (1) Statute or (2) by usage Promissory note, bill of exchange, Cheque – By statute, Bank notes, Bank drafts, share warrants, bearer adventures, dividend warrants, scripts and treasury bills by usage.

### **Nature and requisites of negotiable instruments :-**

#### **■ Features of Negotiable instruments**

- Freely transferable – By delivery or by endorsement and delivery.
- Holder's title free from defect – Holder in due course acquires a goods title not withstanding any defect in a previous holder title. A holder in due course is one who receives the instrument for value and without any notice as to the defect in the titles of the transferor.
- The holder can sue in his own name
- Can be transferred any number of times (Infinity) still its maturity.
- It is subject to certain presumptions

#### **■ Presumptions / Requisites: - (section 118 & 119)**

- As to consideration : Every negotiable instrument is deemed to have been made, drawn, accepted, endorsed, negotiated or transferred or transformed for consideration.
- As to date: Every negotiable instrument bear the date on which it is made or drawn.
- As to acceptance: Every bill of exchange was accepted within a reasonable time after the date mentioned therein and before the date of its maturity.
- As to transfer: Transfer was made before the date of maturity, in the case of an instrument payable, otherwise than on demand.
- As to be order of endorsement: The endorsement appearing on it were made in the order in which they have taken.
- As to lost instruments: Where an instrument has been lost or destroyed, that it was duly stamped and the stamp was duly cancelled.
- As to the holder in due course: The holder of the instrument is a holder in due course.
- As to dishonor: Court shall on the proof of protest, presume the fact of dishonor unless it is disproved.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.



## 1. Discuss the nature & requisites of negotiable instrument.

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### 15.3 TRANSFER OF NEGOTIABLE INSTRUMENTS & LIABILITY OF PARTIES

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#### Transfer of negotiable instruments and liability of parties :

One of the essential characteristics of a negotiable instrument is that it is freely transferable from one person to another person. This transfer may take place either:

- by negotiation
- by assignment

#### [A] Transfer by negotiation

When a promissory note, bill of exchange or cheque is transferred by one party to another, so as to constitute the transferee the holder thereof, the instrument is said to be negotiated. There are two methods of transfer by negotiation, namely,

##### a) *Negotiation by deliver*

An instrument payable to bearer is negotiable by delivery thereof.

**Example:** A is the holder of negotiable instruments payable to bearer.

##### b) *Negotiation by delivery in negotiation*

An instrument payable to order is negotiable by the holder by endorsement and delivery thereof.

**Example:**

A owes B Rs.1, 000. He makes a promissory note for the amount payable to B. He dies & the note is afterwards found among his papers & delivered to B. B cannot sue upon the note if delivered to him.

#### [B] Transfer by assignment

When a person transfers his right to receive the payment of a debt, 'assignment of the debt' takes place. Thus where the holder of an instrument transfers it to another, so as to confer a right on the transferee to receive the payment of the instrument, transfer by assignment takes place.

#### Liability of parties:

The liability of the parties is mentioned below:

**a) Liability of drawer:**

The drawer of a bill of exchange or cheque is bound, in case of dishonor by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonor has been given to, or received by the drawer.

**b) Liability of drawee of cheque:**

The drawee of a cheque having sufficient funds of the drawer in his hands, properly applicable to the payment of such cheque, must pay the cheque when duly required to do so. In default of such payment, the drawee, i.e., the banker must compensate the drawer for any loss or damage caused by such default.

**c) Liability of maker of note and acceptor of bill**

The maker of a promissory note and the acceptor of a bill of exchange are the persons who are primarily liable to pay the amount to the holder on demand.

**d) Liability of indorser**

The indorser of a negotiable instrument before maturity is liable to all subsequent holders in case of dishonor.

**e) Liability of prior parties to a holder in due course**

Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.

**f) Acceptor's liability on a forged endorsement**

An acceptor of a bill of exchange already endorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe the endorsement to be forged when he accepted the bill.

**g) Acceptor's liability for a bill in a fictitious**

Name and payable to the drawer's order is note, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under endorsement by the same hand as the drawer's signature and purporting to be made by the drawer.

**Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

## 1. Discuss Transfer of negotiable instruments.

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## 2. Discuss the liability of parties.

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### 15.4 ENFORCEMENT OF SECONDARY LIABILITY

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#### Secondary liability – the principle of surety ship

##### *a) Maker, drawer and acceptor principals*

In the absence of a contract to the contrary, the maker of a promissory note or cheque, the drawer of a bill of exchange until acceptance, and the acceptor are respectively the parties primarily liable.

##### *b) Prior party a principal debtor in respect of each subsequent party*

As between the parties liable as sureties, each prior party is in the absence of a contract to the contrary, a principal debtor in respect of each subsequent party.

##### *c) Suretyship*

When the holder of an accepted bill of exchange enters into any contract with the acceptor which, under sec 134 or 135 of the Indian Contract Act, 1872 would discharge the other parties, the holder may expressly reserve his rights to charge the other parties, and in such a case they are not discharged.

##### *d) Discharge of endorser's liability*

When the holder of a negotiable instruments, without the consent of the indorser, destroys or impairs the endorser's remedy against a prior party, the indorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity.

### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the enforcement of secondary liability.**

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### **15.5 SOME USEFUL BOOKS**

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### **15.6 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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#### **Check Your Progress – 1**

1. See section 15.2

#### **Check Your Progress – 2**

1. See section 15.3

#### **Check Your Progress – 3**

1. See section 15.4

## UNIT 16:

### HOLDER IN DUE COUSE; CHEQUES & DRAFTS

#### Structure

- 16.1 Objectives
- 16.2 Holder in due course
- 16.3 Special rules for Cheques & Drafts
- 16.4 Some Useful Books
- 16.5 Answer to Check Your Progress Exercise

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#### 16.1 OBJECTIVES

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After studying this unit you should be able to:

- Define the term of Holder & Holder in due course.
- Understand the privileges of holder in due course.
- Describe promissory note & specimen copy of promissory note.
- Explain the specimen of bill of exchange.

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#### 16.2 HOLDER IN DUE COURSE

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##### Holder :-

The holder of a promissory note, bill of exchange or cheque means any persons entitled in his own name:

- i) to the possession thereof, and
- ii) 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.

##### Holder to due course:-

Who for consideration locate the possessor or the payee or the endorse thereof, if payable to order, before the amount mentioned in it, becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title holder in due course acquires a better like than that of its transferor.

- Any person is a holder in due course if he fulfils the following conditions;
  - a) That, for consideration, he became,
    - i) the possessor of the negotiable instrument if payable to bearer, or
    - ii) the payee or endorsee thereof, if payable to order.
- A holder of a negotiable instrument will not be a holder in due course if-
  - b) He has obtained the instrument by gift or for and unlawful consideration or by some illegal method
  - c) He has obtained the instrument after its maturity
  - d) He has not obtained the instrument bona fide.

### **Privileges of a holder in due course**

The special privileges of a holder in due course are as follows:

- **Inchoate stamped instrument**  
A person, who has signed and delivered to another person, a stamped but otherwise inchoate instrument, is precluded from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount.
- **Liability of prior parties**  
Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.
- **Fictitious payee**  
Where a bill is drawn payable to the drawer's order in a fictitious name and is indorsed in the same hand as the drawer's signature, the acceptor is not relieved from liability to any holder in due course, on the plea that the drawer is fictitious.
- **Negotiable instrument without consideration**  
When a negotiable instrument is made, drawn, accepted or transferred without consideration, it creates no obligation of payment between the parties to the transaction. An agreement made without consideration is void. But if the negotiable instrument gets into the hands of a holder in due course, he can recover the amount on it from any of the prior parties thereto.
- **Conditional delivery**  
If a bill or note is negotiated to a holder in due course, the other parties to the instrument cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only.
- **Instrument cleaned of all defects**  
Once a negotiable instrument passes through the hands of a holder in due course, it gets cleared of its defects provided the holder was himself not a party to the fraud or illegally which affected the instrument in some stage of its journey. Thus

any affected in the title of the transferor will not affect the rights of the holder on due course even if he had knowledge of the prior defect provided as he himself is not a party to the fraud.

- **Instrument obtained by unlawful means or for unlawful consideration**

The person liable to pay on a negotiable instrument cannot, as against a holder in due course, contend that he had lost it, or that it was obtained from him by means of an offence or fraud or for an unlawful consideration.

- **Estoppels against denying original validity of instrument**

The maker of a promissory note, the drawer of a bill of exchange or cheque and the acceptor of a bill of exchange for the honor of the drawer cannot, in a suit thereon by a holder in due course, deny the validity of the instrument as originally made or drawn.

- **Every holder is a holder in due course**

The law presumes that every holder is a holder in due course, although the presumption is rebuttable.

- **Estoppels against denying capacity of payee to payee to indorse**

The maker of a promissory note and acceptor of a bill of exchange payable to order cannot, in a suit thereon by a holder in due course, deny the payee's capacity at the date of the note or bill, to indorse the same.

- **Endorser not permitted to deny the capacity of prior parties**

The endorser of a negotiable instrument cannot in a suit thereon by a subsequent holder, deny the signature or capacity to contract of any prior party to the instrument.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Holder & Holder in due course.**

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#### **2. Discuss the privileges of holder in due course.**

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### 16.3 SPECIAL RULES FOR CHEQUES & DRAFTS

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#### PROMISSORY NOTE

An instrument in writing (not being a bank note of a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money to or to the order of a certain person or to the bearer of the instrument.

- **Example of Promissory Notes**

- (a) I promise to pay “B” or order Rs. 500
- (b) I acknowledge myself to be indebted to B for Rs. 1000 to be paid on demand for value received.

- **Not Promissory Notes**

- a) “Mr. B, I.O.U. (I owe you) Rs. 1000
- b) I am liable to pay you Rs. 500
- c) I promise to pay B Rs. 500 and all other sums which shall be due to.
- d) I promise to pay B Rs. 500; first deducting there out any money in own me.
- e) I promise to pay Rs. 1500 on D’s death, provided he leaves me enough to pay that sum.
- f) I promise to pay ‘B’ Rs. 500 seven days after my marriage with C.
- g) I promise to pay ‘B’ Rs. 500 and to deliver him my scooter on 1<sup>st</sup> January 2004.

#### ESSENTIAL CHARACTERISTICS OF A PROMISSORY NOTE :

- Should be in writing
- Promise to pay:
  - We have received a sum of Rs. 9000 from Shri R.R. Sharma. This amount will be repaid on demand.
  - We have received the amount in cash.
  - Use of word promise is not essential to constitute an instrument as ‘Promissory Note’.
- Unconditional
- Signed by the maker
- Certain parties
- Certain sum of money
- Promise to pay money only
- Number, place, date etc – usually found but aspect essential in law – If it is undated it is deemed to have been made when it was delivered.
- May be payable in installments



- It may be payable on demand or after a definite period  
(A demand promissory note becomes times barred on expiry of 3 years from the date it bears)
- It cannot be made payable to bearer on demand or even payable to bearer after a certain period (sec 31 of RBI Act)
- It must be duly stamped under the Indian Stamp Act.

### SPECIMEN OF A PROMISSORY NOTE

Rs 1000	Chennai – 600 025
	10 <sup>th</sup> Sept 2003
Six months after date <b>I promise to pay</b> X or order the sum of rupees ten thousand only for value received to X	
To X	
Address: _____	Stamp Sd/-
_____	

### SPECIMEN COPY OF BILL OF EXCHANGE

Rs 1000	Chennai – 600 025
	10 <sup>th</sup> Sept 2003
Six months after date pay (PAYEE) to A or order the sum of rupees Ten thousand only for value received.	
To X (Drawee)	
Address: _____	Stamp Sd/-
_____	

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.

#### Unconditional order is essential

Please pay Rs. 10,000 to A on demand and oblige - Does not constitute a Bill of Exchange.

Usance bill - Payable after a specified period of time

At sight bill – Payable on demand or payable after certain sight.

## Cheque

Bill of exchange drawn on a specified banker always payable undemanding

### SPECIMEN

Date: \_\_\_\_\_

Rs.

PAY \_\_\_\_\_ OR BEARER

RUPEES \_\_\_\_\_

A/c No.

LF

INTLS

XYZ Bank

ABC Branch

Chennai – 600 xxxx

Cheque no. xxxxxxxxxxxx

Branch Code xxxxxxxxxxxx

## CROSSING OF CHEQUES

Payment cannot be claimed across the counter in a crossed cheque. It can be only credited to an account with a bank

### Type of crossing

- General
- Special.

### General Crossing

- Not Negotiable crossing -It is not non-transferable- The cheque having the special feature as these can be no holder – in due course.
- A/C Payee Crossing: Drawer intends the payment to be credited to payee's account and none else.

### Special crossing

- Not Negotiable,
- A/c Payee Crossing

### Who can cross cheque?

- Drawer
- Holder
- Banker

### How to Opening of Crossing?

- Drawer has the right to cancel.

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the special rules for cheques and drafts.**

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### **16.4 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### **16.5 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

#### **Check Your Progress – 1**

1. See section 16.2

#### **Check Your Progress – 2**

1. See section 16.3

## UNIT 17:

# DISCHARGE OF NEGOTIABLE INSTRUMENTS

### Structure

- 17.1 Objectives
- 17.2 Discharge of Negotiable Instruments
- 17.3 Some Useful Books
- 17.4 Answer to Check Your Progress Exercise

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### 17.1 OBJECTIVES

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After studying this unit you should be able to:

- Define the term of discharge of negotiable instruments.
- Understand the different modes of discharge of negotiable instruments and discharge of parties.

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### 17.2 DISCHARGE OF NEGOTIABLE INSTRUMENTS

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The term discharge in relation to a negotiable instrument is used in two senses like:

- Discharge of the instrument
- Discharge of one or more of the parties from liability thereon

An instrument is said to be discharged when all rights of action under it are completely extinguished and when it ceases to be negotiable. This would happen when the party who is ultimately liable on the instrument is discharged from liability.

In such a case, even a holder in due course does not acquire any rights under the instruments. If, on the other hand, one or more of the parties is /are discharged from liability, the instrument continues to be negotiable on it. The discharge of one or more of the parties continues to be liable on it.

#### Discharge of an Instrument

The different modes of discharge of an instrument are as follows:

**a) *By payment in due course***

This is the most obvious and the usual mode of discharge of an instrument is discharged by payment made in due course by the party who is primarily liable to pay, or by a person who is accommodated in case the instrument was made or accepted for his accommodation. The payment of the amount due on the instrument must be made at or after the maturity to the holder of the instrument if the maker or acceptor is to be discharged. A payment by a party who is secondarily liable does not discharge the instrument. Again, any person liable to pay is entitled to have the instrument shown to him before payment. On payment he is entitled to have the instrument delivered up to him.

**b) *By party primarily liable becoming holder***

If the maker of a note or the acceptor of a bill becomes its holder at or after its maturity in his own right, the instrument is discharged.

**c) *By express waiver***

When the holder of a negotiable instrument at or after its maturity absolutely and unconditionally renounces in writing or gives up his rights against the instrument, the instrument is discharged. The remuneration must be in writing unless the instrument is delivered up to the party primarily liable.

**d) *By cancellation***

Where an instrument is intentionally cancelled by the holder or his agents and the cancellation is apparent thereon, the instrument is discharged. Cancellation may take place by crossing out signatures on the instrument, or by physical destruction of the instrument with intention of putting an end to the liability of the parties to the instrument.

**e) *By discharge as a simple contract***

A negotiable instrument may be discharged in the same way as any other contract for the payment of money. This includes, for example discharged of an instrument by novation or rescission or by expiry of period of limitation.

**Discharge of party or parties**

A party or parties to a negotiable instrument is/are discharged in any one of the following ways:

**a) *By payment***

When payment on an instrument is made in due course, both the instrument and the parties to it are discharged.

**b) By cancellation**

When the holder of a negotiable instrument or his agent cancels the name of a party on the instrument with intent to discharge him, such party and all subsequent parties, who have a right of recourse against the party whose name is cancelled, are discharged from liability to the holder. The subsequent parties are in the position of sureties to the prior party whose name is cancelled and discharge of the principal debtor automatically discharges the sureties.

**c) By release**

Where the holder of a negotiable instrument releases any party to the instrument by any method other than cancellation, the party so released is discharged from liability.

**d) By allowing drawee more than forty- eight hours**

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.

**e) By non-presentment of cheque**

Where a cheque is not presented by the holder for payment within the reasonable time of its issue and the drawer suffers actual damage through the delay because of the failure of the bank, he is discharged from liability to the extent of such damage. In determining what reasonable time is, regard shall be had to the nature of the instrument, the usage of trade and of bankers.

**f) Cheque payable to order**

Where a cheque payable to order purports to be indorsed by the payee, the banker is discharged by payments in due course. Where a cheque is originally expressed to be payable to bearer the drawer is discharged by payment in due course to the bearer thereof. It makes no difference even if any endorsement whether in full or in blank appears on the cheque and even if any such endorsement purports to restrict or exclude further negotiation.

**g) Draft drawn by one branch on another**

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 indorsed by or on behalf of the payee, the bank is discharged by payment in due course.

#### **h) Parties not consenting discharged by qualified acceptance**

If the holder of a bill of exchange acquiesces (assents) in a qualified acceptance, all the previous parties whose consent is not obtained to such acceptance are discharged from liability, they will however, be liable if on a notice being given to them they give their assent to such acceptance.

#### **i) By operation of law**

This includes discharge-

1. By an order of insolvency court, discharging the insolvent
2. By merger- When a judgment is obtained against the acceptor, maker or indorser, the debt under the bill is merged into judgment debt.
3. By lapse of time i.e., when the remedy becomes time barred.

#### **J) By material alteration**

A material alteration of a negotiable instrument renders the same void against persons who were parties thereto before such alteration unless they have consented to the alteration.

#### **k) Discharge by payment of altered instrument**

When a promissory note, bill of exchange or cheque had 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, payment on such an instrument discharges the party liable if he pays according to the apparent tenor of the instrument (as altered) at the time of payment and otherwise in due course. Such a payment cannot be questioned even if it is proved that the instrument has been altered or that the cheque was originally crossed.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Holder & Holder in due course.**

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### 17.3 SOME USEFUL BOOKS

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### 17.4 ANSWER TO CHECK YOUR PROGRESS EXERCISE

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#### Check Your Progress – 1

1. See section 17.2





## UNIT 18:

### CONSUMER PROTECTION ACT – 1986

#### Structure

- 18.1 Objectives
- 18.2 Introduction
- 18.3 Salient Features of Act
- 18.4 Analysis of the Scheme of Act
- 18.5 Consumers protect councils
- 18.6 Establishment of Consumer Disputes Redressal Agencies
- 18.7 Some Useful Books
- 18.8 Answer to Check Your Progress Exercise

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#### 18.1 OBJECTIVES

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After studying this unit you should be able to:

- Describe the objects & the essential elements of the Consumer Protection Act
- Analyse the scheme of the Consumer Protection Act
- Understand the functions of Consumers Protection Councils
- Specify the role of Consumers Protection Courts

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#### 18.2 INTRODUCTION

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Consumerism is the basic thought that “Consumers need to be protected”. The fundamental questions which spring from this basic thought are:

- i) How Consumers can be protected?
- ii) Consumers are protected against what?

