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Business Law

Institute of **Open** and **Distance Education**

Faculty of Management

Business Law

2BBA5

DR. C.V. RAMAN UNIVERSITY
Chhattisgarh, Bilaspur
A STATUTORY UNIVERSITY UNDER SECTION 2(F) OF THE UGC ACT

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CONTENTS

BLOCK I

LAW OF CONTRACT

CONTENTS

Contd...

1.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Know the meaning and essentials of a valid contract
- Understand the importance of offer and acceptance as the building block of a contract
- Appreciate the significance of capacity and free consent of parties to a contract
- Understand the meaning of legality of object of a contract

1.1 INTRODUCTION

We enter into contracts every day. Some of these are made consciously, for example, purchase or sale of a share of a company or a plot of land. Sometimes we do not even realize that we are making a contract, e.g., hiring a taxi, buying a book, etc. In any case, a contract, howsoever made, confers legal rights on one party and subjects the other party to some legal obligation. People engaged in business carry on business by entering into different contracts. Thus, the business executives, corporate counsels, entrepreneurs, and professionals in different fields deal frequently with contracts. At times, they have to draft one such contract or scrutinize it or provide inputs to its making or even interpret it. Therefore, it is necessary for them to know what constitutes a contract. The law relating to contracts is contained in the Indian Contract Act, 1872. For business executives, contract law is tremendously significant because it underlies or is related to all major areas of law affecting business.

The general principles of the law of contracts are covered in 75 sections. This lesson explains the different provisions of these sections with the help of case law. Contract forms the basis of almost all the business law therefore you must know it thoroughly. The understanding of how a contract is made and breached and how the remedies for breach of the contract can be avoided is essential to deal with laws given in later sections. Towards the end of the lesson, there are five sections concerning "Gaining Practical Experience".

That branch of law which determines the circumstances in which, promises made by the parties to a contract shall be legally binding on them is governed by the Indian Contract Act, 1872. Also, it defines the remedies that are available through a court against a person who fails to uphold his contract, and prescribes conditions under which the remedies are available.

The Indian Contract Act is concerned with the most important branch of business law as it affects all of us in one way or the other at one time or the other. However, it is of particular importance to business persons as bulk of their transactions are based on contracts. The Act imparts definiteness in business transactions as it ensures that what a person has been led to expect shall come to pass and what has been promised to him shall be performed. Thus the purpose of the law of contract is to ensure the realization of reasonable expectations of the parties who enter into a contract.

The Indian Contract Act, 1872 is not a complete code on the law of contracts. The preamble to the Act reads: "Whereas it is expedient to define and amend certain parts of the law relating to contracts, it is hereby enacted as follows." Thus, the Act does not profess to be a complete and exhaustive code regarding all classes of contracts. It deals with only certain parts of the contracts and with some special contracts only. However, so far as it goes, the Act is exhaustive and imperative.

Further the Indian Contract Act does not affect any usage or custom of trade. Thus, the parties to a contract, which clearly provide for the application of usages into their

contracts, are expressly saved from the operation of this Act. However, such usages should not be inconsistent with the provisions of the Act. Furthermore, the provisions of any statute, Act or Regulation, which are not expressly repealed by this Act, are not affected by this legislation. Moreover, the English principles of equity can be applied to contracts in suitable cases by Indian courts if such principles are not contrary to the provisions of the Act.

1.2 INDIAN CONTRACT ACT, 1872

For business executives, contract law is tremendously significant because it underlies or relates to all major areas of law affecting business. The Indian Contract Act occupies the most important place in the Commercial Law. Without Contract Act, it would have been difficult to carry on trade or any other business activities. It is also related with employment law. It is not only the business community which is concerned with the Contract Act, but it affects everybody. The objective of the Contract Act is to ensure that the rights and obligations arising out of a contract are honoured and that legal remedies are made available to those who are affected. According to Indian Contract Act, 1872 Section 1, this Act may be called as the Indian Contract Act, 1872.

The general principles of the law of contracts are covered in 75 sections. Contract forms the basis of almost all the business law and you must know it thoroughly. The branch of law which determines the circumstances in which promises made by the parties to a contract shall be legally binding on them is governed by the Indian Contract Act, 1872. It defines the remedies that are available through a court against a person who fails to perform his contract, and prescribes conditions under which the remedies are available.