Answer to the above questions may be aptly termed with 'Consumerism'. Thus, who is a Consumer? When and by whom a complaint can be made? And what is the relief available to consumers? Are the aspects of 'Consumerism'? It can be compared with a coin having two sides, viz., trader and consumer (customer). The words trader and customer have its relevance since the date of civilizations. So protection of interest of customers has been a

matter of concern from the olden times and what we find today is not a product of a day or a year but has been a matter of constant process.

### **The Consumer Protection Act 1986**

Objects and reasons which have been mentioned under S 6 of the Act. They are:

- The right to be protected against marketing of goods which are hazardous to life and property.
- The right to be informed about the quality, quantity, potency, purity, standards and price of goods to protect the consumer against unfair trade practices;
- The right to be assured, wherever possible, access to variety of goods at competitive prices,
- The right to be heard and to be assured that consumer's interest will receive due consideration at appropriate forums,
- The right to seek redressal against unfair trade practice or unsulptuous exploitation of consumers, and
- The right to consumer education.
- Virtually, this is the Consumer's Charter which has been provided under S.6 of the Act.
- The following rights have been added by the Amendment Act, 1993 and 2002 respectively.
- The right to be protected from unfair trade practices as defined under section 36A of M.R.T.P.Act, 1969, and
- Protection from spurious goods or offering such goods for sale or adopting deceptive practice in the provision of services.

The above mentioned, rights may be explained as follows:

#### **▪ Right to Safety**

It is right to be protected against the marketing of goods and services, which are hazardous to life and property. Traders must ensure that goods are safe for users, in case of hazardous goods; they give clear instructions as to mode of use, the risk involved in improper use of goods, vital safety information is conveyed to consumers. Where product is found such as is likely to be hazardous traders should either recall it and modify the same, or replace it with a new product, or adequately compensate for it.

- **Right to information**

It is right to be informed about the quality, quantity, potency, purity, standards of price of goods or services, with a view to protect the consumer. Consumer should be instructed in the proper use of goods and should be informed of the risks involved in the intended or normally foreseeable use. Vital safety norms should be conveyed to consumers against unfair trade practices.

This is very significant right of consumers, since adequate information is very important in order to make a right choice of the goods and services. This ensures consumers of having maximum information about the wide variety of competing goods available in the market. Now, the Supreme Court has designated this legal right as a fundamental right of the consumer within the purview of Articles 19(1)(a), 21 & 25 of the Constitution.

- **Right to choose**

It is a right to be assured, wherever possible, access to variety of goods at competitive prices. It can be made more meaningful by ensuring access to a variety of goods and services at competitive prices. Fair and effective competition in the market must be encouraged so as to provide consumers with the widest range of products and the services at the reasonable price.

- **Right to Represent**

It is a right to be heard and to be assured that consumer's interest will receive due consideration at appropriate forums. Under the provisions of the Act every consumer has a right to file complaint and be heard in that context.

- **Right to Redressal**

It is a right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers. This right has been ensured by establishing three-tier system of consumer FORA and by providing procedure of getting redress as well as recognizing restrictive and unfair trade practices as a ground to make a complaint.

- **Right to Education**

The right to consumer education is a right, which ensures that consumers are informed about the practices prevalent in the market and the remedies available to them. Booklets informing citizens about their rights to services will be made available. The Government should also plan to set-up monitoring agencies for this purpose. The role of media and NGOs may be significant in this direction. Wider publicity of consumer rights and the rights available in the Act is needed to make this right effective throughout the country.

- **Protection from Unfair Trade Practices**

This has been provided by the Amendment Act, 1993 which ensures protection to consumers against unfair trade practices of traders.

- **Protection against Spurious Goods**

This right has been added by the Amendment Act, 2002. Goods which are spurious or hazardous shall be prevented from marketing. This is essential which protects the public health and life. The rationale behind this provision is to ensure physical safety of the consumers.

### **A Fundamental Right of consumers**

“Right to know whether food products, cosmetics and drugs are of non-vegetarian or vegetarian origin; is fundamental Right of Consumers.” Consumerism is the basic thought that 'consumer needs to be protected'. The fundamental questions which spring from this basic thought are,

- i) How consumers can be protected?
- ii) Consumers are protected against what?

The Consumer Protection Act is an apt answer of the above two questions. The Act provides a machinery for redressal agencies known to 'Consumer FORA' and certain rights of consumers viz., right to safety, right to information, right to choose, right to represent, right to redressal and right to education.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about the Consumer protection act**

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### **18.3 SALIENT FEATURES OF ACT**

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**The salient features of the Act are:**

- It covers all the sectors whether private, public, and cooperative or any person. The provisions of the Act are compensatory as well as preventive and punitive in nature

and the Act applies to all goods covered by sale of goods Act and services unless specifically exempted by the Central Government;

- It enshrines the following rights of consumers:
  - (a) right to be protected against the marketing of goods and services which are hazardous to life and property;
  - (b) right to be informed about the quality, quantity, potency, purity, standard and price of goods or services so as to protect the consumers against unfair trade practices;
  - (c) right to be assured, wherever possible, access to a variety of goods and services at competitive prices;
  - (d) right to be heard and to be assured that consumers' interests will receive due consideration at the appropriate fora;
  - (e) right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers; and
  - (f) right to consumer education;
- The Act also envisages establishment of Consumer Protection Councils at the central, state and district levels, whose main objectives are to promote and protect the rights of consumers;
- To provide a simple, speedy and inexpensive redressal of consumer grievances, the Act envisages a three-tier quasi-judicial machinery at the national, state and district levels. These are: National Consumer Disputes Redressal Commission known as National Commission, State Consumer Disputes Redressal Commissions known as State Commissions and District Consumer Disputes Redressal Forum known as District Forum; and
- The provisions of this Act are in addition to and not in derogation of the provisions of any other law for the time being in force.

### **Definition of 'Defect' and 'consumer'**

Under the CPA, Consumer Forums at the District, State and National level have been specifically constituted to adjudicate claims of consumers for any "defect" in goods. A "defect" has been defined in Section 2(1) (f) of the Act as "any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or under any contract, express or implied, or as is claimed by the trader (which includes the manufacturer) in any manner whatsoever in relation to any goods."

It is important to mention herein that by virtue of Section 2 (1)(d) persons/entities who had purchased goods for 'commercial purpose' (other than those persons who have purchased goods for using them to earn their livelihood by means of self employment) are excluded from the scope of CPA; they cannot institute proceedings under the CPA even if there is any 'defect' in the goods purchased by them for using the goods for commercial purposes.

### **Purview of a 'complaint'**

According to the CPA, 'Complaint' means any of the following allegations made in writing by a complainant-

- any unfair trade practice or a restrictive trade practice has been adopted by a trader,
- the goods hired or bought suffer from one or more defects
- The goods hired or availed of are deficient in any respect
- A trader has charged price in excess of price fixed by law or displayed on the goods or any package containing goods
- Goods which will be hazardous to life and safety when used, are being offered for sale to the public in contravention of the provisions of any law requiring traders to display information in regard to the contents, manner and effect or use of such goods.

### **Grant of Relief's under CPA**

On arriving at a finding of defect in the goods according to Section 14 CPA, the jurisdictional Consumer Forum may direct one or more of the following:

- (i) to remove the defect;
- (ii) to replace the goods with new goods of similar description which shall be free from any defect;
- (iii) to return to the complainant the price;
- (iv) to pay such amount as may be awarded as compensation to the consumer for the loss or injury suffered by the consumer due to the negligence of the opposite party;
- (v) to discontinue the unfair trade practice or the restrictive trade practice or not to repeat them;
- (vi) to cease and desist manufacture of hazardous goods; (vii) to pay such sums as orders if injury/loss is suffered by a large number of consumers not identifiable conveniently;
- (vii) to issue corrective advertisement for neutralizing effect of misleading advertisement;
- (viii) not to offer the hazardous goods for sale;
- (ix) to withdraw the hazardous goods from being offered for sale;

(x) to provide for adequate costs to parties (the Complainant).

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the salient features of Consumer protection act.**

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### **18.4 ANALYSIS OF THE SCHEME OF THE ACT**

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Any 'person', Here the term 'person' has been used in a very wide sense. It means any individual, corporate body, firm, or any group of association or persons. So far as the scheme of the Act it includes any individual, company registered under Companies Act, corporation, firm or societies registered under Societies Registration Act, group of persons, or any association of persons. So a club, religious endowment; any Institution or Institute will be covered under this expression.

**For consideration:** *Assuring Your Future.....*

To bring the case within the ambit of this act it is necessary that goods bought or services availed of must be for consideration. Here the meaning and scope of consideration is the same as defined in Contract Act. Payment of tax which goes into the general revenue of the state or local authority will not legally constitute payment of consideration for any specific service.

The maintenance of public roads and highways by the Government may be considered to be a 'service' but the road using public cannot be considered to have hired this service for consideration.

A person who goes to receive medical treatment in a Government Hospital is not a consumer. For the purposes of the Act consumers may be classified:

- As to goods (buyer of goods) and
- As to services (hirer of services)

## **As to Goods :**

### **▪ Buyer of Goods**

Any person, who buys goods for consideration, is a consumer. Any person who buys any goods for consideration which has been paid, or promised or partly paid and partly promised or under any system of deferred payment is a consumer. Thus, any buyer of goods for consideration, which has been paid or promised or partly paid and partly promised, or under any system of deferred payment such as Hire-Purchase system or Installment sale. Buyer means any person who buys or agrees to buy goods. Here it is clear that position of a buyer depends upon contract of sale.

“*Contract of Sale*” is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. Under Sale of Goods Act a transaction to be a sale, it is necessary that property in goods (ownership) must be transferred for price. Price must be in terms of money. But for the purpose of Consumer Act the transfer must be for consideration. It need not be in terms of money. So transactions of transfer for services, or barter, or exchange will come under the purview of this Act and such transferee will be a consumer. Consideration must be there whether it is actual paid or promised to pay.

In view of the above it is clear that the term 'buyer' has been used in a wide important and it includes a transferee under Exchange, Barter, lease, Hire purchase system, Conditional Sale and like any other transaction. It is also to be noted that the term transfer does not limited only to goods but it also includes transfer of other property such as immovable property like building, etc.

### **▪ User of Goods**

The other category of consumer in respect to goods is user of the goods. Consumer includes any user of goods other than the person who buys 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.

### ***With the Approval of Buyer***

Any person who uses goods with the approval of the buyer is also consumers provided that such buyer must have bought the goods for consideration. So all the family members who use the goods are consumers. Here consent of the buyer for the use of his family members or invites or guest, is implied. So a guest who uses goods with the consent of such buyer is also a consumer.



## **As to Services**

### **▪ Hirer of Services**

Any person who 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. Thus, any person who hires or avails of any service for consideration is a consumer. The term 'Service' has been defined under S. 2(1)(0). It includes service of any kind rendered for consideration (See *supra*)

In society there are so many fields in which services are rendered by individuals, institutions whether private or statutory specially by Banks, Telephone Department, Post Offices, Insurance, whether life or general, Railways, Doctors, Caterers, Contractors, Transport Operators, Engineers, etc. for consideration. Persons availing or using services of them are consumers.

A customer of a Bank is a consumer. A person who obtains Bank Draft from a Bank is a consumer. A person who hires services of caterers in the marriage is consumer. A person after buying ticket from Railway window travels by train is a consumer.

### **4. Beneficiary of Services**

In respect of services, the beneficiary of such service is also a consumer. It 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 such person.

### **5. Deemed Consumer**

The new concept of deemed consumer has been evolved by the Supreme Court in *Regional Provident Fund Commissioner v. Shiv kumar Joshi* [A.I.R.2000 SC 331], it was held that the facilities provided by the Scheme under the provident Fund Act were "Service". It was further held that even if the administrative charges for running the Scheme are "paid by the Central Government and no part of it is paid by the employee, the services of the Provident Fund Commission in running the Scheme shall be deemed to have been availed of for consideration by the Central Government for the benefit of the employees who would be treated as beneficiaries within the meaning of that word used in the definition of consumer". After considering the entire Scheme as provided under the Employees Provident Fund Act, the S.C. held that "it was a service within the meaning of S.2 (1) (0) of the Act. It was further held that the member of the Scheme is a consumer within the meaning of section 2(1)(d) of the Act.

### ***Approval of Hirer***

Any person availing any service with the approval of hirer is a consumer. So a tenant using the facilities of telephone, electricity or water supply with the approval of landlord is a consumer. The term 'beneficiary' includes all persons using such service with the approval of hirer. A Guest or Licensee is also consumer.

We may put consumer in the following heads:

1. Buyer of goods
2. User of the goods
3. Hirer of services
4. Beneficiary of services and
5. Buyer for earning his livelihood (see in the heading commercial purpose).

### **Exceptions (who is not consumers)**

The following are not consumers;

1. Buyer of the goods without consideration
2. Hirer of services without consideration
3. Services free of charge
4. Contract of personal services
5. Buyer for resale
6. Buyer for commercial purpose.

#### ***1. Buyer of the Goods without consideration***

It is clear from the provisions of the Act that to be consumer one must buy goods for consideration. So, any one gets goods without consideration is not a consumer, i.e. anyone who gets goods under a reward, or under a clearance sale or under scheme of free sale or gift is not a consumer.

A person who receives movable or immovable property under gift will not be a consumer because he gets such thing without consideration.

Here it is also noted that any person who uses such goods with the consent of the person getting it will also not be a consumer. For example, 'A' under a sale scheme gets free a Hawkins Pressure cooker at the time of buying a Hero Honda motor cycle. 'A' `s wife right hand is damaged while using the Pressure Cooker since it was defective. Here A or A`s wife is not a consumer within the meaning of the Act, so he/she is not entitled for damages.

## ***2. Hirer of service without consideration***

On the analogy of hirer of this service for consideration it is obvious that one who avails of any service without consideration is not a consumer. So providing free transport facilities or medical facilities or any service by any person or institution will not be under the purview of this Act and user of such services will not be a consumer.

## ***3. Services Free of Charge***

Any person who avails of service free of charge will not be a consumer. This exception comes from the definition of 'service' under S.2 (1) (0). It provides: rendering of any service free of charge or under a contract of personal service”.

There are so many charitable, religious or welfare societies which render services free of charge for the sake of humanity or in the service of society. Such activities do not come within the purview of this Act.

## ***4. Contract of Personal Services***

Definition of service also excludes contract of personal services from the jurisdiction of this Act. Contract of personal service does not constitute consumer dispute.

The term contract of personal service has not been defined in the Act but such contracts are quite different from commercial services.

Supreme Court has made nice distinction between “contract for service” and “contract of service” in *V.P.Santha Case*. The former is subject matter of this Act whereas the later is not.

### ***Contract for Service***

Contract for service implies a contract whereby one party undertakes to render services e.g. professional or technical services to or for another in the performance of which he is not subject to detailed direction and control but exercise professional or technical skill and uses his own knowledge and decision. This is subject-matter of this Act.

### ***Contract of Service***

Contract of service implies a relationship of a master and servants and involves the order to obey in the works to be performed and as to its mode and manner of performance. This is not subject matter of this Act.

### **5. Buyer for Re sale**

The definition of consumer does not include a person who obtains such goods for resale or for any commercial purpose.

Where goods have been bought for the purpose of resale, such buyer of the goods is not a consumer. If a retailer buys goods from wholesale dealer for the purpose of resale, he will not be a consumer, but when he buys for consumption, will be a consumer. Where goods have been bought for resale or consumption is a matter of fact depending on facts, circumstances of the case and conduct of the parties. The raw materials imported with the object to manufacture finished goods for resale. It is a commercial purpose. Manufacture is not a consumer.

### **6. Commercial purpose**

This is the last and most important exception. By the definition it is clear that a buyer of goods for commercial purpose is not a consumer.

The term, “Commercial purpose” has not been defined in the Act. In absence of a definition we have to go by its ordinary meaning, 'commerce' denotes 'pertaining to commerce'. According to Chamber's Twentieth Century Dictionary. It means connected and with or engaged in commerce”.

### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the analysis of the scheme of the act.**

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## **18.5 CONSUMERS PROTECTION COUNCILS**

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The object of the Act is to protect the interest of consumers and for that purpose Consumer Councils and Remedial Agencies have been established under the provisions of the Act.

**To quote the objects and reasons of the Act:**

“The Consumer Protection Bill, 1986 seeks to provide for better protection of the interest of consumers and for that purpose, to make provision for the establishment of consumer councils and other authorities for the settlement of consumer disputes and for matters connected therewith”. Thus, the Act provides:

- Establishment of Consumer Councils, and
- Establishment of Remedial Agencies

**Classes of councils**

- The Central Consumer Protection Council
- The State Consumer Protection Council
- The District Consumer Protection Council.

It is, therefore, clear that the Act provides establishment of councils at three stages: National, State and District.

**The Central Consumer Protection Council:-**

- The Central Government shall by notification, establish with effect, 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)
- **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.
- **The Constitution of the Central Consumer Protection Council and the Working Groups -**
- The Central Government shall, by notification in the Official Gazette constitute the Central Consumer Protection Council (hereinafter referred to as the Central Council) which shall consist of the following members, not exceeding 150, namely-
  - a) The Minister in-charge of Consumer Affairs in the Central Government) who shall be the Chairman of the Central Council);
  - b) The Minister of State (where he is not holding independent charge) of Deputy Minister (in-charge of Consumer Affairs in the Central Government) who shall be the Vice-Chairman of the Central Council;
  - c) The Minister in-charge of Consumer Affairs in States;
  - d) Eight members of Parliament - five from the Lok Sabha and three from the Rajya Sabha;
  - e) The Secretary of the National Commission for Schedule Castes and Schedule tribes;

- f) Representatives of the Central Government Departments and autonomous organisations concerned with consumer interest - not exceeding twenty;
- g) Representatives of the Consumer Organisations or consumers - not less than thirty five;
- h) Representatives of women - not less than ten;
- i) Persons capable of representing consumer interest and specified above - not exceeding fifteen;
- k) The [Secretary in-charge of Consumer Affairs in the Central Government] shall be the member-secretary of the Central Council.

- The term of the Council shall be three years.
- Any member may, by writing under his hand to the Chairman of the Central Council, resign from the Council. The vacancies so caused or otherwise, shall be filled from the same category by the Central Government and such person shall hold office so long as the member whose place he fills would have been entitled to hold office, if the vacancy had not occurred.
- For the purpose of monitoring the implementation of the recommendations of the Central Council and to suggest the working of the Council, the Central Government may constitute from amongst the members of the Council, a Standing Working Group, under the chairmanship of the Member Secretary of the Council. The Standing Working Group shall consist of not exceeding 30 members and shall meet as and when considered necessary by the Central Government.
- **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 fora;
  - 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.

Objects of the Central Council have been expressed as Charter of Protection of Consumer Rights which may be grouped in the following heads:

1. The right to be protected,

2. The right to be informed,
3. The right to be assured,
4. The right to be heard,
5. The right to be seeks redressal,
6. The right to be consumer education.

**The state Consumer Protection Council:-**

- [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 thereafter referred to as the State Council
- The State Council shall consist of the following members, namely -
  - a) the Minister - in-charge of consumer affairs in the State Government who shall be its Chairman;
  - b) such member 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.
- The State Council shall meet as and when necessary but not less than two meetings shall be held every year.
- 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.
- **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.

**District Council:**

The Provisions as to composition of District Council have been provided under sections 8A and 8B by Amendment Act, 2002. In original Act there was no such provision.

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.

The District Consumer Protection Council (hereinafter referred to as the District Council) shall consist of the following members, namely -

- The Collector of the district (by whatever name called), who shall be its Chairman; and
- Such number of other official and non-official members representing such interests as may be prescribed by the State Government.

The District Council shall meet as and when necessary but not less than two meetings shall be held every year.

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.

- **Objects of the District Council** - 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.]

### **Nature of Consumer Council :**

These consumer and other working groups have been established to make and suggest recommendation for better protection of consumer's interest. Thus councils have only recommendatory nature. Its recommendation is not binding but only persuasive. Rule 4 provides that resolution passed by the Central Council shall be recommendatory in nature.

### **Remedial Agencies or Consumer Courts (Consumer -Disputes Redressal Agencies) :**

This takes provision for the establishment of Remedial Agencies, i.e., consumer courts for settlement of consumers disputes and for matters connected therewith. There is three-tier system in the Act. They are -

- A Consumer Disputes Redressal Forum to be known the "*District Forum*", CDRF
- A Consumer Disputes Redressal Commission to be known as the "*State Commission*", SCDRC, and
- A National Consumer Disputes Redressal Commission to be known as the "*National Commission*", NCDRC.
- Section 9 deals with establishment of these Redressal Agencies:

### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about the consumer protection councils.**

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## 18.5 CONSUMERS DISPUTES REDRESSAL AGENCIES

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### Establishment of Consumer Disputes Redressal Agencies: -

There shall be established for the purposes of this Act, the following agencies, namely

- A Consumer Disputes Redressal Forum to be known as the “*District Forum*” established by the State Government in each district of the State by notification;
- [Provided that the State Government may, if it deems fit, establish more than one District Forum in a district;]
- A Consumer Disputes Redressal Commission to be known as the “State Commission” established by the State Government in the State by notification; and
- A National Consumer Disputes Redressal Commission established by the Central Government by notification.

### Who can file Complaint?

#### (a) By Consumer:

- The consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided.
- It should be kept in mind that every person who is consumer may file complaint. So the buyer of goods or to who service has been provided and the persons who are beneficiaries of such or availing services are also included (see definitions of consumer).

#### (b) Any Recognised consumer Association

- Any recognised consumer association whether the consumer to whom the goods sold or delivered or agreed to be sold or delivered or service provided or agreed to be provided is a member of such association or not. Association must be registered under the Indian Companies Act, 1956 or the Society Registration Act.
- There are 314 recognised Consumer Associations given in the Appendices. SEBI may also file complaint for the protection of the interest of the consumers.

#### c) By One or More consumers

- The complaint may be filed by one or more consumers, where there are numerous consumers having the same interest, with the permission of the District Forum, on behalf of, or for the benefit of all, consumers so interested.

#### d) Central or State Government

- The Central or State Government, as the case may be, either in its individual capacity or as a representation of interests of the consumers in general may be complainant or file complaint.

### Check Your Progress – 4

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss about the consumer disputes redressel.**

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**18.6 SOME USEFUL BOOKS**

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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**18.7 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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**Check Your Progress – 1**

1. See section 18.2

**Check Your Progress – 2**

1. See section 18.3

**Check Your Progress – 3**

1. See section 18.4

**Check Your Progress – 4**

1. See section 18.5

## UNIT 19:

# INFORMATION TECHNOLOGY ACT, 2003

### Structure

- 19.1 Objectives
- 19.2 Introduction, Scope & Definitions
- 19.3 Authentication of Electronic Records using Digital System
- 19.4 Secure Electric Records & Secure Digital System
- 19.5 Regulations of Certify Authorities
- 19.6 Duties of Certify Authority
- 19.7 Duties of Subscribers
- 19.8 Penalties & Adjudication
- 19.9 Offences
- 19.10 Act apply for offence committed outside India
- 19.11 Some Useful Books
- 19.12 Answer to Check Your Progress Exercise

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### 19.1 OBJECTIVES

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After studying this unit you should be able to:

- Understand about the objectives of the Information technology Act
- Know about the formalities of electronic records authentication.
- Determine the need and scope the Electronic commerce.
- Know what is Electronic signatures and its procedures of recognition
- Understand the functions of Cyber regulations Appellate Tribunal
- Specify the role of Cyber regulations advisory committee

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## 19.2 INTRODUCTION

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New communication systems and digital technology have made dramatic changes in the way we live and the means to transact our daily business. There is a remarkable change in the way people transact business. Businessmen are increasingly using computers to create, transmit and store and retrieve and speedier to communicate. Although people are aware of the advantages which the electronic form of business provides, people are reluctant to conduct business or conclude and transaction in the electronic form due to lack of appropriate legal framework. Electronic commerce eliminates need for paper based transactions. The two principal hurdles which stand in the way of facilitating electronic commerce and electronic governance, are the requirements of writing and signature for legal recognition. At present many legal provisions assume the existence of paper based records and documents which should bear signatures. The law of evidence is traditionally based upon paper based records and oral testimony. Hence to facilitate-commerce, the need for legal changes has become an urgent necessity.

The government of India realized the need for introducing a new law and for making suitable amendments to the existing laws to facilitate e-commerce and give legal recognition to electronic records and digital signatures in turn will facilitate the conclusion of contracts and the creation of legal rights and obligations through the electronic communication like Internet. This gave birth to the Information Technology Bill, 1999.

In May 2000, both the houses of the Indian Parliament passed the Information Technology Bill. The Bill received the assent of the President in August 2000 and came to be known as the Information Technology Act, 2000. Cyber Law is contained in the IT, Act, 2000. This Act aims to provide the legal infrastructure for e-commerce in India and would have a major impact for e-businesses and the new economy in India. Therefore, it is important to understand what are the various perspectives of the IT Act, 2000 and when it offers.

The Information Technology Act, 2000 also aims to provide the legal framework under which legal sanctity is accorded to all electronic records and other activities carried out by electronic means. The Act states that unless otherwise agreed, an acceptance of contract may be expressed by electronic means of communication and the same shall have legal validity and enforceability.

Arrangement of Sections: The Act consists of 94 sections spread over thirteen chapters, and four schedules to the Act, The various chapters are discussed in detail later. The Schedules to the Act contain related amendments made in other acts as outlined in the

objectives of the Act, namely, the Indian Penal Code, the Indian Evidence Act, 1972, the Banker's Book Evidence Act, 1891 and the Reserve Bank of India, 1934.

**The objectives of the Act are:**

- To grant legal recognition for transactions carried out by means of electronic data interchange and other means of electronic communication commonly referred to as "electronic commerce" in place of paper based methods communications,
  - To give legal recognition to digital signature for authentication of any information or matter which requires authentication under any law;
  - To facilitate filing of documents with government departments
  - To facilitate electronic storage of data;
  - To facilitate and give legal sanction of electronic fund transfers between banks and financial institutions
  - To give legal recognition for keeping books of account by bankers in electronic form.
- Evidence Act, 1891 and the Reserve Bank of India Act, 1934.

**Scope of the Act :**

The Act extends to the whole of India and unless otherwise provided in the Act, it applies also to any offence or contravention there under committed outside India by any person. The Act shall not apply to the following:

- A negotiable instrument as defined in Section 13 of Negotiable Instruments Act, 1881
- A power of attorney as defined in Section 1A of the Powers-of-
- A trust as defined in Section 3 of the Indian Trusts Act, 1882;
- A will as defined in of section 2 ® of Indian Succession Act, 1925 including any other testamentary disposition by whatever name called;
- Any contract for the sale or conveyance of immovable property or any interest in such property.
- Any such class of documents or transactions as may be notified by the Central Government in the Official Gazette.

**Definitions (Section 2) :**

- **"Access"** with its grammatical variations and cognate expressions means gaining entry into, instructing or communicating with the logical, arithmetical, or memory function resources of a computer, computer system or computer network;
- **"Addressee"** means a person who is intended by the originator to receive the electronic record but does not include any intermediary;

- **“Affixing digital signature”** with its grammatical variations and cognate expressions means adoption of any methodology or procedure by a person for the purpose of authenticating an electronic record by means of digital signature;
- **“Appropriate Government”** means the Central Government except in the following two cases where it means the State Government; (i) in matter enumerated in List II of the Seventh Schedule to the Constitution; (ii) relating to any state law enacted under List III of the Seventh Schedule to the Constitution,
- **“Asymmetric crypto system”** means a system of a secure key pair consisting of a private key for creating a digital signature and a public key to verify the digital signature,
- **“Computer”** means any electronic magnetic, optical or other high-speed data processing device or system which performs logical, arithmetic and memory functions by manipulations of electronic, magnetic or optical impulses, and includes all input output, processing, storage, computer software, or communication facilities which are connected or related to the computer in a computer system or computer network;
- **“Computer network”** means the interconnection of one or more computers through -  
 (i) the use of satellite, microwave, terrestrial line or other communication media; and  
 (ii) terminals or a complex consisting of two or more interconnected computers whether or not the interconnection is continuously maintained;
- **“Computer resource”** means computer system, computer network, data, computer data base or software;
- **“Computer system”** means device or collection of devices, including input and output support devices and excluding calculators which are not programmable and capable of being used in conjunction with external files, which contain computer programmes, electronic instructions, input data and output data, that performs logic, arithmetic, data storage and retrieval, communication control and other functions.
- **“Data”** means a representation of information, knowledge, facts, concepts or instructions which are being prepared or have been prepared in a formalized manner, and is intended to be processed, is being processed or has been processed in a computer system or computer network, and may be in any form (including computer printouts magnetic or optical storage media, punched tapes or stored internally in the memory of the computer.

- **“Digital signature”** means authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provisions of Sec 3.
- **“Electronic form”** with reference to information means of any information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film, computer generated micro fiche or similar device ;
- **“Electronic record”** means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche;
- **“Function”** in relation to a computer, includes logic, control arithmetical process, deletion, storage and retrieval and communication or telecommunication from or within a computer;
- **“Information”** includes data, text, images, sound, voice, codes, computer programmes, software and database or micro film or computer generated micro fiche.
- **“Intermediary”** with respect to any particular electro message means any person who on behalf of another person receives stores or transmits that message or provides any service with respect to that message;
- **“Key pair”** in an asymmetric crypto system, means a private key and its mathematically related public key, which are so related that the public key can verify a digital signature created by the private key;
- **“Originator”** means a person who sends, generates, stores or transmits any electronic message or causes any electronic message to be sent, generated, stored or transmitted to any other person but does not include an intermediary;
- **“Prescribed”** means prescribed by rules made under this Act;
- **“Private key”** means the key of a key pair used to verify a digital signature and listed in the Digital Signature Certificate;
- **“Secure system”** means computer hardware, software, and procedure that -
  - (a) are reasonably secure from unauthorised access and misuse;
  - (b) provide a reasonable level of reliability and correct operation;

- (c) are reasonably suited to performing the intended functions; and
- (d) adhere to generally accepted security procedures;

- **“verify”** in relation to a digital signature, electronic record or public key, with its grammatical variations and cognate expressions means to determine whether -
  - (a) the initial electronic record was affixed with the digital signature by the use of private key corresponding to the public key of the subscriber;
  - (b) the initial electronic record is retained intact or has been altered since such electronic record was so affixed with the digital signature.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about the objectives & Scope of the Act**

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#### **2. Discuss about the various Definitions of the Act.**

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### **19.3 AUTHENTICATION OF ELECTRONIC RECORDS USING DIGITAL SIGNATURES**

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The section provides the conditions subject to which an electronic record may be authenticated by means of affixing digital signature. The digital signature is created in two distinct steps, first the electronic record is converted in to a message digest by using a mathematical function known as 'hash function' which digitally freezes the electronic record thus ensuring the integrity of the content of the intended communication contained in the electronic record. Any tampering with the contents of the electronic record will immediately invalidate the digital signature. Secondly, the identity of the person affixing the digital signature is authenticated through the use of a private key which attaches itself to the message digest and which can be verified by anybody who has the public key corresponding to such private key. This will enable anybody to verify whether the electronic record is retained intact or has been tampered with since it was so fixed with the digital signature. It will also enable a person who has a public key to identify the originator of the message.



For the purpose of this sub-section, 'hash function' means an algorithm, mapping or translation of one sequence of bits into another generally smaller, set known as 'hash result' such that an electronic record yields the same hash result every time the algorithm is executed with the same electronic record as its input making it computationally infeasible -

- To derive or reconstruct the original electronic record from the hash result produced by the algorithm;
- That two electronic records can be produced the same hash result using the algorithm.

### **Electronic Governance:**

**Section 4** - This section provides for '*legal recognition of electronic records*'. It provides that where any law requires that any information or matter should be in the typewritten or printed form then such requirement shall be deemed to be satisfied if it is in electronic form.

**Section 5** - This section provides for *legal recognition of Digital signature*. Where any law requires that any information or matter should be authenticated by affixing the signature of any person, then such requirement shall be satisfied if it is authenticated by means of Digital signatures affixed in such manner as may be prescribed by the Central Government.

For the purposes this section 'signed' with its grammatical variations and cognate expressions, shall with reference to a person, mean affixing of his hand written signature or any mark or any document and the expression 'signature' shall be construed accordingly.

**Section 6** - lays down the foundation of Electronic Governance. It provides that the filing of any form, application or other documents, creation, retention or preservation of records, issue or grant of any license or permit or receipt or payment in government offices and its agencies may be done through the means of electronic form. The appropriate Government has the power to prescribe the manner and format of the electronic records and the method of payment of fee in that connection.

**Section 7** - This Section provides that the documents, records or information which to be retained for any specified period shall be deemed to have been retained if the same is retained in the electronic form provided the following conditions are satisfied:

- The information therein remains accessible so as to be usable subsequently.
- The electronic record is retained in its original format or in a format which accurately represents the information contained.
- The details which will facilitate the identification of the origin, destination, dates and time of despatch of receipt of such electronic record are available therein.

This section does not apply to any information, which is automatically generated solely for the purpose of enabling an electronic record to be dispatched or received. Moreover, this section does not apply to any law that expressly provides for the retention of documents, records or information in the form of electronic records.

**Section 8** - provides for the publication of rules, regulations and notifications in the Electronic Gazette. It provides that where any law requires the publication of any rule, regulation, order, bye-law, notification or any other matter in the Official Gazette, then such requirement shall be deemed to be satisfied if the same is published in an electronic form. It also provides where of Official Gazette is published both in the printed as well as in electronic form, the date of publication shall be date of publication of the Official Gazette, which was first published in any form.

However, **Section 9** of the Act provides that the conditions stipulated in Sections 6, 7 and 8 shall not confer any right to insist that the document should be accepted in an electronic form by any Ministry or department of the Central Government or the State Government. Power to Central Government to make rules (**Section 10**): This section provides that the Central Government, in respect of Digital Signature may prescribe by rules the following:

- The type of digital signature
- The manner and format in which the digital signature shall be affixed
- The manner or procedure which facilitates identification of the person affixing the digital signature.
- Control processes and procedures to ensure adequate integrity, security and confidentiality of electronic records or payments; and
- Any other matter which is necessary to give legal effect to digital signatures.

### **Attribution, Receipt and Dispatch of Electronic records (Sections 11 - 13)**

- Section 11 Deals with attribution, receipt and dispatch of electronic records `Attribution` with regard to a certain means `to consider it to be written or made by someone`. Hence, this section lays down how an electronic record is to be attributed to the person who originated it.
- Section 12 provides for the manner in which acknowledgement of receipt of an electronic record by various modes shall be made.
- Section 13 provides for the *manner in which the time and place of despatch and receipt of electronic record* sent by the originator shall be identified. It is provided that in general, an electronic record is deemed to be dispatched at the place where the originator has his place of business and received where the addressee has his place of business.

For the purpose of this Section -

- If the originator or the addressee has more than one place of business, the principal place of business shall be the place of business.
- If the originator or the addressee does not have a place of business, his usual place of residence shall be deemed to be the place of business;
- Usual place of residence` in relation to a body corporate, means the place where it is registered.

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss Authentication of Electronic Records Using Digital Signatures.**

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## **19.4 SECURE EELCTRONIC RECORDS & SECURE DIGITAL SIGNATURES**

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The I.T. Act sets out the conditions that would apply to qualify electronic records and digital signatures as being secure. It contains sections 14 to 16.

**Section 15** provides for the security procedure to be applied to Digital Signatures for being treated as a secure digital signature.

**Section 16** provides for the power of Central Government to prescribe the *security procedure* in respect of secure electronic records and secure digital signatures. In doing so, the Central Government shall take into account various factors like nature of the transaction, level of sophistication of the technological capacity of the parties, availability and cost of alternative procedures, volume of similar transactions entered into by other parties, etc.

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## 19.5 REGULATION OF CERTIFYING AUTHORITIES

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The I.T.Act contains detailed provisions relating to the appointment and powers of the controller and certifying Authorities. It contains sections 17 to 34.