The Indian Contract Act is concerned with the most important branch of business law as it affects all of us in one way or the other at one time or the other. However, it is of particular importance to business persons as bulk of their transactions are based on contracts. The Act imparts definiteness in business transactions as it ensures that what a person has been led to expect should take place and what has been promised to him in the contract should be performed. Thus the purpose of the law of contract is to ensure the realization of reasonable expectations of the parties who enter into a contract.

A contract or an obligation to perform a promise could arise in the following ways:

1. By Agreement and Contract
2. By Standard Form Contract
3. By Promissory Estoppel

1. ***Agreement and Contract:*** The most common way of making contract is through an agreement. The two parties may agree to something by mutual negotiations. When one party makes an offer and the other accepts the same, there arises an agreement, which may be enforceable by law.

2. ***Standard Form Contract:*** In the modern age some persons, institutions or establishments' such as the Railway, Insurance Companies, Bank, Manufacturers of various goods, etc., may have to enter into a very large number of **contracts** with thousands of persons. They cannot possibly negotiate individually with the persons with whom the **contracts** are to be made. **Contract** with pre-drafted matters are generally prepared by one party, which the other has to agree to. As a general rule, such standard Form **Contracts** are as much valid as those entered into through due negotiation.

3. ***Promissory Estoppel:*** Sometimes there may be no agreement and **contract** in strict sense of the term, but a person making a promise may become bound because of the application of the equitable doctrine of Estoppel.

1.3 SOME FUNDAMENTAL DEFINITIONS

Some important fundamental definitions are given below:

Contract 2(h)

A contract is an agreement, enforceable by law, made between at least two parties by which rights are acquired by one and obligations are created on the part of another. If the party, which had agreed to do something, fails to do that, then the other party has a remedy.

The term 'Contract' has been defined in Section 2(h) of the Indian Contract Act, 1872. It defines the Contract as an agreement enforceable by law.

An agreement cannot become a contract unless it can be enforceable by law. To be enforceable by law, a contract must contain all the essential elements of a valid contract as defined in Section 10.

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

Example: D Airlines sells a ticket on 1 January to *X* for the journey from Mumbai to Mangalore on 10 January. The Airlines is under an obligation to take *X* from Mumbai to Mangalore on 10 January. In case the Airlines fail to fulfil its promise, *X* has a remedy against it.

Thus, *X* has a right against the Airlines to be taken from Mumbai to Mangalore on 10 January. A corresponding duty is imposed on the Airlines. As there is a breach of promise by the promissory (the Airlines), the other party to the contract (i.e., *X*) has a legal remedy.

Some examples of contracts which we enter into day after day should be noted. Taking a seat in a bus amounts to entering into a contract. When a coin is put into the slot of a weighing machine, a contract is entered into. Going to a restaurant and taking snacks therein amounts to entering into a contract. In such cases, we do not even realise that we have entered into a contract.

Section 2(h) defines a contract as "an agreement enforceable by law". Thus, a contract essentially consists of two elements: (i) an agreement and (ii) its enforceability by law.

Agreement 2(e)

Section 2(e) defines an agreement as *"every promise and every set of promises forming consideration for each other"*. In this context, the word 'promise' is defined by s.2 (b). In a contract there are at least two parties. One of them makes a proposal (or an offer) to the other, to do something, with a view to obtaining the assent of that other to such act. When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted becomes a promise [s.2(b)]. The person making the proposal is called 'promissory' and the person accepting the proposal is called the 'promisee' [s.2(c)].

In short, agreement = offer + acceptance.

Promise 2(b)

As per Section 2(b) of the Contract Act, a proposal when accepted becomes a promise.

Offer (i.e. Proposal) [section 2(a)]

Section 2(a) states that when one person signifies another person his willingness to do or abstain from doing anything with a view to obtaining the assent of that other to such an act or abstinence, he is said to make a proposal'. A proposal is also known as an offer.

Defendant

A person against whom a suit has been filed in court and who has to defend himself against the charges of breach of contract is called the defendant.

Plaintiff

A person who files a suit in a court of law against another for breach of contract is called the plaintiff.

Promisor and Promise 2(c)

According to Section 2c of the Act, the person making the proposal is called the 'promisor' and the person accepting the proposal is called the 'promisee'.

Acceptance

When the person to whom the proposal is made, signifies his assent there to, the proposal is said to be accepted.

Promise 2(b)

A Proposal when accepted becomes a promise. In simple words, when an offer is accepted it becomes promise.

Consideration 2(d)

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

Void Agreement 2(g)

Section 2(g) of the Act defines a void agreement as "an agreement not enforceable by law'.

Voidable Contract 2(i)

An agreement is a voidable contract if it is enforceable by Law at the option of one or more of the parties there to (i.e., the aggrieved party), and it is not enforceable by Law at the option of the other or others.

Void Contract

A contract which ceases to be enforceable by Law becomes void when it ceases to be enforceable.

Enforceability by Law

The agreement must be enforceable by law so as to become a contract. Thus, there are certain agreements which do not become contracts as the element of enforceability by law is absent. For example, an agreement to go for a stroll together or for a picnic does not become a contract, and therefore, neither rights nor obligations are created on the part of the parties to the agreement. Thus, all agreements are not contracts; but all

contracts are agreements. Further all legal obligations are not contractual. Only those legal obligations which have their source in an agreement are contractual. Thus, a legal obligation not to create a nuisance for others does not give rise to a contract; but nevertheless it is actionable by law under the law of Tort.

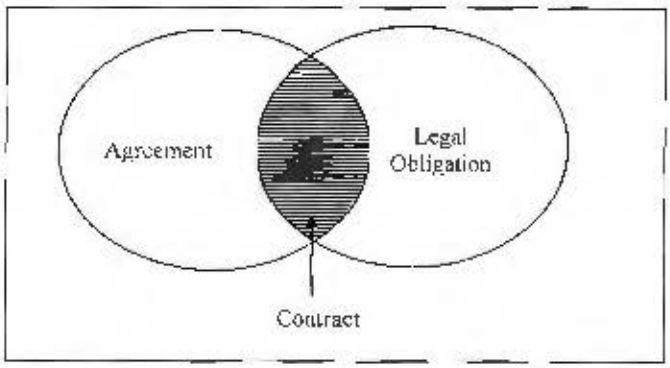

Figure 1.1: Contract = Agreement + Legal Obligation

Examples

(i) *A* agrees to sell his motorcycle to *B* for ₹ 10,000. The agreement gives rise to a legal obligation on the part of *A* to deliver the motorcycle to *B* and on the part of *B* to pay ₹ 10,000 to *A*. The agreement is a contract. If *A* does not deliver the motorcycle, 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 motorcycle and *B* refuses to pay the price, *A* can go to the court and file a suit against *B* for non-performance of promise.

(ii) *A* invites *B* for dinner in a restaurant. *B* accepts the invitation. On the appointed day, *B* goes to the restaurant. To his utter surprise *A* is either not there or refuses to entertain *B*. *B* shall have no remedy against *A*. Similarly, in case *A* is present in the restaurant but *B* fails to turn up, then *A* shall have no remedy against *B*.

(iii) *A* gives a promise to his son to give him a pocket allowance of ₹ 150 every week. In case *A* fails or refuses to give the promised amount, his son has no remedy against *A*.

In the above examples, (ii) and (iii), the promises are not enforceable by law as there was no intention to create legal obligation. Such agreements are social agreements which do not give rise to legal consequences. In example (i) the obligation has its source in an agreement and the parties intend to be bound by the same and therefore it gives rise to a contract.

What constitutes a contract?

It is necessary for us to know as to what constitutes a contract as it is the key to understand many legal questions. Very often a dispute does not centre on whether someone has violated a contract but whether there was a contract in the first place. Other disputes centre on whether a change in circumstances has made the contract unenforceable.

1.4 NATURE OF CONTRACT

Indian Contract Act is the Act which regulates the entire arena of business world. It is particularly crucial for those who do their business on the basis of contract. Contract Act contains 238 sections. It covers a wide range of area like: Formation of contracts, contingent contracts, performance of the contract, and consequences of breach of contract, sale of goods, indemnity and guarantee, bailment, agency and so on.

The Law of Contract came to force on 1 September 1872:

1. The Indian Contract Act was passed and implemented to control various kinds of commercial and business contracts.
2. This act is not a complete code of contracts. It deals with general principles of 'The Law of Contract and special Contract'.
3. Under Section 1 of contract Act it says that the Act is applicable to the whole of India, except the state of Jammu and Kashmir.
4. The Contract Act only provides rules and regulations for the purpose of contract. It does not list any rights and liabilities between parties to the contract.
5. Rights and liabilities and their manner of performance are decided by the parties themselves under the contract but it is within the purview of the act.