- **Section 17** Provides for the *appointment of controller and other officers* to regulate the Certifying Authorities.
- **Section 18** lays down *the functions which the controller* may perform in respect of activities of Certifying Authorities.
- **Section 19** provides for the power of the Controller with previous approval of the Central Government *to grant recognition to foreign certifying Authorities* subject to such conditions and restrictions as may be imposed regulations.
- **Section 20** This section proves that the *controller shall be acting as repository of all digital signature Certificates* issued under the Act. He shall also adhere to certain security procedure to ensure secrecy and privacy of the digital signatures and also to satisfy such other standards as may be prescribed by the Central Government. He shall maintain a computerized database of all public keys in such a manner that they are available to the general public.
- **Section 21** This section provides that a license to be issued to a certifying Authority to issue Digital Signature Certificates by the controller shall be in such form and shall be in such form and shall be accompanied with such fees and other documents after considering the application may either grant the license or reject the application after giving reasonable opportunity of being heard.
- **Section 22** This section provides that the application for license shall be accompanied by a certification practice statement and statement including the procedure with respect to identification of the applicant. It shall be further accompanied by a fee not exceeding Rs.25, 000 and other documents as may be prescribed by the Central Government.
- **Section 23** provides that the application for *renewal of a license* shall be in such form and accompanied by such fees not exceeding Rs.5,000 which may be prescribed by the Central Government.
- **Section 24** deals with the procedure for *grant or rejection of license* by the controller on certain grounds. However, that no application shall be rejected under this section, unless the applicant has been given a reasonable opportunity of presenting his case.

- **Section 25** provides that the controller may revoke a license on grounds such as incorrect or false material particulars being mentioned in the application and also on the ground of contravention of any provisions of the Act, rule, regulation or order made there under.

However, no license shall be revoked unless the Certifying Authority has been given a reasonable opportunity of showing cause against the proposed revocation. Also, no license shall be suspended for a period exceeding ten days unless the Certifying Authority has been given a reasonable opportunity of showing cause against the proposed suspension. Thereafter, the controller shall publish a notice of suspension or revocation, as the case may be, shall be made available through a web site which shall be accessible round the clock. It also provided that the controller may, if he considers necessary, publicize the contents of database in such electronic or other media, as he may consider appropriate.

#### **Controller's power to delegate:**

Under Section 27 controller may in writing authorize the Deputy Controller, Assistant controller or any officer to exercise any of his powers under the Act.

#### **Other powers:**

The controller shall have power to investigate contravention of the provisions of the Act or rules or regulations made there under either by himself or through any officer authorized in this behalf. The controller or any person authorized by him, shall have access to any computer system, data or any other material connected with such system if he has reasonable cause to suspect that contravention of the provision of the Act or the rules or regulation is being committed.

#### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about the certifying authorities.**

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## 19.6 DUTIES OF CERTIFYING AUTHORITIES

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- This section provides that every Certifying Authority shall follow certain procedures in respect of digital signature as given below:
  - a. Make use of hardware, and procedures that are secure from intrusion and misuse
  - b. Provide a reasonable level of reliability in its services which are reasonably suited to the performance of intended functions
  - c. Adhere to security procedures to ensure that the secrecy and privacy of the digital signatures are assured and
  - d. Observe such other standards as may be specified by regulations.
- Every Certifying Authority shall also ensure that every person employed by him complies with provisions of the Act, or rules, regulations or orders made there under.
- A Certifying Authority must display its license at a conspicuous place of the premises in which it carries on its business and a Certifying Authority whose license is suspended or revoked shall immediately surrender the license to the Controller.
- *Section 34* further provides that every Certifying Authority shall disclose its digital signature certificate which contains the public key corresponding to the private key used by that Certifying Authority and other relevant facts.

### **Digital signature certification** (*Section 35 - 39*)

Section 35 lays down the procedure for issuance of a digital signature Certificate. It provides that an application for such certificate shall be made in the prescribed form and shall be prescribed by the Central Government, and different fees may be prescribed for different classes of applicants. The section also provides that no Digital Signature Certificate shall be granted unless the Certifying Authority is satisfied that -

- The applicant holds the private key corresponding to the public key to be listed in the Digital signature Certificate;
- The applicant holds a private key, which is capable of creating a digital signature;
- The public key to be listed in the certificate can be used to verify a digital signature affixed by the private key held by the applicant

However, no application shall be rejected unless the applicant has been given a reasonable opportunity of showing cause against the proposed rejection. While issuing a Digital Signature Certificate the Certifying Authority should certify that it has complied with provisions of the Act, the rules and regulations made there under and also with other conditions mentioned in the Digital Signature Certificate.

## **Suspension of Digital Signature Certificate**

The certifying Authority may suspend such certificate if it is of the opinion that such a step needs to be taken in public interest. Such certificate shall not be suspended for a period exceeding 15 days unless the subscriber has been given an opportunity of being heard. Section 38 provides for the revocation of *Digital Signature Certificates* under certain circumstances. Such revocation shall not be done unless the subscriber has been given an opportunity of being heard in the matter. Upon *revocation* or suspension. The Certifying Authority shall publish the notice of suspension of a Digital Signature Certificate

### **Check Your Progress – 4**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Duties of certifying authorities.**

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### **19.7 DUTIES OF CERTIFYING SUBSCRIBERS**

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- On acceptance of the Digital Signature Certificate the subscriber shall generate a key paid using a secure system.
- A subscriber shall be deemed to have accepted a Digital Signature Certificate if he publishes or authorizes the publication of such signature to one more persons or otherwise demonstrates his approval of the Digital Signature Certificate. By so accepting the certificate, the subscriber certifies to the public the following.
  - a. That he holds the private key corresponding to the public key listed in the Digital Signature Certificate; and
  - b. That all the information contained in the certificate as well as material relevant to them are true
- The subscriber shall exercise all reasonable care to retain control of his private key corresponding to the public key. If such private key has been compromised (i.e. endangered or exposed), the subscriber must immediately communicate the fact to the Certifying Authority.
- Otherwise, the subscriber shall be liable till he has informed the Certifying Authority that the private key has been compromised.

## **Check Your Progress – 5**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss the Duties certifying subscribers.**

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## **19.8 PENALTIES AND ADJUDICATION**

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The Act provides for awarding compensation or damages for certain types of computer frauds. It also provides for the appointment of Adjudicating Officer for holding an inquiry in relation to certain computer crimes and for awarding compensation.

### **Types of penalties**

Penalty for damage to computer, computer system or network: *Section 43* deals with penalty for damage to computer, computer system, etc. by any of the following methods:

- Securing access to the computer, computer system or computer network;
- Downloading or extracting any data, computer database of information from such computer system or those stored in any removable storage medium.
- Introducing any computer contaminant or computer virus into any computer system or network
- Damaging any computer, computer system or network or any computer data database or programme
- Disrupting any computer, computer system or network
- Denying access to any person authorised to access any computer, computer system or network
- Providing assistance to any person to access any computer, computer system or network in contravention of any person by tampering with or manipulating any computer, computer system or network.
- *Explanation* - For the purposes of this section,
- ***Computer contaminant*** means any set of computer instructions that are designed -
  - a. to modify, destroy, record, transmit data or programme residing within a computer, computer system or computer network; or
  - b. by any means to usurp the normal operation of the computer, computer system, or computer network;
- ***'computer database'*** means a representation of information, knowledge, facts, concepts or instructions in text, image, audio, video that are being prepared or have



been prepared in a formalized manner or have been produced by a computer, computer system or computer network and are intended for use in a computer, computer network;

- '**computer virus**' means any computer instruction, information, data or programme that destroys, damages, degrades or adversely affects the performance of a computer resource or attaches itself to another computer resource and operates when a programme, data or instruction is executed or some other even takes place in that computer resource;
- '**damage**' means to destroy, alter, delete, add, modify or rearrange any computer resource by any means.

**Section 46** confers the *power of adjudicate contravention* under the Act to an officer not below than the rank of a Director to the Government of India or an equivalent officer of a State Government. Such appointment shall be made by the Central Government. In order to be eligible for appointment as an adjudicating officer, a person must possess adequate experience in the field of Information Technology and such legal or judicial experience as may be prescribed by the Central Government. The adjudicating officer so appointed shall be responsible for holding an inquiry in the prescribed manner after giving reasonable opportunity of being heard and thereafter, imposing penalty where required.

**Section 47** provides that while deciding upon the quantum of compensation, the adjudicating officer shall have due regard to the amount of gain of unfair advantage and the amount of loss caused to any person as well as the respective nature of the default.

### **Check Your Progress – 6**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about the penalties & adjudication.**

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## **19.9 OFFENCES**

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Tampering with computer source documents (Section 65): This section provides for punishment with imprisonment up to three years or with a fine which may extend to Rs. 2 lakhs or with imprisonment up to 3 years, or with both.

Hacking with computer system (Section 66) : '*Hacking*' is a term used to describe the act of destroying or deleting or altering any information residing in a computer resource or diminishing its value or utility, or affecting it injuriously in spite of knowing that such action is likely to cause wrongful loss or damage to the public or that person. *Section 66* provides that a person who commits hacking shall be punished with a fine upto Rs. 2 lakhs or with imprisonment upto 3 years, or with both.

Publishing of information which is obscene in electronic form: *Section 67* provides for punishment to whoever transmits or publishes or causes to be published or transmitted, any material which is obscene in electronic form with imprisonment for a term which may extended to five years and with fine which may extended to five years and with fine which may extended to Rs.1 lakh on first conviction. In the event of second or subsequent conviction the imprisonment would be for a term which may extend to ten years and fine which may extend to Rs.2 lakhs.

### **Power of the controller**

*Section 68* provides the controller may give directions to certifying authority or an employee of such authority to take such measures or cease carrying on such activities as specified in the order, so as to ensure compliance with this law. If any person fails to comply, he shall be liable to imprisonment upto 3 years or five upto Rs. 2 lakhs, or both.

*Section 69* empowers the controller, if he is satisfied that it is necessary or expedient so to do in the interest of sovereignty and integrity of India. Security of the state, friendly relation with foreign states or public order, to intercept any information transmitted through any computer system or computer network.

*Section 70* empowers the appropriate Government to declare by notification any computer, computer system or computer network to be protected system. Any unauthorized access of such systems will be punishable with imprisonment which may extend to ten years or with fine.

### **Penalty for Misrepresentation (Section 71)**

This Section provides that any person found misrepresenting or suppressing any material fact from the controller or the certifying authority shall be punished with imprisonment for a term which may extend to two years or with fine which may extend Rs. 1 lakh or with both.

Penalty for publishing False Digital signature certificate

**Section 73** This section provides punishment for publishing a Digital Signature certificate false in material particulars or otherwise making it available to any person with imprisonment for a term which may extend to two years or with fine which may extend to Rs. 1 lakh or with both.

**Penalty for Fraudulent Publication (Section 74)**

This Section provides for punishment with imprisonment for a term which may extend to two years or with fine which may extend to Rs. 1 lakh or with both to a person whoever knowingly publishes for fraudulent purpose any Digital Signature certificate.

**Check Your Progress – 7**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss the Offences.**

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**19.10 ACT APPLY FOR OFFENCE COMMITTED OUTSIDE INDIA**

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**Section 75** provides for punishment for commission of any offence or contravention by a person outside India irrespective of his nationality if the act of conduct constituting the offence or contravention involves a computer, computer system or computer network located in India.

**Confiscation (Section 76)**

This Section provides for confiscation of any computer, computer system, floppies, compact disks, tape drives or any other accessories related thereto in respect of contravention of any provision the Act, rules, regulations or orders made there under.

It is also provided that where it is established to the satisfaction of the court adjudicating of the confiscation that the person in whose possession, power or control of any such computer, computer system, floppies, compact disks, tape drives or any other accessories relating thereto is found is not responsible for the contravention of the provisions of this Act, rule, orders or regulations made there under, the court may instead of making an order for confiscation of such computer, computer system, floppies, compact disks, tape drives or any other accessories related thereto, make such other order authorised by this Act

against the person contravening the provisions of this Act, orders or regulations made there under as it may think fit.

**Section 77** further provides that penalty and confiscation provided under this act shall not interfere with other punishment provided under any other law for the time being in force.

**Section 78** provides for power to investigate the officers under the Act by a police officer not below the rank of Deputy Superintendent of Police.

### **Power of Central Government to make Rules**

**Section 87** of the Act confers on the Central Government the power to make rules by notifying in the Official Gazette and the electronic gazette, in respect of certain matter, some of which are:

- the manner in which any matter may be authenticated by a Digital signature
- the manner and format in which electronic records shall be filed or issued
- the type of Digital signature, manner and format in which it may be affixed
- the security procedure for the purpose of creating same electronic record and secure Digital signature
- the qualifications, experience and terms and conditions of service of controller , Deputy controllers and Assistant controllers
- the requirements, manner and form in which application is to be made for license to issue **Digital Signature Certificate**
- the period of validity of the license the qualifications, experience of an adjudicating officer, as well as other officers
- the salary, allowances and terms and conditions of service of the Presiding Officer, etc.

Every notification made by the Central Government shall be laid, as soon as possible after it is made, before each House of Parliament, while it is in session, for a total period of thirty days. This period maybe comprised in one session or in two or more successive sessions. If before the expiry of the session immediately following the above period, both Houses agree in making any modification, the rule will thereafter have effect only in the modified form. Similarly if both Houses agree that the rule should not be made, the notification shall have no effect, thereafter.

### **Power of State Government to make Rules**

The State Government may be notification in the Official Gazette, make rules to carry out the provisions of this Act, Such rules may provide for all or any of the following matters:

- The electronic form in which filing, issue, grant receipt or payment shall be effected in respect of use of electronic records and Digital signatures in Government and its agencies.
- The manner and format in which such electronic records shall be filed or issued and the fee of charges in connection of the same
- Any other matter required to be provided by rules by the State Government. Every such rule shall be laid before each House of the State Legislature.

### **Check Your Progress – 8**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the about the act apply for offence committed outside India.**

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### **19.11 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

### **19.12 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

#### **Check Your Progress – 1**

1. See section 19.2

#### **Check Your Progress – 2**

1. See section 19.3

#### **Check Your Progress – 3**

1. See section 19.5

#### **Check Your Progress – 4**

1. See section 19.6

**Check Your Progress – 5**

1. See section 19.7

**Check Your Progress – 6**

1. See section 19.8

**Check Your Progress – 7**

1. See section 19.9

**Check Your Progress – 8**

1. See section 19.10



## UNIT 20:

### INTRODUCTION OF THE COMPANY LAW

#### Structure

- 20.1 Objectives
- 20.2 Introduction
- 20.3 Types of Companies
- 20.4 Formation of a Company
- 20.5 Some Useful Books
- 20.6 Answer to Check Your Progress Exercise

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#### 20.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a company
- Understand the principles of company
- Describe the scope and nature of the types of companies

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#### 20.2 INTRODUCTION

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A company means a group of persons associated voluntarily together for the attainment of a common goal either, social or economic. Much the way people came together to buy and sell, lend and borrow, so did people come together and pooled their resources for common benefit. It represents different kinds of associations, both business and otherwise. Late 1800s early 1900 were the period of much industrial and commercial activity. The vigorous activity raised several disputes and the courts were called upon to adjudicate this. The courts had to apply the provisions in a new and emergent context. In this, the courts gave several landmark judgments in interpreting the provisions.

The British Act, as well as the Indian Act, was amended, enlarged and consolidated several times. The law which governs companies in India at present is the Companies Act, 1956. As a result the companies act become voluminous. The Act, 1956 runs into 658 Sections and 15 Schedules. Companies incorporated under the Companies act, 1956 are

mostly business companies but they may also be formed for promoting art, charity, research, religion, commerce, or other useful purpose.

### **Meaning of the company**

The company is one of the forms of organization. It has its distinctive characteristics and advantages which make it suitable for different purposes.

### **Nature and Types of a Company**

On analyzing the aforesaid definitions the following characteristics of a company are revealed:

- ***An artificial person created by law:*** A company is called an artificial person because it does not take birth like a natural person but comes into existence through law. Being the creation of law, the company possesses only those properties, which are conferred upon it by its charter.
- ***Separate Legal Entity:*** The case of *Salomon v. Salomon and Company Ltd.* Mr. Saloman was running a shoe business in England. He formed a company known as Saloman and Co.Ltd. It is considered of Saloman himself, his wife, his four sons and a daughter. The shoes business of Saloman was sold to the company for \$ 30,000. Mr.Saloman received from the company purchase price in the form of \$20,000 fully paid shares of \$1 each and \$ 10,000 in debentures which carried a floating charge over the assets of the company. One share of \$1 each was subscribed for in cash by each member of course of business, the company became liable for some unsecured loan. The company ran into financial difficulties after some time and went into liquidation within a year. On winding up, the assets realized \$ 6,000. The company owed \$10,000 to holder, (Mr.Saloman), nothing was left for unsecured creditors. Thus, after paying off the debenture priority over the debuntures contending that Mr.Saloman and Saloman and Co.Ltd. Were one and the same person, the Company was only a façade to defraud the innocent creditors. Mr.Saloman should not therefore, be treated as a secured creditor.

***Held:*** The Company had been validly constituted and it had an independent existence distinct from its members. Therefore, Mr.Saloman business belonged to the company and not to Mr. Saloman. The company and Mr.Saloman enjoyed separate legal entities. The fact that the members were from one single family had no bearing upon the validity of the company.



- **Perpetual Existence:** The term perpetual existence means the continued existence. The death, insolvency or unsoundness of mind of its members or transfer of shares by its members does not in any way affect the existence of the company. Members may come and members may go but the company goes on forever. The company can be compared with flowing river where water (members) keeps on changing continuously, still the identity of the river (company) remains the same.
- **Common Seal:** The term Common Seal means the official signature of the company. Since the company being an artificial person cannot sign its name on a document, every company is required to have its common seal with its name engraved on the same. This seal acts as the official signature of the company. Any document bearing the common seal of the company and duly witnessed by at least two directors will be binding on the company.
- **Limited Liability:** In case of a company limited by share, the liability of a member is limited up to the amount remaining unpaid on the shares held by a member.
- **Free Transferability of shares:** The shares of a public company are freely transferable. A shareholder can transfer association, even a public limited company can put certain restrictions on the transfer of shares but it cannot altogether stop it. A shareholder of public company possessing fully paid up shares is at liberty to transfer his shares to anyone he likes in accordance with the manner provided for in the articles of association of the company.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss about the meaning & Types of Company Act**

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## **20.3 TYPES OF COMPANIES**

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### **Types of Companies**

The companies can be classified under the three categories as follows:

- **Basis of incorporation**
- **Basis of liability**
- **Basis of control**

**Basis of incorporation:-**

This is further divided into three categories. They are as follows:

**Chartered company:** A company incorporated under a special charter granted by the king or Queen of England is called “chartered Company”. The familiar examples of chartered company are the East India Company and the Bank of England. This type of company cannot now be formed in India.