1.5 ESSENTIALS OF A VALID CONTRACT

Section 10 provides that all agreements are contracts, if they are made by free consent of parties, competent to contract, for a lawful consideration, and with a lawful object, and are not expressly declared by law to be void. To constitute a contract, there must be an agreement between two or more than two parties. No one can enter into a contract with himself. An agreement is composed of two elements - offer or proposal by one party and acceptance thereof by the other party. The party making the offer (or proposal) is known as the offerer or proposer; the party to whom the offer is made is known as the offeree. When the offeree gives his assent to the offer, then he is known as 'acceptor'. At the time of entering into a contract, parties must be thinking of the same thing (say about the subject matter of the contract) in the same sense. In other words they must have what is known as *consensus ad idem*. Their minds must meet about the different facets of the subject matter of the contract. Further, there must be an intention on the part of the parties to create a legal relationship.

An agreement of a purely social or domestic nature is not a contract. In commercial agreements, the law presumes that the parties intended those agreements to have legal consequences. However, this presumption may be negative by express terms to the contrary. Similarly, in the case of agreements of purely domestic and social nature the presumption is that they do not give rise to legal consequences. However, this presumption is rebuttable by showing that the intention of the parties was to create legal obligations.

The *consent* of the parties to the agreement must be *free and genuine*. The consent will not be free if it is obtained by misrepresentation, fraud, undue influence, coercion or mistake. If in a consent any of these flaws is present, the contract may not be valid. Further, the parties to the contract must be *competent* to contract. The flaw in capacity of parties to contract may be due to minority, lunacy, idiocy, drunkenness or status. If a party to a contract suffers from any of these flaws, the contract may not be a valid one. Also, the contract must be supported by *consideration* on both sides. Each party to the contract must give or promise something, and receive something or a promise in return. However, this consideration need not be in terms of money. In case the promise is not supported by consideration, the promise will be *nudum pactum* (a bare promise) and would not be enforceable by law. The object of the agreement must be lawful, and not one of which the law disapproves. Also, there are certain agreements which have been expressly declared by law to be illegal or void.

Also, the meaning of the agreement must be certain or capable of being made certain. For instance, *A* agrees to buy 10 metres of cloth from a shopkeeper. There is nothing whatsoever to show what type of cloth was intended. The agreement would not be

enforceable for want of certainty of meaning. If, on the other hand, the special description of the cloth is expressly stated, say terrycot (80:20), the agreement would be enforceable as there is no ambiguity as to its meaning. The terms of the agreement should be capable of performance. An agreement, to do an impossible act, in itself cannot be enforced. An agreement to make two parallel lines meet cannot be enforced.

Effect of Absence of one or more Essential Elements of a Valid Contract: If one or more essentials of a valid contract are missing, then the contract may be voidable, void, illegal or unenforceable.

Offer + Acceptance = Promise

+

Consideration

=

Agreement

+

Enforceability by Law

⇩

Contract

1. Proper offer and proper Acceptance with Intention to create legal Relationship.

Cases: A and B agree to go to a movie on coming Sunday. A does not turn, in resulting B's loss of time but B cannot claim any damages from A since the agreement to watch a movie is a domestic agreement which does not result in a contract.

In case of social agreement there is no intention to create legal relationship and there is no contract (Balfour v. Balfour).

In case of commercial agreements, the law presume that the parties had the intention to create legal relations.

An agreement of a purely domestic or social nature is not a contract.

2. Lawful Consideration

Lawful consideration must not be unlawful, immoral or opposed to the public policy.

3. Capacity

The parties to a contract must have capacity (legal ability) to make valid contract. Section 11 of the Indian contract Act specifies that every person is competent to contract provided.

(i) Is of the age of majority according to the Law which he is subject, and

(ii) Who is of sound mind and

(iii) Is not disqualified from contracting by any law to which he is subject.

- Person of unsound mind can enter into a contract during his lucid interval.
- An alien enemy, foreign sovereigns and accredited representative of a foreign state. Insolvents and convicts are not competent to contract.