**Statutory Company:** A statutory company is one, which is created by a special Act of Parliament or a state legislature. Such companies are usually formed for achieving a purpose related with public utilities. The nature and powers of such companies are laid down in the special Act under which they are created. A statutory company has also a separate legal entity companies is conducted under the control and supervision of the Auditor General of India and the annual report of working is required to be placed before the Parliament or state legislature, a the case may be. Example is Reserve Bank of India.

**Registered or Incorporated Company:** A registered company is one, which is registered in accordance with the provisions of the Companies Act of 1956 and also includes the existing companies. By existing company means that a company formed and registered under any of the previous laws.

A registered company may either be a private company or a public company. It is explained as follows:

**(I) PRIVATE COMPANY:-**

A private company means a company which has a minimum paid up capital of Rs.1, 00,000 or such higher paid up capital as may be prescribed, and by its articles-

- a) Restricts the right to transfer its shares, if any
- b) Limits the number of its members to fifty, and
- c) Prohibits any invitation to the public to shares in or debentures of the company.
- d) Prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

▪ **Restriction on Transfer of shares-**

The right of transfer is generally restricted in the following manner:

- a) Authorizing the directors to refuse shares to persons whom they do not approve or by compelling the shareholder to offer his shareholding to the existing shareholders first.

b) By inspecting the method for calculating the price at which the shares may be sold by one member to another

c) By providing that the shareholders who are employees of the company shall offer the shares to specified persons or class of persons when they leave the company's service.

- **Limitation of Membership-** The articles must contain a provision whereby the company limits the number of its members to 50.
- **Prohibition on Making an Invitation to Public-** The articles must prohibit any invitation to the public to subscribe for any of its shares or debentures. Such a prohibition is necessary for the substance of the private character of the company.
- **Prohibition on Invitation/Acceptance of Deposit-** It is desirable and advisable as a good secretarial practice to alter the articles.

## (II) PUBLIC COMPANY:-

The Public company means a company which is either

- Not a private company and has a minimum paid up capital of Rs 5,00,000 or such higher paid-up capital as may be prescribed: or
- Is a private company, which is subsidiary of public company.

### (A). Based on Liability:-

On the basis of liability, an incorporated company may either be

- **A company limited by shares**
- **A company limited by guarantee**
- **An unlimited company**
- **Company Limited by Shares-**

A Company limited by shares is a company in which the liability of its members is limited by its memorandum to the amount unpaid on the share respectively held by them. The companies limited by shares may be either public companies or private companies. If a member has paid the full amount of shares, then his liability shall be nil.
- **Company Limited by Guarantee-**

A Company limited by guarantee is a company in which the liability of its members is limited by its memorandum to such an amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

- **Unlimited Company-**

An unlimited company is a company in which the liability of its members is not limited by its memorandum. In other words, the liability of members is unlimited. The members of such companies may be required to pay company's losses from their personal property.

**(B). Based on Control:-**

On the basis of control, the companies may be grouped as follows:

- **Government Company-**

A government company means any company in which at least 51% of the paid up share capital is held by the central government or by any state government or government or partly by the central government and partly by one or more state governments and includes a company which is a subsidiary of a government company as thus defined.

**Example:** Hindustan Aeronautics Ltd.

- **Non-Government Company-**

A company which may not be termed as a government company as defined in Section 617 is regarded as a non-government company

- **Foreign Company-**

A foreign company means a company which is incorporated in a country outside India under the law of that country. After the establishment of business in India, the following documents must be filed with the registrar of companies within 30 days from the date of establishment.

- **Domestic Company-**

A company which cannot be termed as foreign company under the provisions of the companies act as a domestic company.

- **Holding and Subsidiary Company-** If one company controls the other company, the controlling company may be termed as the "Holding Company" and company so controlled may be termed as a "Subsidiary Company".

- **Multi National Company**

A multinational company is huge industrial organization which-

- a) Operate in more than one country
- b) Carries out production, marketing and research activities on international scale in those countries, and
- c) Attempts to maximize profits world over.

## **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss the Types of Companies.**

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## **20.4 FORMATION OF COMPANY**

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The various steps involved in the formation of a company are given below:

### **I. Approval at name**

**Step No.1** consult –

- a. the latest edition of Directory of Companies together supplements updating it,
- b. the Guidelines issued by the Department of Company affairs, and
- c. the Emblems and Names (Prevention of Improper Uses) Act, 1950

**Step No. 2** Select in order of preference at least three names which –

- a. are not identical with or too similar to the name of another registered company,
- b. are not prohibited under the Emblem and Names (Prevention of Improper Uses) Act, 1950 and
- c. are not in contravention of the Guidelines issued by the Department of Company affairs.

**Step No. 3** Apply to the Registrar of Companies of the state in which registered office is to be situate to ascertain the availability of names in the prescribed Form No. 1A long with a fee of Rs., 500

**Step No.4** Get ensured about the availability of names within 14 days from date of submission of application since the Registrar is required to inform the status of the application within 14 days.

- If available – Complete all the formalities within a period of 3 months
- If not available – Apply again (if satisfied with the reason for refusal given), or Make an appeal against refusal.

### **II. Memorandum and Articles of Association**

**Step No.5** Get the Drafts of Memorandum of Association and Articles of Association Prepared. However a public company limited by shares need not prepared its own articles. It may adopt Table A as given in Schedule I of the Act.

**Step No. 6** Get the Draft of Memorandum of Association and the Articles of Association by the Registrar.

**Step No. 7** Get the Memorandum Association and Articles of Association **printed**.

**Step No. 8** Get the Memorandum of Association and Articles of Association **stamped**.

**Step No. 9** Get the Memorandum of Association and Articles of Association signed by atleast 2 subscribers in case of a private company and 7 subscribers in case of a public company. Each subscriber shall also write in his own hand his address, description, occupation and number of shares subscribed for in presence of at least one witness who shall attest the signature and shall write his own hand his address, description and occupation (if any). This document s may be signed by an outsider against if he is authorized to do so by a power of attorney.

**Step No. 10** Ensure that Memorandum and Articles of Association are dated on a date after the date of stamping.

### **III. Consent to Act as Direction in Form No. 29**

**Step No. 11** Get Form No. 29 (in duplicate) duly filled up and signed to accord to **consent** of a person willing to act as director if he is so appointed by the Articles of Association of a public company having share capital [Section 266].

### **IV. Notice of Situation in Form No. 18 (May be given within 30 days of Incorporation)**

**Step No. 12** Get Form No. 18 (in duplicate) fully filled up and signed to give the notice of the situation of the registered office of the company if the subscribers have already chosen a registered office and they wish to give notice to the Registrar at the time of registration. *Alternatively such notice may be given within 30 days of the incorporation of the company.* [Section 146]

### **V. Particulars of Directors, Manager or Secretary in Form No. 32 May be given within 30 days of Incorporation.**

**Step No. 13** Get Form No. 32 (in duplicate) duly filled up and signed to provide particulars of directors, manager or secretary if they are appointed by Articles of Association and the subscribers wish to give notice to the Registrar at the time of registration. Alternatively, such form may be sent within 30 days of appointment of first directors.

### **VI. Statutory Declaration in Form No.1**

**Step No. 14** Get the statutory declaration prepared in Form No.1 statutory declaration is a declaration to the effect that all the requirements of the act and rules there under relating to the registration of the company have been complied with. Such declaration can be signed by any one of the following persons:

- a. an advocate of the Supreme Court or of a High Court; or
- b. an attorney or a pleader entitled to appear before a High court; or
- c. a secretary, or a chartered accountant practicing in India and who has been engaged in the formation of the company; or
- d. by a person named in the articles as a director, manager or secretary of the company.

## **VII. Filling of Documents with Fees**

**Step No. 15** File the following document with the Registrar of companies along with the forwarding application with necessary registration and filing fees:

- a. The Memorandum of Association, duly signed by the prescribed minimum number of subscribers, and duly stamped and signed by witness. [Section 33(1) (a)]
- b. The Articles of Association similarly signed, stamped and witnessed. [Section 33 (1) (b)]
- c. A copy of agreement, if any, which the company purposes to enter into with any individual for appointment as its managing director or whole-time director or manager [section 33 (1) (c)]
- d. A copy of any other agreement, if referred to in the Memorandum and Articles of Association in that case, it will form a part of the Memorandum and Articles of Association.
- e. Power of Attorney duly stamped and signed by the subscribers authorizing a representative to make amendments and/or alterations in the Memorandum and Articles of Association
- f. A Certified copy of letter of the Registrar of Companies, intimating the availability of the proposed name.
- g. Consent of director or act in Form No. 29 (in duplicate) wherever necessary).
- h. Notice of the situation of the registered office in Form No. 18) in duplicate) wherever necessary.
- i. Particulars of directors, managing director, manager and secretary in Form No. 32 (in duplicate) wherever necessary
- j. Statutory declaration in Form No. 1

## **VIII. Certificate of in-corporation**

When the necessary documents have been filed with the Registrar along with the payment of requisite fee, the Registrar shall scrutinize these documents and if he is satisfied that (a) all the documents are in order, and (b) the requirement of the Act in respect of registration have been duly complied, with he shall enter the name of the company in the Register of Companies and shall issue a certificate which is termed as 'Certificate of Incorporation'.

Note: If the Registrar is of the view that there are some minor defects in any document, he may require that the defects be rectified. But, if there are some material and substantial defects, the Registrar may refuse to register the company.

### **Contents of Certificate of Incorporation**

The certificate incorporation contains:

- (a) The name of the company
- (b) The date of its issue, and
- (c) The signature of the Registrar with his seal

This certificate is literally the birth certificate of the company evidencing that the company is born with its name on the date mentioned in the certificate.

Note: A print of this certificate is to be a part of all copies of Memorandum and Articles of association.

### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Formation of Companies.**

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### **20.5 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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### **20.6 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

#### **Check Your Progress – 1**

1. See section 18.2

#### **Check Your Progress – 2**

1. See section 18.3

#### **Check Your Progress – 3**

1. See section 18.4



## **UNIT 21:**

### **PROMOTORS OF A COMPANY**

#### **Structure**

- 21.1 Objectives
- 21.2 Introduction
- 21.3 Legal position & Duties of promoters
- 21.4 Liabilities of Promoters
- 21.5 Remuneration of Promoters
- 21.6 Some Useful Books
- 21.7 Answer to Check Your Progress Exercise

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#### **21.1 OBJECTIVES**

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After studying this unit you should be able to:

- Define a meaning of promotion & promoters of a company
- Understand the legal position & duties of promoters.
- Describe the liability and remuneration of companies

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#### **21.2 INTRODUCTION**

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##### **PROMOTION**

##### **Meaning of Promotion**

Promotion is the first stage in the formation of a company. Promotion involves identification of a business opportunity or idea, analysis of its prospects and taking steps in implement it through the formation of a Company. C.W. Gerstenberg has defined promotion as the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profit there from. Promotion stage comprises the following activities to be undertaken:

- Discovery of business idea or identification of business opportunity
- Detailed investigation to find out the strong and weak points of the ideal
- Organization of resources

- Securing the co-operation of the required number of persons willing to associate themselves with the project
- Obtaining the consent of persons willing to act as first directors
- Appointing Legal Advisors
- Application for proposed name of the company
- Preparation of necessary documents like memorandum of association, articles of association
- Entering into preliminary contracts
- Filing of the necessary documents with the Registrars

### Meaning of Promoters

The Companies Act does not define the term promoters anywhere; it only refers to the liabilities of the promoters. A number of judicial decisions have defined the term 'promoter'.

*According to L.J. Bowen*, the term promoter is a term not of law but of business, usefully summing up in a single word, a number of business operations familiar to the commercial world by which a company is generally brought into existence.

*Lord Blackburn* states that 'the term 'promoter' is a short and convenient way of designating those who set in motion the machinery by which the Act enables them to create an incorporated company'.

*Justice C. Cockburn* described a promoter as 'one who undertake to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose'.

Thus, a promoter is one who identifies a business opportunity, ideal, analysis its prospects and takes steps to implement it through the formation of a company. A company may have more than one promoter. The promoter may be an individual, firm, an association of persons or a body corporate. The promoter may be an individual, firm, an association or persons or a body corporate. For example, J.R.D. Tata was promoter of Tata Group, G.D. Birla was promoter of Birla Group, Dhirubhai Ambani was the promoter of Reliance Group.

### Functions of a Promoter

The various functions performed by the promoters include the following:

**To Conceive Business Idea:** First of all the promoters conceive the idea of business.

**To make Detailed Investigation:** After conceiving the idea of business, they make detailed investigations to find out the weakness and strong points of the idea.

**To Organize the Resources:** After satisfying about the profitability and feasibility of the idea, they organize the resources to convert the idea into a reality by forming a company.

The steps to be taken in this regard include the following:

- (i) Securing the co-operation of a the required number of persons willing to associate themselves with the project (Note: 7 persons are required to form public company and 2 persons are required to form a private company)
- (ii) Appointing Legal Advisors and to other experts
- (iii) Entering into preliminary contracts
- (iv) Preparing detailed financial plan.

**To Obtain the Consent of Persons Willing to Act as First Directors:** The first directors are generally appointed by the promoters. The promoters seek the consent of some individuals whom they deem appropriate so that they agree to be the first directors.

**To Decide about the Name of the Company :** The promoters have to seek the permission of the Registrar of companies for selecting the name of the company. The promoter usually gives three names in order of preference. The promoters should ensure that the name of the company should not be identical without should not too closely resemble the name of another existing company.

**To Get the Necessary Documents Prepared:** The promoters on the advice of legal experts get the memorandum of association and articles of association prepared and printed.

**To Arrange for Filling of the Necessary Documents with the Registrar:** The promoters are required to pay the stamp duty, filing fee and other charges for registration of the company. The promoters are to see that the various legal formalities for incorporating the company are complied with.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss about the meaning & Types of Company Act**

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## 21.3 LEGAL POSITION & DUTIES OF PROMOTER

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### Legal Position of Promoters

The legal position of a promoter is somewhat peculiar. The promoter's legal position is that he is *neither* an agent *nor* a trustee of the company he promotes. He is not an agent because there is no principal in existence. You will recall from your exposure to the Contract of Agency that in order to be a valid contract of agency both the principal and the agent must be in existence. For the same reason, he also cannot be called the trustee of the company..

However, it does not mean that the promoters do not have any legal relationship with the proposed company. The legal position of a promoter can be correctly described by saying that he stands in fiduciary position (relationship of trust and confidence) in relation to the company he promotes. The fiduciary relation of a promoter really begins when the company is formed.

Lord Cairns has rightly stated the position of promoter in *Erlanger v. New Sombrero Phosphate Co.*, "The promoters of company stand undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how and when and in what shape, and under whose supervision, it shall come into existence and begin to act as a trading corporation". In fact, the promoters occupy a fiduciary position in regard to the company they promote and also the original allottees that they induce to buy shares of the company.

### Duties of Promoters

The fiduciary obligation of a promoter begins as soon as he sets out to act for or promote the company. The fiduciary obligation of promoters means an obligations of promoters to disclose fully all material facts relating to the nature and extent of contract and profit made by them either directly or indirectly., Such disclosure must be express and actual and not merely constructive. The promoters in their fiduciary capacity have the following important duties:

#### (a) Not to make Secret Profit:

A promoter cannot make any direct or indirect profits out of the promotion of the company. Since he occupies a position of a trust, it is his duty to be honest and uphold the trust of his position. The law prohibits only the making of secret profit i.e. the profits which the promoter has not disclosed to the company. The promoters of a company are perfectly free to make a profit provided they disclose this fact to an independent Board of Directors. If there is no independent Board of Directors, then he must disclose the profits to the intended shareholders. When a promoter makes a secret profit, the company has the following remedies against him:

**(i) Recession of the Contract:** The company may on learning of the secret profit, rescind the contract entered into by the promoter to make the said profit.

**(ii) Order for Refund:** The Company may require the promoter to refund the amount of secret profit.

**(iii) Suit for Breach of Duty:** The Company may sue the promoter for misfeasance, a promoter, by making the secret profit, has defaulted in his duty towards the company.

**(b) To make full Disclosure to the Company of all Relevant Facts:**

In keeping with his fiduciary capacity, a promoter is bound to disclose to the company all relevant facts including any profit made from the sale of his own property to the company and his personal interest in a transaction with company. While making a disclosure the promoter must make the full and complete disclosure. If he contracts to sell his own property to the company without making a full disclosure, the company may either repudiate the contract or affirm the contract and recover the profits made by the promoter. Such disclosure is ineffective if made merely to directors who are nominees of the promoters. Disclosure may be made either to an independent board by means of prospectus to the prospective shareholders. If the promoter makes a secret profit the company can rescind the contract of compel him to account for it. Where all the members of a private company are cognizant of the facts, the rule would not apply.

Let us explain these fiduciary duties of the promoter with the help of case of *Erdanger v. New Sombrero Phosphate Co.*, (1878) 3 A.C. 1218.

“A” was the owner of some land. He and some of his friends, decided to form a company to manufacture microchips. They appointed the first directors of the company and ‘A’ sold his own land to the company at a price higher than the actual valuation of the land. When the company was formed, the purchase agreement of land was approved at the meeting of the shareholders but the fact of A’s ownership and the profit made by him were not disclosed at the meeting. Subsequently when the company went into liquidation, the liquidator filed a suit against ‘A’ to recover the profits made by him in the sale of land. You would observe that in this case ‘A’ had defaulted in his duty to make full disclosure of all material facts and had made a secret profit out of promotion. As there was no disclosure by the promoters of the profits they were making, the company is entitled to rescind the contract. ‘A’ could have retained the profit made by him if he had made a full disclosure to the directors of the company or to the shareholders of the company, all the relevant facts of the transaction including his personal interest and the profits made.

**(c) To give the Benefit of Negotiation to the Company:**

The promoter must pass on to the company, the benefit of any negotiation or agreement that he has carried on in his capacity of a promoter. For example, when he has negotiated a certain price for some land for the company, he must sell the property to the company at the negotiated price. If he charges a price higher than the negotiated price, the company may rescind the contract on discovering the truth of the matter. If, due to some reason, the contract could not be rescinded, the company is entitled to claim damages from the promoters and the amount of damages shall be equal to the amount of profits made by promoters. However, it should be remembered that secret profits on the sale of property can be recovered from the promoter only when the property was bought and sold to the company while he was acting as a promoter. The promoter must act honestly and diligently to escape liability with respect to dealing with the future company and the outsiders.

**(d) Duty of Promoters towards Future Allottees:**

The promoters stand in a fiduciary position towards the company. It does not mean that they stand in such relation only to the company but they also stand in this position to the future allottees of shares. The promoters must ensure that the prospectus issued at their instance contains all materials facts and particulars and does not contain any mis-statements.

**Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

**1. Discuss the Legal position & duties of Promoters.**

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**21.4 LIABILITIES OF PROMOTER**

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**Liabilities of promoters**

The liabilities of the promoters under the various provisions of The Companies Act are discussed below:

**(i) Liability for not complying with the provisions of section 56:**

Explains the matters that should be stated and the report that should be stated and the reports that should be set out in the prospectus. If this provision is not complied with, the promoter may be held liable by the shareholders.

**(ii) Civil Liabilities for any untrue statements made in the prospectus [Section 62]:**

The promoter may be held liable to pay compensation to every person who subscribes for shares or debentures for any loss or damage sustained by him on account of the untrue statement made in the prospectus. Under Section 62 specific provisions have also been made of the grounds on which the promoter can avoid his liability.

**(iii) Criminal Liabilities for Issuing a Prospectus which Contains Untrue Statements [Section 63]:**

The promoter can be held criminally liable if the prospectus issued by them contained mis-statements. The punishments prescribed are imprisonment extending up to two years or a fine up to Rs. 50,000 or both. The promoters may have to bear this criminal liability for misstatements unless he can prove that the untrue statement was immaterial or that he was justified in believing, because of reasonable grounds, that the statement was true at the time of issue of prospectus.

**(iv) Liabilities for Public Examination [Section 478]:**

If in the event of winding up of the company the liquidator's report alleges a fraud in the promotion or formation of the company, the promoter can also be held liable for public examination by the Court like any other director or officer of the company.

**(v) Liability for Misfeasance or Breach of Trust by Misapplication of Funds [Section 543]:**

Like any other director or officer of the company, a promoter can also be held liable if he had misapplied or retained any of the property of the company or is found guilty of breach of trust or misfeasance in relation to the company.

**(vi) Liable to be Suspended from Taking Part in the Management of the Company [Section 203]:**

The court may suspend a promoter from taking part in the management of the company for a period of five years if he is convicted of any offence in connection with the promotion, formation or management of a company.

**(vii) Personality Liability for Pre-incorporation Contracts:**

Even the death of the promoter does not relieve him from this liability

**Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### 1. Discuss the Liabilities of a Promoter.

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## 21.5 REMUNERATION OF PROMOTER

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### Remuneration of promoters

A promoter has no right to demand any remuneration from the company, for his promotional services in the absence of an express contract with the company. In the absence of a contract, he cannot even recover from the company payments he has made towards legal fees, stamp duties, registration fees, or other expenses in connection with the formation of the company.

He, therefore, is not entitled to recover any remuneration for his service unless the company after getting formed enters into a specific contract with the promoter for this purpose. Even if the promoter has entered into a contract with the prospective directors before the incorporation, he has no valid claim against the company for remuneration. This is so because the directors cannot enter into any contract on behalf of a company that is not yet in existence. There are also cases where the articles of a company may specifically provide that a specified sum may be paid to the promoters as remuneration for their services. While this provision gives the director an authority to make such payment, it does not give the promoters a right to claim remuneration or to sue the company, for the same.

### Check Your Progress – 3

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### 1. Discuss the Remuneration of a Promoter.

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## **21.6 SOME USEFUL BOOKS**

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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## **21.7 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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### **Check Your Progress – 1**

1. See section 21.2

### **Check Your Progress – 2**

1. See section 21.3

### **Check Your Progress – 3**

1. See section 21.4

### **Check Your Progress – 4**

1. See section 21.5



## UNIT 22:

# MEMORANDUM OF A COMPANY

### Structure

- 22.1 Objectives
- 22.2 Introduction
- 22.3 Alteration of Memorandum
- 22.4 Some Useful Books
- 22.5 Answer to Check Your Progress Exercise

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### 22.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a meaning of Articles of memorandum of a company
- Understand the Articles of Association

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### 22.2 INTRODUCTION

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According to Section 2(28) of The Companies Act, Memorandum mean the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company laws or of this Act. But this definition is not an exhaustive one. The status and importance of Memorandum of Association has been clearly brought out in many decided cases as follows:

“Memorandum of Association of a company contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors and the outside public as well of the shareholders”.

To sum up Memorandum of Association is the constitution of the company which lays down the fundamental conditions upon which along the company is allowed to be formed. It defines as well as confines the powers of the company. It not only shows the objects of formation but also determines the utmost possible scope of its operations beyond which its action cannot go. If it enters into a contract which is beyond the powers conferred

on it by the memorandum, such contract will be *ultra vires* the company and hence void. Even the unanimous consent of the entire of its members cannot ratify such contract. Thus, in this respect it is the company's charter defining its constitution and scope of the powers with which it has been established under the Act.

### **Purpose of memorandum of association**

The purpose of Memorandum is two-fold

- a) First, to enable the intending shareholders to know the purpose for which their money is going to be used and within what field they are taking risk in making the investment.
- b) Second, to enable the persons intending to deal with the company to know with certainty as to whether the contractual relationship which they intend to enter into with the company is within its corporate objects or not [Cotman v. Broughman, (1918) A.C. 514]

Thus, Memorandum gives protection not only to the shareholders but also to persons who intend to deal with the company.

### **Form of memorandum [section 14]**

According to Section 14, the Memorandum of Association of a company must be in one of the forms given in Schedule I as may be applicable to the case of the company or in a form as near thereto as circumstances admit. The Tables in Schedule I to the Act specify the following forms applicable to different types of companies as under:

- Table B : Memorandum of Association of a Company Limited by Shares.
- Table C: Memorandum Association of a Company Limited by Guarantee and not having a share capital
- Table D: Memorandum of Association of a Company Limited by Guarantee and having a share capital
- Table E: Memorandum of Association of an Unlimited Company.

### **Printing and signature of memorandum [section 15]**

The memorandum must be –

printed

divided into paragraphs numbered consecutively, and

signed by at least 7 persons in case of a public company and by at least 2 persons in case of a private company. The persons signing the Memorandum are known as subscribers to the Memorandum.

Each subscriber must give his address, description and occupation (if any).

The signature of each subscriber must be attested in the presence of at least one witness.

The witness must attest the signature and add his address, description and occupation (if any).

### **Contents of memorandum [section 13]**

The memorandum of association of a company must state the following clauses:

1. The Name Clause;
2. The Registered Office Clause;
3. The Objects Clause;
4. The Liability Clause;
5. The Capital Clause; and
6. The Subscription Clause.

Let us know about each of the aforesaid clauses in detail.

### **Name clause - Legal Requirements**

#### **(a) Last Word [Section 13(1)(a)]:**

The Memorandum of every company must state the name of the company with the word “Limited” as the last word of the name in the case of a Public Limited Company and with “Private Limited” as the last words of the name in the case of a private limited company.

#### **(b) Undesirable Name to be avoided [Section 20 (1)]:**

#### **(c) Publication of Name and Address [Section 147]**

### **Registered office clause [section 13(1) (b) and section 146] -Legal Requirements**

Name of the State [Section 13(1)] The Memorandum of every company must state the name of the State in which the registered office of the company is to be situated. It may be noted that the exact address of the registered office need not be stated in the Memorandum.

### **Time Limit within which the Company must have its Registered Office Notice of situation**

### **Objects clause [section 13(1) (d)]**

The Company registered after the commencement of the Companies (Amendment) Act, 1965 must divide its object clause into two sub-clauses, namely:

Main Objects of the Company to be pursued on its incorporation, and Objects incidental or ancillary to the attainment of the main objects

### **Liability clause [section 13(2)]**

The liability clause states the nature of the liability of members. The legal requirements regarding this clause in respect of various types of companies are as follows:

- (a) In case of a company limited by shares
- (b) In case of a company limited by guarantee

### **Capital clause [section 13(4)]**

In case of limited companies by shares, this clause must state the amount of share capital with which the company is to be registered and the division thereof into shares of fixed amount. Such capital is called 'Authorized' or 'Nominal' or 'Registered' capital. The fixed amount of a share is known as 'Par' or 'Nominal' value of a share. The amount of authorized capital should be sufficiently high considering the immediate need of the business and possible expansion in the near future. The stamp duty and registration fee are payable on the basis of amount of authorized capital.

### **Association or subscription clause**

#### **Legal Requirements**

Each of the subscribers must give in his own handwriting his name with surname, address, description (by the name of father, husband or wife as the case may be), [Section 15(C)]

In case of a company having share capital the each of the subscriber must also write in his own handwriting opposite to his name, the number of shares agreed to be subscribed by him.

Each subscriber must take at least one share. [Section 13(4) (b), (c)]

That such declaration must be signed by at least 7 persons (in case of a public company) or 2 persons (in case of a private company). [Section 12(1)]

That an agent may sign the memorandum of association on behalf of subscriber if he is authorized by a power of attorney to do so.

That the signatures of the subscribers must be attested by at least one witness who must not be from among the subscribers. [Section 15 (c)]

That each of the witness must give in his own handwriting, his name, with surname, the description and occupation, if any. [Section 15 (c)]

Such clauses must be strictly in accordance with such one of formats given in Tables, B.C.D and E of Schedule I as may be applicable to the case of company.

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

- 2. Check your answers with those given at the end of the unit.

## 1. Discuss about the meaning & purpose of Memorandum.

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## 1. Discuss about the contents of Memorandum.

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### 22.3 ALTERATION OF THE MEMORANDUM

A company may alter the conditions contained in this memorandum in the cases, in the mode and to the extent for which express provision is made in the Act [Section 16(1)]. Let us now discuss the procedure for making alternations in the different clauses of the memorandum.

#### ▪ Alteration of the name

The procedure for changing the name of the company is given below:

	Case		Legal Requirements
(i)	Where the only change in the name of the Company is the deletion there from the words 'private' consequent on the conversion of a private company into a public company. [Proviso to Section 21)]	(a)	The company may change its name by passing a special resolution at a general meeting of the members.
		(b)	A copy of resolution is required to be filed with the Registrar within 30 days of passing the resolution
(ii)	Where the only change in the name of the company is the addition thereto the words 'private' consequent on the conversion of a public company into a private a company. [Proviso to Sections 21 and 31 (1)]	(a)	The company may change its name by passing a special resolution. However, to alter the Articles in this case, the approval of Central Government would be necessary in addition to special resolution
		(b)	A copy of resolution is required to be field with the Registrar within 30 days of passing the resolution
		(c)	A copy of order of the Central Government's approval is required to be filed with the Registrar within 3 months of the order.
(iii)	To change the name which is identical with or too nearly resembles the name of an already registered existing company or on an application by	(a)	The company may change its name by passing an ordinary resolution and with the previous approval of the Central Government signified in writing.

	registered proprietor of a trade mark, is in the opinion of Central Government identical with or too nearly resembles, a registered trade mark of such proprietor under Trade Marks Act, 1999 [Section 22 (1) (a)]	(b)	A copy of resolution is required to be filed with the Registrar within 30 days of passing the resolution
		(c)	A copy of order of the Central Government's approval is required to be filed with the Registrar within 3 months of the order.
(iv)	To change the name on direction by the Central Government within 12 months of registration of name / new name. [Section 22 (1) (b)]	(a)	The company must change its name by passing a ordinary resolution and with the previous approval of the Central Government within a period of 3 months from the date of direction or such longer period as the Central Government may think fit to allow.
		(b)	A copy of resolution is required to be filed with the Registrar within 30 days of passing the resolution.
		(c)	A copy of order of the Central Government's approval is required to be filed with the Registrar within 3 months of the order.
(v)	To change the name, including or consisting of the omission of the words 'Limited' or the words 'Private Limited' in case of licensed companies [Section 25(3)]	(a)	The company may change its name by passing a special resolution
		(b)	A copy of resolution is required to be filed with the Registrar within 30 days of passing the resolution.
		(c)	A copy of order of the Central Government's approval is required to be filed with the Registrar within 3 months of the order.
(vi)	To change the name in any other case, [Section 21]	(a)	The company may change its name by passing a special resolution and with the written approval of the Central Government
		(b)	A copy of resolution is required to be filed with the Registrar within 30 days of passing the resolution
		(c)	A copy of order of the Central Government's approval is required to be file with the Registrar within 3 months of the order.

### Registration of Change of Name [Section 23]

The provisions relating to the registration of change of name are given below:

A copy of the resolution passed at the general meeting must be filed with the Registrar within 30 days of passing the resolution

A copy of the order of the Central Government's approval (whenever if any required) must be filed with the Registrar within 3 months of the order.

The Registrar shall enter the new name on the Register in the place of the former name and shall issue a fresh certificate of incorporation with the necessary alterations embodied therein. [Section 23 (1)]

The change of name shall be complete and effective only on the issue of such a certificate. [Section 23 (1)]

The Registrar shall also make the necessary alteration in the Memorandum of association of the company. [Section 23 (2)]

The change of name shall not affect any right or obligations of the company. [Section 23(3)]

The change of name shall not render defective any legal proceedings by or against it. Any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by its new name. [section 23(3)]

### Alteration of registered office

Procedure for changing the Registered Office

Case		Legal Requirements	
(i)	Change from one place to another within the same city, town or village [Section 146(2)]	(a)	A resolution of the Board of Directors is required to be passed.
		(b)	Notice of new location must be given to the Registrar within 30 days of the change [Section 146(2)]
(ii)	Change from one city, town or village to another within the jurisdiction of the same ROC within the same State.	(a)	<b>Special Resolution</b> A special resolution is required to be passed at a general meeting of the shareholders. [Proviso to Section 146(2)]
		(b)	<b>Filing of Copy of Special Resolution with ROC.</b> A copy of the special resolution, as aforesaid, is to be filed with the Registrar within 30 days of change [Section 146(2)]
(iii)	Change from the jurisdiction of one ROC to the jurisdiction of another ROC within the same State.	(a)	<b>Special Resolution.</b> A special resolution is required to be passed at a general meeting of the shareholders. [Proviso to Section 146(2)]
		(b)	<b>Confirmation of Regional Director.</b> Confirmation of Regional



			Director is to be obtained where the change is from Registrar of Companies. The Regional Director must convey his confirmation within 4 weeks from the date of receipt of application for such change.
		(c)	<b>Filing of Copy of Special Resolution with ROC.</b> A copy of the special resolution, as aforesaid, is to be filed with the Registrar within 30 days in Form No. 23.

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Alteration of Memorandum.**

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### **22.4 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

### **22.5 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

#### **Check Your Progress – 1**

1. See section 22.2

#### **Check Your Progress – 2**

1. See section 22.3

## UNIT 23:

# ARTICLES OF ASSOCIATION

### Structure

- 23.1 Objectives
- 23.2 Introduction
- 23.3 Contents of Articles of Association
- 23.4 Alteration of Articles of Association
- 23.5 Difference between Alteration and Memorandum
- 23.6 Some Useful Books
- 23.7 Answer to Check Your Progress Exercise

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### 23.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a meaning of Articles of Association
- Describe contents of Association
- Understand the alteration of Articles & Memorandum and difference between of both

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### 23.2 INTRODUCTION

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#### Meaning of Articles

Section 2(2) of the Companies Act defined Articles as of a company as originally framed or as altered from time to time in pursuance of any previous companies' law or of this Act. This definition is not sufficient to explain its meaning. Let us look at some of the observation made in judicial cases

- The Articles of Association of a company are the internal rules and regulations to the management of its internal affairs (Guinness v. Land Corporation of Ireland, (1882)22 Ch. D. 349)
- 'The articles play a part subsidiary to memorandum of association. They accept the memorandum of association as the Charter of Incorporation of the company and so accepting it, they proceed to define the duties, rights and powers of governing body as between themselves and the company at large and the mode

and form in which changes in the internal regulation of the company may from time to time be made.” (Ashbury Railway Carriage Co. Ltd. V. Riche, (1875) L.R. 7 H.L. 653, p. 670).

- The document containing the articles of association of a company is a business document; hence it has to be construed strictly. It regulates domestic management of a company and creates certain rights and obligations between the members and the company (S.S. Rajkumar vs. Perfect Castings (P.) Ltd., [1968] 38 Camp. Case187)
- The Articles of Association are in fact the bye-laws of the company according to which director and other officers are required to perform their functions as regards the management of the company, its accounts and audit.

Thus, the memorandum lays down the objects for which the company is formed the article lay down rules and regulations for the attainment of those objects.

### **Form of articles [section 29]**

According to Section 29, the Articles of Association of a company must be in one of the forms given in Schedule I as may be applicable to the case of the company or in a form as near thereto as circumstances admit.

The Tables in Schedule I to the Act specify the following forms applicable to different types of companies as under:

- **Table C:** Articles of Association of a company limited by guarantee and not having a share capital.
- **Table D:** Articles of Association of a company limited by guarantee and having a Share capital.
- **Table E:** Articles of Association of an unlimited company.
- **Note:** Additional matters which are not inconsistent with the provisions contained in the form in any of the Tables C, D, and E may be included in the Articles. (Proviso to Section 29)

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

## 1. Discuss about the meaning & forms of Articles

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### 23.3 CONTENTS OF ARTICLES OF ASSOCIATION

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#### Contents of articles of association

The Articles of Association of a company may contain the regulation for the attainment of objects stated in the memorandum subject to the following restrictions:

- The articles must not include anything which is illegal or contrary to general law.
- The articles must not include anything which is against public policy.
- The Articles must not include anything which is prohibited by the Companies Act, 1956.

#### Articles usually contain provisions relating to the following matters:

Share capital and Right of Shareholders, variation of these rights  
Allotment of shares  
Calls on shares and Lien on shares  
Transfer of Shares  
Transmission of Shares  
Forfeiture of Shares  
Conversion of Shares into Stock  
Share Warrants and Shares Certificates  
Alteration of Capital  
General Meeting and proceedings thereat  
Voting Rights, Voting and Poll and Proxies  
Directors, their appointment, remuneration, qualification, powers and  
Proceedings of Board of Directors  
Manager/Secretary  
Seal  
Dividend and Reserves  
Capitalization of Profits  
Accounts, Audit and borrowing powers  
Winding up  
The extent to which Table A of Schedule I of the Act is to apply or  
not to apply.