4. Free Consent

Free consent of the parties must be genuine consent, means agreed upon same thing in the same sense i.e., there should be *consensus ad –idem.* A consent is said to be free when it is not caused by coercion, undue influence, fraud. misrepresentation or mistake.

5. Lawful Object

- The object of agreement should be lawful and legal.
- Two persons cannot enter into an agreement to do a criminal act.
- Consideration or object of an agreement is unlawful if it

  (a) is forbidden by law; or

  (b) is of such nature that, if permitted, would defeat the provisions of any law; or

  (c) is fraudulent; or

  (d) involves or implies, injury to person or property of another; or

  (e) Court regards it as immoral, or opposed to public policy.

6. Possibility of Performance

- The terms of the agreement should be capable of performance.
- An agreements to do act, impossible in itself cannot be enforced.

Example: A agrees to B to discover treasure by magic. The agreement is void because the act in itself is impossible to be performed from the very beginning.

7. The terms of the agreements are certain or are capable of being made certain

Example: 'A' agreed to pay ₹ 5 lakh to 'B' for ultra-modern decoration of his drawing room. The agreement is void because the meaning of the term "ultra – modern" is not certain.

8. Not Declared Void

- The agreement should be such that it should be capable or being enforced by law.
- Certain agreements have been expressly declared illegal or void by the law.

9. Necessary Legal Formalities

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

Example: A promise to pay a time. Barred debt must be in writing.

1.6 PRIVITY OF CONTRACT

As a contract is entered into by two or more persons thereby creating rights and obligations for them, it is a party to the contract only who can enforce his rights as against the other party (i.e., the promisor). The basic principle underlying law of contracts is that a stranger to a contract cannot maintain a suit for a remedy. The law entitles only those who are parties to the contract to file suits for exercising their

rights. This is known as 'privity of contract'. This rule can be traced to the fact that the law of contracts creates *jus in personam* (against a person) as distinguished from *jus in rem* (against a thing). Therefore, a stranger to a contract cannot maintain a suit.

Example: *A* is indebted to *B*. *A* sells certain goods to *C*. *C* gives a promise to *A* to pay off *A*'s debt to *B*. In case *C* fails to pay, *B* has no right to sue *C*, being a stranger to the contract between *C* and *A*. In other words *C* is not in privity with *B*. However, *C* is in privity with *A*.

The concept of privity of contracts is illustrated below:

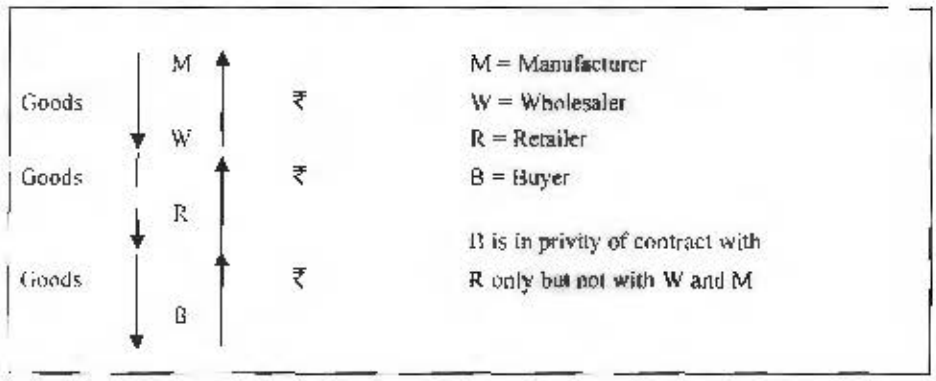

Figure 1.2: Privity of Contract

Formation of a Contract: There are different modes of formation of a contract. It may be made in writing or by word of mouth, or be inferred from the conduct of the parties or the circumstances of the case. The contracts are classified accordingly.

1.7 CLASSIFICATION OF CONTRACTS

In connection with contracts, there are four types of classifications. Types of contracts in contract law are as follows:

- On the basis of Formation
- On the basis of Nature of Consideration
- On the basis of Execution
- On the basis of Validity

1.7.1 Classification of Contracts according to Formation or Creation

A contract may be (a) Made in writing (b) By words spoken and (c) Inferred from the conduct of the parties or the circumstances of the case. We can classify contracts in the following manner.

a. Express contract

b. Implied contract

c. Tacit contract

d. Quasi contract

e. E-contract

- ***Express contract:*** This contract is made by word, spoken or written. According to sec 9 in so for as the proposal or acceptance of any promise is made in words, the promise is said to be express. For example, A has offered to sell his house and B has given acceptance. It is 'Express Contract'.