## **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

### **1. Discuss the contents of Article of Association.**

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## **23.4 ALTERATION OF ARTICLES OF ASSOCIATION**

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Section 31 empowers the company to alter or add to its Articles. This fundamental power of the company to alter its Article is subject to the following limitations:

- **Special Resolution:** The alteration must be affected by passing a special resolution at the general meeting of the company [Section 31 (1)]. A copy of the special resolution authorizing such alteration must be filed with the Registrar within 30 days of passing the resolution and a printed copy of altered articles must be filed with the Registrar within 3 months of passing the resolution. The effect if change must be incorporated in all copies of articles of association issued after the date of alteration [Section 40].
- **Approval of Central Government in Case of Conversion of Public Company into Private Company:** No alteration having the effect of converting a public company into a private company shall have effect unless approved by the Central Government [Provision to Section 31(1)]. In this case, a printed copy of the altered articles must be filed with the Registrar within 1 month of the date of receipt of the order of approval [Section 31(2A)].
- **Valid as if originally contained:** Any alteration made in the Article shall subject to the provisions of this Act, as valid as if originally contained in the Articles. [Section 31(2)]
- **Not inconsistent with any Act:** The alteration must not be inconsistent with any provisions of the Companies Act or any other statute.

- **Not inconsistent with Memorandum:** The alteration must not be inconsistent with any provisions of the Memorandum of Association. Articles being subordinate to the memorandum must not override.
- **Not inconsistent with CLB Order:** The alteration must not be inconsistent with an order of Company Law Board.

### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the alteration of Articles.**

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### **23.5 DIFFERENCE BETWEEN ARTICLES & MEMORANDUM**

The Memorandum of Association differs from the Articles of Association in the following respects:

<b><i>Basis of Distinction</i></b>	<b><i>Memorandum of Association</i></b>	<b><i>Articles of Association</i></b>
<b>1.Contents</b>	It contains the fundamental conditions upon which alone the company is allowed to be incorporated	It contains the internal rules and regulations relating to management of internal affairs.
<b>2.Fundamental/ Subordinate document</b>	It is Fundamental document.	It is subordinate to the Memorandum
<b>3.Compulsory or optional</b>	Every company must have its own memorandum.	A public company limited by shares need have its own Articles. It may adopt Table A as its articles.
<b>4.Relationship defined</b>	It defines the relationship between the company and outsiders.	It defines the relationship between the company and its members as members only and as members <i>inter se</i> .
<b>5.Alteration whether easy or difficult</b>	The memorandum cannot be so easily altered. The company has	Articles can be easily altered by passing a special

	to follow the strict procedure for the alteration of its clauses. In some cases alteration requires the approval of the Company Law Board.	resolution.
<b>6. Binding Effect of <i>ultra vires</i> act</b>	An act which is beyond the powers given in the Memorandum <i>ultra vires</i> and void and it cannot be ratified even by the unanimous consent of all the members.	An act is <i>intra vires</i> the Memorandum but <i>ultra vires</i> the Articles may be ratified by share-holders by passing a special resolution.
<b>7. Remedy in case of <i>ultra vires</i> contracts</b>	In case of the contracts <i>ultra vires</i> the memorandum, outsiders have no remedy against the company.	In case of contracts <i>ultra vires</i> the Articles, the outsiders can enforce the contract against the company provided they had no knowledge of irregularity.

#### **Check Your Progress – 4**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the difference between Articles of Association & Memorandum.**

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#### **23.6 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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## **23.7 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

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### **Check Your Progress – 1**

1. See section 23.2

### **Check Your Progress – 2**

1. See section 23.3

### **Check Your Progress – 3**

1. See section 23.4

### **Check Your Progress – 4**

1. See section 23.5





## UNIT 24:

# PROSPECTUS OF A COMPANY AND DUTIES, POWERS OF A DIRECTOR

### Structure

- 24.1 Objectives
- 24.2 Introduction
- 24.3 Powers and Duties of Directors
- 24.4 Liabilities of Directors
- 24.5 Some Useful Books
- 24.6 Answer to Check Your Progress Exercise

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### 24.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a meaning of Prospectus of a company.
- Describe the powers & Duties of Directors
- Understand the liabilities of Directors

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### 24.2 INTRODUCTION

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#### Meaning of prospectus (section 2(36)]

According to Section 2(36) prospectus means “any document described or issued a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of, a body corporate”. In simple words, the term ‘Prospectus’ means a document which invites deposits from the public or invites offers from the public to subscribe or buy the shares or debentures of the company. Thus, a prospectus is *not an offer* in itself but an *invitation* to make an offer. Application for making a deposit or for purchase of shares or debentures constitutes an offer by the applicant to the company. It is only on the acceptance of the offer, by the company, a binding contract comes into existence. The prospectus must be in writing. An oral invitation to subscribe for shares will not be considered prospectus. Television or film advertisement cannot be treated as prospectus.

### ***Significance of prospectus***

Prospectus is an important document because of the following reason

- **Invitation** - It serves as an invitation by the company to the public to invest through making deposit or subscribing shares or debenture.
- **Advertisement**- It acts as a medium of advertisement since it informs the public about its present operations and future prospects.
- **Authentic Record** -It serves as an authentic record of the terms and conditions of the issue of deposits, shares or debentures,
- **Protection** -It protects the interests of the investors who invest on the faith of the prospectus since any misstatement in the prospectus attracts both civil and criminal liability for persons who authorize the issue of prospectus.

### **When prospectus is not required to be issued (section 56)**

The issue of a prospectus is not necessary in the following cases:

- Where shares are not offered to the public [Section 56(3)]
- Where a person is bonafide invited to enter in to an underwriting agreement. [Section 56(3)]
- When shares or debentures are offered to existing holders of shares or debentures. [Section 56(5)]
- When the issue relates to shares or debentures uniform in all respects with shares or debentures previously issued and dealt in or quoted in a recognized stock exchange. [Section 56(5)]

### **Check Your Progress – 1**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss about the meaning & significance of Prospectus.**

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## **24.3 POWERS AND DUTIES OF DIRECTORS**

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### **Who is a director of the company?**

A company in the eyes of the law is an artificial person. It has no physical existence. It has neither soul nor a body of its own. As such, it cannot act in its own person.

“The company itself cannot act in its own person, for it has no person; it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent.”

The directors are the brain of a company. They occupy a pivotal position in the structure of the company. They are in fact the mainspring of the company. Speaking about the importance of directors, Neville J., observed in *Bath c., Standard Land Co.*, (1910) 2 Ch. 408 that “ the Board of directors are the brain and the only brain of the company which is the body, and the company can and does act only through them.” It is only “when the brain functions that the corporation is said to function.”

**Definition [Sec. 2 (13)]**

‘Director’ includes any person occupying the position of director, by whatever name called. The important factor to determine whether a person is or not a director is to refer to the nature of the office and its duties. It does not matter by what name he is called. If he performs the functions of a director, he would be termed a director in the eyes of the law even though he may be named differently. A director may, therefore, be defined as a person having control over the direction, conduct, management superintendence of the affairs of a company. Any person in accordance with whose directions or instructions, the Board of the company. But such a person shall not be deemed to be a director if the Board acts on the advice given by him in a professional capacity. Only individuals can be directors (Sec. 253), No body corporate, association or firm can be appointed director of a company. Only an individual can be so appointed.

**Number of directors**

Every public company (other than a deemed public company) shall have be at least 3 directors and every other company (e.g., a private company, a deemed public company) at least 2 directors. [Sec. 252(1)].

- However a public company having-
- A paid-up capital of Rs. 5 crore or more;
- One thousand or more small shareholders;

Shall have at least one director elected by such small shareholders in the manner as may be prescribed. “Small shareholder” means a shareholder holding shares of nominal value of Rs. 20,000 or less in a public company to which Sec. 252(1) applies [Provison to Sec. 252(1) as introduced by the Companies (Amendment) Act, 2000].

Increase or reduction in number of directors (Sec. 258). Subject to the statutory minimum limit, the articles of a company may prescribe the maximum and minimum number of directors for its Board of directors. The number so fixed may be increased or reduced within the limits prescribed by the Articles by an ordinary resolution of the company in general meeting, if the number falls below the minimum, prima facie the Board cannot act. Sanction by the Central Government (Sec. 259). Any increase in number of directors beyond the maximum permitted by the Articles shall be approved by the Central Government. But where the increase in number does not make the total number of directors more than 12, no approval of the Central Government is needed.

### **Appointment of directors**

**First directors** (Sec. 254 and Clause 64 of Table A). (a) The Articles of a company usually name the first directors by their respective names or prescribe the method of appointing them.

(a) If the first directors are not named in the Articles, the number of directors and the names of the directors shall be determined in writing by the subscribers of the Memorandum or a majority of them (Clause 64 of Table A).

(b) If the first directors are not appointed in the above manner, the subscribers of the Memorandum who are individuals become directors of the company. They shall hold office until directors are duly appointed in the first annual general meeting (Sec. 254).

- **Appointed of directors by the company** (Secs. 255 to 257, 263 and 264). Directors must be appointed by shareholders in general meeting. In the case of a public company or a private company which is a subsidiary of a public company, at least  $\frac{2}{3}^{\text{rd}}$  of the total number of directors shall be liable to retire by rotation. Such directors are called rotational directors and shall be appointed by the shareholders in general meeting. Ascertainment of directors retiring by rotation and filling of vacancies (Sec. 256).

- a. At the annual general meeting of a public company or a private company which is a subsidiary of a public company  $\frac{1}{3}^{\text{rd}}$  (or the number nearest to  $\frac{1}{3}^{\text{rd}}$  of the rotational directors shall retire from office.
- b. The directors to retire by rotation at every annual general meeting shall be those who have been longest in the office since their last appointment.
- c. At the annual general meeting at which a director retires by rotation, the company may fill up the vacancy (thus created) by appointing the retiring director or some other person.
- d. If the place of the retiring director is not filled up, the meeting may resolve not to fill the vacancy. If there is no such resolution, the meeting shall stand

adjourned till the same day in the next week. If at the adjourned meeting also, the place of retiring director is not filled up, nor is there a resolution not to till the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting.

- **Appointed of directors by directors** (Sec. 260, 262 and 313). The directors of a company may appoint directors-

(1) As additional directors (Sec. 260). Any additional directors appointed by the directors shall hold office only up to the date of the next annual general meeting of the company. The number of directors and additional directors must not exceed the maximum strength fixed for the Board by the Articles [Patrakola Tea Co., Re, A.I.R. (1967) Ca. 406].

If the annual general meeting of a company is not held or cannot be held, the additional director shall vacate his office on the day on which the annual general meeting should have been held. If an additional director has been appointed as managing director also, the moment he ceases to be an additional director, and he will cease to be the managing director.

(2) In a casual vacancy (Sec. 262). In the case of a public company, or a private company which is a subsidiary of a public company, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may be filled by the Board of directors at a meeting of the Board. This power of the Board is subject to any regulations in the Articles of the company. By 'casual vacancy' is meant any vacancy which occurs by reason of death, resignation, disqualification, or failure of an elected director to accept the office for any reason other than retirement by rotation. A vacancy caused by the retirement of a director by rotation is not a casual vacancy; such a vacancy has to be filled by the annual general meeting. (3) As alternate director (Sec. 313). An alternate director can be appointed by the Board if it is so authorized by (i) the Articles of the company, or (ii) a resolution passed by the company in the general meeting. He shall act for a director, called 'the original director' during his absence for a period of at least 3 months from the State in which Board meetings are ordinarily held.

- **Appointed of directors by third parties.** The Articles under certain circumstances give power to the debenture-holders or other creditors, e.g., a banking company or financial corporation, who have advanced loans to the company to appoint their nominees to the Board. The number of directors so appointed shall not exceed  $1/3^{\text{rd}}$  of the total number of directors, and they are not liable to retire by rotation.
- **Appointed by proportional representation** (Se. 265). The Articles of a company may provide for the appointment of not less than  $2/3^{\text{rd}}$  of the total number of directors of a public company or of a private company which is a subsidiary of a public company according to the principle of proportional representation. The proportional representation may be by a single transferable vote or by a system of cumulative voting or otherwise. The appointment shall be made once in 3 years and interim casual vacancies shall be filled in the manner as provided in the Articles.
- **Appointed of directors by the Central Government** (Sec. 408). Sec. 408 empowers the Central Government to appoint such number of directors on the Board of a company as the Tribunal may, by order in writing, specify as necessary to effectively safeguard the interests of the company or its shareholders or the public interest. The appointment will be for a period not exceeding 3 years on any one occasion. The purpose of the appointment is to prevent the affairs of the company from being conducted either in the manner-
  - (a) Which is oppressive to any members of the company; or
  - (b) Which is prejudicial to the interests of the company or to public interest?

The Tribunal may pass the above order on a reference made to it by the Central Government or on the application-

- Of not less than 100 members of the company, or
- Of members of the company holding not less than  $1/10^{\text{th}}$  of the total voting power therein.

Any director appointed by the Central Government shall not be required to hold any qualification shares not shall his period of office be liable to termination by retirement of directors by rotation. Any such director may be removed by the Central Government from his office and another person may be appointed in his place.

### **Duties of directors**

The statutory duties of directors have been discussed at appropriate places. Again, there are certain duties of a general nature of the following type:

- Fiduciary duties, and
- Duties of care, skill and diligence.

**Fiduciary duties.** As fiduciaries, the directors must-

- (a) exercise their powers honestly and bona fide for the benefit of the company as a whole;
- (b) not place themselves in a position in which there is a conflict between their duties to the company and their personal interests. They must not make any secret profit out of their position. If they do, they have to account for it to the company.

**Fiduciary duties owed to the company.**

The fiduciary duties of directors are owed to the company and not to the individual shareholders. The leading case on the point is *Percival v. Wright*, (1902) a Ch. 421, already discussed in this unit.

**Duties of care, skill and diligence.**

Directors should carry out their duties with reasonable care and exercise such degree of skill and diligence as is reasonably expected of persons of their knowledge and status. He is not bound to bring any special qualifications to his office.

**Standard of care.**

The standard of care, skill, and diligence depends upon the nature of the company's business and circumstances of the case. There are various standards of the care depending upon:

- (a) The type and nature of work;
- (b) Division of powers between directors and other officers;
- (c) General usages and customs in that type of business; and
- (d) Whether directors work gratuitously or remuneratively.

**Other duties of directors.**

The other duties of a director are-

- (1) To attend Board meetings.
- (2) Not to delegate his functions except to the extent authorized by the Act or the constitution of the company, and
- (3) To disclose his interest.

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

- 2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Duties of Directors.**

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## 24.4 LIABILITIES OF DIRECTORS

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The liabilities of directors may be discussed under the following four heads:

**Liability to third parties.** This may arise-

- (1) **Under the Act.** Liability of directors to third parties may arise in connection with the issue of a prospectus which does not contain the particulars required by the Companies Act, or which contains material misrepresentation. Directors may also incur personal liability-
  - On their failure to repay application money if minimum subscription has not been subscribed (Sec. 69).
  - On an irregular allotment of shares to an allottee (and likewise to the company) if loss or damage is sustained (Sec. 71).
  - On their failure to repay application money if the application for the securities to be dealt in on a recognized stock exchange is not made or is refused (Sec. 73).
  - On failure by the company to pay a bill of exchange, hundi, promissory note, cheque or order for money or goods wherein the name of the company is not mentioned in legible characters (Sec. 147).
- (2) **Independently of the Act.** Directors, as agents of a company, are not personally liable on contracts entered into as agents on behalf of the company. But there are a number of exceptions to this rule. If a director fails to exclude personal liability, for instance, by signing a negotiable instrument without mentioning the company's name and the fact that he is signing on company's behalf, he is personally liable to the holder of such instrument. He is also personally liable if he acts in his own name.

**Liability to the company.** The liability of director towards the company may arise from-

- **Ultra vires acts.** Directors are personally liable to the company in respect of ultra vires acts and it is not necessary to prove fraud in such cases, e.g., when they pay dividends out of capital or when they dissipate the funds of the company in ultra vires transactions. They are liable jointly and severally and, inter se, they have a right to ratable contribution.
- **Negligence.** A director may incur liability for the negligence in the exercise of his duties. There is no statutory definition of negligence, and as such each case has to be decided after due consideration of the particular facts thereof. The question to be answered in each case is: "Has the director exercised the necessary care and shown



the necessary diligence in the discharge of his duties?” If he has not, he is liable. If he has, there can be no question of liability. It is essential in an action for negligence that the company suffers some damage, as negligence without damage or damage without negligence is not actionable.

- **Breach of trust.** Directors of a company, being in a fiduciary position, hold the position of trustees as regards its money and property which comes into their hands and of the powers entrusted to them by the Articles. They must discharge their duties as such trustees in the best interest of the company. They are liable to the company for any loss resulting from breach of trust. Directors are also accountable to the company for any secret profits they might have made in transactions on behalf of the company.
- **Misfeasance.** Directors are liable to the company for misfeasance which means ‘willful misconduct’ of directors for which they may be sued in a Law Court. In case of misfeasance proceedings the directors may apply for relief under Sec. 633.

#### **Liability for breach of statutory duties.**

There are numerous statutory duties of directors which they must carry out. Most of these duties relate to maintenance of proper accounts, filing of returns or observance of certain statutory formalities. If they fail to perform these duties, they render themselves liable to penalties.

#### **Liability for acts of his co-directors.**

A director is not liable for the acts of his co-directors provided he has no knowledge and he is not a party. His co-directors are not his servants or agents who can by their acts impose liability on him.

#### **Check Your Progress – 3**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Liabilities of Directors.**

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## 24.5 SOME USEFUL BOOKS

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- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

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## 24.6 ANSWER TO CHECK YOUR PROGRESS EXERCISE

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### Check Your Progress – 1

1. See section 24.2

### Check Your Progress – 2

1. See section 24.3

### Check Your Progress – 3

1. See section 24.4



## UNIT 25:

### WINDING UP OF COMPANY

#### Structure

- 25.1 Objectives
- 25.2 Introduction
- 25.3 Modes of Winding up
- 25.4 Some Useful Books
- 25.5 Answer to Check Your Progress Exercise

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#### 25.1 OBJECTIVES

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After studying this unit you should be able to:

- Define a meaning of Winding up of a company.
- Describe the modes of Winding up of a company

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#### 25.2 INTRODUCTION

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##### Meaning of winding up

Winding up or liquidation of a company represents the last stage in its life. It means a proceeding by which a company is dissolved. The assets of the company are disposed of, the debts are paid off out of the realized assets (or from contributions from its members), and the surplus, if any, is then distributed among the members in proportion to their holdings in the company. The two terms 'winding up' and 'liquidation' are used interchangeably. According to Prof. Gower, winding up of a company is a process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator, called liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights.

#### Check Your Progress – 1

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

## 1. Discuss about the meaning of winding up.

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### 25.3 MODES OF WINDING UP

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There are two modes of winding up of a company, viz.,

- Winding up by the Tribunal (Secs. 433 to 483).
- Voluntary winding up (Secs. 484 to 521). This may be-
  - Members' voluntary winding up, or
  - Creditors' voluntary winding up.

#### A. Winding up by the tribunal (Secs. 433 to 483)

Winding up of a company under the order of a Tribunal is also known as compulsory winding up.

#### Groups for compulsory winding up (Sec. 433)

A company may be wound up by the Tribunal in the following cases:

- **Special resolution of the company** [Sec. 433 (a)]. Winding up order under this head is not common because normally the members of a company prefer to wind up the company voluntarily for in such a case they shall have a voice in its winding up. Moreover, a voluntary winding up is far cheaper and speedier than a winding up by the Tribunal.
- **Default in delivering the statutory report to the Registrar or in holding statutory meeting** [Sec. 433 (b)]. A petition on this ground can be made either by the Registrar or by a contributory. In the latter case the petition for winding up can be filed only after the expiry of 14 days from the day on which the statutory meeting ought to have been held [Sec. 439 (7)].
- The Tribunal may, instead of making a winding up order, direct that the statutory report is delivered or that a statutory meeting is held. The Tribunal may order the costs to be paid by any persona who are responsible for the default [Sec. 443 (3)].

#### Failure to commence, or suspension of business [Sec. 433 (c)].

- The Tribunal exercises power in this case only if the company has no intention of carrying on its business or if it is not possible for it to carry on its business.

- If a company has not begun to carry on business within a year from its incorporation or suspends its business for a whole year, the Tribunal will not wind it up if –
  - (a) there are reasonable prospects of the company starting business within a reasonable time, and
  - (b) there are good reasons for the delay, i.e., the suspension of business is satisfactorily accounted for and appears to be due to temporary causes.

**Reduction in membership** [Sec. 433 (d)]. If, at any time, the number of members of a company is reduced in the case of a public company, below 7 or in the case of private company, below 2, the company may be ordered to be wound up by the Tribunal. If the company carries on business for more than 6 months while the number is so reduced every member who is cognizant of the fact that it is carrying on business with members fewer than the statutory minimum, will be severally liable for the payment of the whole of the debts of the company contracted after those 6 months (Sec. 45).

**Inability to pay its debts** [Sec. 433 (e)]. A company may be wound up by the Tribunal if it is unable to pay its debts. The test is whether the company has reached a stage where it is commercially insolvent—that is to say, that its existing and probable assets would be insufficient to meet the existing liabilities. “Commercially insolvent”- means that the company is unable to pay debts or liabilities as they arise in the ordinary course of business.

**When is a company unable to pay its debts?** According to Sec. 434, a company shall be deemed to be unable to pay its debts in the following cases:

- (1) Demand for payment neglected. If a creditor to whom the company is indebted for a sum exceeding Rs. 1,00,000 has served on the company, at its registered office, a demand for payment and the company has for 3 weeks thereafter neglected to pay or otherwise satisfy him, the company is unable to pay its debts. The demand may be signed by any agent or legal adviser duly authorized or in the case of a firm, by such agent or legal adviser or by any member of the firm.
- (2) Decreed debt unsatisfied. If execution or other process issued on a decree or order of any Tribunal in favor of a creditor of the company is returned unsatisfied in whole or in part, the company is deemed to be unable to pay its debt.
- (3) Commercial insolvency. A company is deemed to be unable to pay its debts, if it is proved to the satisfaction of the Tribunal that the company is unable to pay its debts. In determining whether a company is unable to pay its debts, the Tribunal shall take into account the contingent and prospective liabilities of the company also.

**Just and equitable** [Sec. 433 (f)]. The words 'just and equitable' are of the widest significance and do not limit the jurisdiction of the Tribunal to any particular case. The principle of just and equitable clause baffles a precise definition. It must rest with the judicial discretion of the Tribunal depending upon the facts and circumstances of each [Hind Overseas (Pvt.) Ltd. v. R.P. Jhunjhunwalla, (1976) 46 Comp. Cas. 91 (S.C.)].

**What is 'just and equitable' clause?** It depends upon the facts of each case. The Tribunal may order winding up under the 'just and equitable' clause in the following cases:

- When the substratum of a company is gone. The substratum of a company can be said to have disappeared only when the object for which it was incorporated has substantially failed, or when it is impossible to carry on the business of the company except at a loss, or the existing and possible assets are insufficient to meet the existing liabilities.

The substratum of a company disappears:

- (i) When the very basis for the survival of the company is gone.

Pirie v. Stewart, (1904) 6 F. 847. A shipping company lost its only ship, the remaining asset being a paltry sum of pound 363. A majority in number and value of shareholder opposed this and desired to carry on the business as charter. Held, it was 'just and equitable' that the company should be wound up.

- (ii) When the main object of the company has substantially failed or become impracticable. Where a company's main object fails, its substratum is gone and it may be wound up even though it is carrying on its business in pursuit of a subsidiary object.

- (iii) When the existing and probable assets of the company are insufficient to meet its existing liabilities. Where a company is totally unable to pay off creditors and there is ever-increasing burden of interest and deteriorating state of management and control of business owing to sharp differences between shareholders, the Tribunal will order winding up.

- (1) When the management is carried on in such a way that the minority is disregarded or oppressed. Oppression of minority shareholders will be a 'just and equitable' ground where those who contribute company abuse their power to such an extent as to seriously prejudice the interest of minority shareholders.

- (2) Where there is a deadlock in the management of the company. When shareholding is more or less equal and there is a case of complete deadlock in the company on account of lack of probity in the management of the company and there is no hope or possibility of smooth and efficient continuance of the company as a commercial concern, there may arise a case for winding up on the 'just and equitable' ground.

- (3) Where public interest is likely to be prejudiced. Having regard to the provisions of Sec. 397 and 398 (dealing with prevention of oppression and mismanagement) where the concept of prejudice to public interest is introduced, it would appear that the Tribunal winding up a company will have to take into consideration not only the interest of shareholders and creditors but also public interest in the shape of need of the community, interest of the employees, etc.
- (4) When the company was formed to carry out fraudulent or illegal business or when the business of the company becomes illegal.
- (5) When the company is a mere bubble and does not carry on any business or does not have any property [London & County Coal Co., Re (1867) L.R. 3 Eq. 355].
- (6) Acting against the interest of the State. If the company has acted against the interests of the sovereignty and integrity of India, the security of the state, friendly relations with foreign states, public order, decency or morality.
- (7) Winding up of a sick company. If the tribunal is of the opinion that the company should be wound up under the circumstances specified in Sec. 424G. The last two clauses in Sec. 333(i) have been added by the Companies (Amendment) Act, 2002.

#### **B. Voluntary winding up (Secs. 484 to 520)**

Voluntary winding up means winding up by the members or creditors of a company without interference by the Tribunal. The object of a voluntary winding up is that the company, i.e. the members as well as the creditors are left free to settle affairs without going to the Tribunal. They may however apply to the tribunal for any directions if and when necessary.

*Circumstances in which a company may be wound up voluntarily* (sec. 484)- A company may be wound up voluntarily—

**1) By passing an ordinary resolution:** When the period, if any, fixed for the duration of a company by the Articles has expired, the company in general meeting may pass an ordinary resolution for its voluntary winding up. The company may also do so when the event, if any, on the occurrence of which the Articles provide that the company is to be dissolved, has occurred.

**2) By passing a special resolution-** A company may at any time pass a special resolution that it be wound up voluntarily. No reasons need be given where the members pass a special resolution for the voluntary winding up of the company. Even the Articles cannot prevent the exercise of this statutory right.

**Commencement of voluntary winding up (Sec. 486)-** A voluntary winding up shall be deemed to commence at the time when the resolution (ordinary or special, as the case may be) for its voluntary winding up is passed.

**Advertisement of resolution. (Sec. 485)-** Within 14 days of the passing of the resolution for voluntary winding up of the company, the company shall give notice of the resolution by advertisement in the *Official Gazette*, and also in some newspaper circulating in the district of the registered office of the company.

**Types of voluntary winding up:**

A voluntary winding up may be a

- members` voluntary winding up, or
- creditors` voluntary winding up.

**1. Members` voluntary winding up**

**Declaration of solvency (Sec. 488).** In a voluntary winding up of a company if a *declaration* of its solvency is made in accordance with the provisions of Sec.488, it is a members` voluntary winding up. The declaration shall be made by a majority of the directors at a meeting of the Board that the company has no debts or that it will be able to pay its debts in full within 3 years from the commencement of the winding up. The declaration shall be verified by an affidavit. The declaration shall have effect only when it is made within five weeks immediately before the date of the resolution, and delivered to the Registrar for registration before that date; and accompanied by a copy of the report of the auditors of the company on (i) the profit and loss account of the company from the date of the last profit and loss account to the latest practicable date immediately before the declaration of solvency. ii) the balance sheet of the company and iii) a statement of the company's assets and liabilities as on the last mentioned date. A winding up in the case of which a declaration has been made and delivered is referred to as a *member's voluntary winding up*, and a winding up in the case of which a declaration has not been so made and delivered is referred to as a *creditors` voluntary winding up*.

**Provisions applicable to a members` voluntary winding up**

Secs. 490 to 498 shall apply in relation to a members` voluntary winding up (Sec. 489). The provisions of these Sections are as follows:

**1. Appointment and remuneration of liquidators (Sec. 490)** The company in general meeting shall appoint one or more liquidators for the purpose of winding up its affairs and distributing the assets. It shall also fix the remuneration, if any, to be paid to the liquidator or liquidators. Any remuneration so fixed shall not be increased in any circumstances. The liquidator shall not take charge of his office before his remuneration is fixed as aforesaid.



**2. Board's powers to cease on appointment of a liquidator (sec. 491).** On the appointment of a liquidator, all the powers of the Board of directors, the managing or whole-time directors, and manager, shall cease except when the company in general meeting or the liquidator may sanction them to continue.

**3. Power to fill vacancy in office of liquidator (sec. 492)** If a vacancy occurs by death, resignation or otherwise in the office of any liquidator appointed by the company, the company in general meeting may fill the vacancy. For this purpose a general meeting may be convened by any contributory or by the continuing liquidator or liquidators, if any.

**4. Notice of appointment of liquidator** to be given to Registrar (Sec.493). The company shall give notice to the Registrar of the appointment of a liquidator or liquidators. It shall also give notice of every vacancy occurring in the office of liquidator and of the names of the liquidators appointed to fill every such vacancy. The company shall give the notice within 10 days of the event to which it relates.

**5. Power of liquidator to accept shares, etc. as the consideration for sale of property (Sec. 494).**

**6. Duty of liquidator to call creditors' meeting in case of insolvency (Sec.495)** If the liquidator is at any time of opinion that the company will not be able to pay its debts in full within the period stated in the declaration, he shall forthwith summon a meeting of the creditors. He shall lay before the meeting a statement of the assets and liabilities of the company. Thereafter the winding up shall become creditors voluntary winding up.

**7. Duty to call general meeting at the end of each year (Sec. 496).** In the event of the winding up continuing for more than 1 year, the liquidator shall call a general meeting of the company at the end of the first year from the commencement of the winding up. Likewise, he shall call a general meeting at the end of each succeeding year. He shall lay before the meeting an account of his acts and dealings and of the conduct of the winding up during the year.

**8. Final meeting and dissolution (Sec. 497).** As soon as the affairs of the company are fully wound up, the liquidator shall make up an account of the winding up, showing how the winding up has been conducted and how the property of the company has been disposed of. He shall then call a general meeting of the company and lay before it the accounts showing how the winding up has been conducted.

The meeting shall be called by advertisement –

- a) specifying the time, place and object of the meeting; and
- b) published not less than one month before the meeting in Official Gazette, and also in some newspaper circulating in the district the registered office of the company.

Within one week after the meeting, the liquidator shall send to the Registrar and the Official Liquidator a copy each of the account and shall make a return to each of them of the holding of the meeting and of the date thereof. If a quorum is not present at the final meeting, the liquidator shall make a return that the meeting was duly called but could not be held for want of quorum.

The Registrar on receiving the account and return shall register them. The Official Liquidator, on receiving them, shall make a scrutiny, the books and papers of the company. The liquidator of the company present officers shall give the Official Liquidator all reasonable facilities to make the scrutiny. On such scrutiny the Official Liquidator shall make a report to the Tribunal. If the report shows that the affairs of the company have been conducted in a manner not prejudicial to the interests of its members or to public interest, then from the date of the submission of the report to the Tribunal, the company shall be deemed to be dissolved.

**9. Provisions as to annual and final meeting in case of insolvency (Sec.498)** If in the case of a member's voluntary winding up, liquidator finds that the company is insolvent, Secs. 508 and 509 (what deal with the duty of the liquidator to call a meeting of the company of creditors at the end of each year (Sec. 508) and final meeting and dissolution (Sec.509) in case of a creditors' voluntary winding up] shall apply as if the winding up were a creditors' voluntary winding up and a members' voluntary winding up. It should be noted that in such a case Secs. 508 and 509 shall apply to the exclusion of Secs. 496 and 497.

## **2. Creditors voluntary winding up**

A voluntary winding up of a company in which a declaration of solvency is not made is referred to as a creditors' voluntary winding up.

### **Provisions applicable to creditors' voluntary winding up**

Secs. 500 to 509 shall apply in relation to a creditor's voluntary winding up (Sec.499).

The provisions of these Sections are as follows:

**Meeting of creditors (Sec. 500)** The company shall call a meeting of the creditors of the company on the day on which there is to be held the general meeting of the company at

which the resolution for voluntary winding up is to be proposed, or on the next day. It shall send notices of the meeting to the creditors by post simultaneously with the sending of the notices of meeting of the company. It shall also cause notice of the meeting of the creditors to be advertised once at least in the Official Gazette and once at least in 2 newspapers circulating in the district of the registered office of the company.

**Notice of resolution to be given to Registrar (Sec. 501).** Notice of any resolution passed at a creditors' meeting shall be given by the company to the Registrar within 10 days of the passing thereof.

**Appointment of liquidator (Sec. 502).** The creditors and the members at their respective meeting may nominate a liquidator. If they nominate different persons, the creditors' nominee shall be the liquidator. But any director, member or creditor of the company may apply to the Tribunal for an order that the person nominated as liquidator by the company or any other Tribunal within 7 days after the nomination, on which the nomination was made by the creditors. If no person is nominated by the creditors, the person nominated by the members shall be the liquidator. Likewise, if no person is nominated by the company, the person nominated by the creditors shall be the liquidator.

**Appointment of committee of inspection (Sec. 503).** The creditors at their meeting may, if they think fit, appoint a committee of inspection consisting of not more than 5 persons. If such a committee is appointed, the company may also at a general meeting appoint not more than 5 members to the committee. However, the creditors may, if they think fit, dissolve that all or any of the persons appointed by the company ought to be members of the committee of inspection. If the creditors and members do not agree on a common list, the Tribunal may constitute a committee of inspection.

**Liquidator's remuneration (Sec.504),** The committee of inspection, if there is no such committee, the creditors, may fix the remuneration of the liquidator. Where the remuneration is not so fixed, it shall be determined by the Tribunal. The remuneration shall not be increased in any circumstances.

**Board's powers to cease on appointment of liquidator (Sec.505).** On the appointment of a liquidator, all the powers of the Board of directors shall cease. But the committee of inspection, or if there is no such committee, the creditors in general meeting, may sanction the continuance of the Board.

**7) Power to fill vacancy in office of liquidator (Sec.506).** If a vacancy occurs by death, resignation or otherwise, in the office of a liquidator (other than a liquidator appointed by, or by the direction of, the Tribunal), the creditors in general meeting may fill the vacancy.

**8) Power of liquidator to accept shares, etc., as consideration for sale of property .** The provisions of Sec. 494 shall apply in the case of a creditors` voluntary winding up. However the powers of the liquidator under Sec. 494 shall not be exercised except with the sanction either of the Tribunal or of the committee of inspection.

**9) Duty of liquidator to call meeting at the end of each year (Sec.508).** The liquidator shall call a general meeting of the company and a meeting of the creditors every year, within 3 months from the close of every year. This will be so if the winding up continues for more than 1 year. He shall lie before the meeting an account of his acts and dealings and of the conduct of winding up during the preceding year and position of the winding up.

**10) Final meeting and dissolution (Sec. 509)** As soon as the affairs of the company are fully wound up, the liquidator shall make up an account of the winding up showing how the winding up has been conducted and how the property of the company has been disposed. He shall then call a general meeting of the company and a meeting of the creditors for the purpose of laying the account before the meeting and giving explanation thereof. Thereafter the procedure shall be the same and laid down in Sec.497.

#### **Members` and creditors` voluntary winding up compared**

**Declaration of solvency.** In case of a member` voluntary winding up, there is declaration of solvency. In case of a creditors` voluntary winding up, there is no such declaration.

**Control of winding up.** In a members` voluntary winding up, members control the winding up of the company and the creditors do participate directly as the company makes a declaration of solvency. In creditors` voluntary winding up, the creditors control the winding up the company as the company is deemed to be insolvent.

**Meetings.** In a members` voluntary winding up, there is no meeting of creditors. In a creditors` voluntary winding up, whenever there is meeting of contributories, there is a corresponding meeting of creditors.

**Appointment of liquidator.** In a members` voluntary winding up, liquidator is appointed by the company and his remuneration is fixed by the company. In a creditors` voluntary

winding up, he is appointed by the creditors and his remuneration is fixed by the committee inspection or, if there is no such committee, by the creditors.

**Committee of inspection.** There is no committee of inspection members` voluntary winding up; in a creditors` voluntary winding up creditors may appoint a committee of inspection.

**Powers of liquidator.** In a members` voluntary winding up, liquidator can exercise certain powers with the sanction of a special resolution of the company; in a creditors` voluntary winding up, he do so with the sanction of the Tribunal or the committee of inspection of a meeting of the creditors.

### **Check Your Progress – 2**

Note: 1. Give your answer in the space given below.

2. Check your answers with those given at the end of the unit.

#### **1. Discuss the Duties of Directors.**

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### **24.4 SOME USEFUL BOOKS**

- **K.C.Garg, V.K.Sareen, Mukesh Sharma & R.C.Chawla** -“Mercantile Law [Incorporating Latest Amendments in Company Law, Economic Laws & other Laws]”
- **N.D.Kapoor** - “Mercantile Law”
- **Thulsyan Singh** - “Legal Aspects of Business”
- **Akileshwar Pathek** - “Legal Aspects of Business”

### **24.5 ANSWER TO CHECK YOUR PROGRESS EXERCISE**

#### **Check Your Progress – 1**

1. See section 25.2

#### **Check Your Progress – 2**

1. See section 25.3