- ***Implied contract:*** Implies contract means implied by law i.e., the law implied a contract through parties, never intended. According to sec 9 in so for as such proposed or acceptance is made otherwise than in words, the promise is said to be implied. A contract inferred by:
  - The conduct of person or
  - The circumstances of the case.

  For example, when A takes a cup of milk in a hotel, there is an implied contract.
- ***Tacit contract:*** A contract is said to be tacit when it has to be inferred from the conduct of the parties. For example obtaining cash through automatic teller machine.
- ***Quasi contract:*** In case of Quasi Contract there will be no offer and acceptance so, there will be no contractual relations between the partners. Such a contract which is created by virtue of law is called 'Quasi Contract'. Sections 68 to 72 of Contract Act read about the situations where court can create Quasi Contract.
  - Sec. 68: When necessaries are supplied
  - Sec. 69: When expenses of one person are paid by another person.
  - Sec. 70: When one party is benefited by the activity of another party.
  - Sec. 71: In case of finder of lost tools.
  - Sec. 72: When payment is made by mistake or goods are delivered by mistake.

  Example: A's husband is no more. She is very poor and therefore not capable of meeting even the cost of cremation of her husband. B, one of her relatives, understands her position and spends his own money for cremation. It is done so without A's request. Afterwards B claims his amount from A where A refuses to pay. Here Court applies Sec. 68 and creates a Quasi Contract between them. Chowal vs. Cooper.
- ***E–Contract:*** An e–contract is one, which is entered into between two parties via the internet.

1.7.2 Classification of Contracts according to Nature of Consideration

On this base, Contracts are of two types namely Bilateral Contracts and Unilateral Contracts.

- ***Bilateral Contracts:*** If considerations in both directions are to be moved after the contract, it is called Bilateral Contract. For example, a Contract was formed between X and Y on 1st Jan. According to which X has to deliver goods to Y on 3rd Jan and Y has to pay amount on 3rd Jan. It is a bilateral contract.
- ***Unilateral Contract:*** If a consideration is to be moved in one direction only after the Contract, it is called Unilateral Contract. For example, A has lost his purse and B is its finder. There after B searches for A and hands it over to A. Then A offers to pay ₹ 1000/- to B to which B gives his acceptance. Here, after the Contract consideration moves from A to B only. It is Unilateral Contract.

1.7.3 Classification of Contracts according to the Basis of Execution

On this basis Contracts can be classified into two groups namely, Executed and Executory Contracts.

- ***Executed Contract:*** A contract is said to be executed contract when both the parties to contract have performed their share of obligation. For example, A contracts to buy a car from B by paying cash, B instantly delivers his car.
- ***Executory Contract:*** An executory contract is one which is, either wholly unperformed, or something remains in there to be done by both the parties to complete the contract. Sometimes, a contract may be partly executed and partly executory. For example, D agrees to buy V's cycle by promising to pay cash on 15th July. V agrees to deliver the cycle on 20th July.
- ***Partly executed and partly executory:*** A contract in which one of the parties has fulfilled his obligation but the other party is yet to fulfill his obligation.

  Example: A sells his car to B and A has delivered the car but B is yet to pay the price. For A, it is executed contract whereas it is executory contract on the part of B since the price is yet to be paid.

1.7.4 Classification of Contracts according to the Basis of Validity

On this basis Contracts can be classified into 5 groups, namely---Valid, Void, Voidable, Illegal and Unenforceable Contracts.

- ***Valid:*** The Contracts which are enforceable in a court of law are called Valid Contracts. To attain Validity the Contract should have certain features like *consensus ad idem* (of the same mind), certainty, free consent, two directional consideration, fulfillment of legal formalities, legal obligations, lawful object, capacity of parties, possibility of performance, etc. For example, there is a Contract between X and Y and let us assume that their contract has all those above said features. It is a Valid Contract.
- ***Void:*** A Contract which is not enforceable in a court of law is called a Void Contract. If a Contract lacks any one or more of the above features (except free consent and legal formalities), it is called Void Contract. For example, There is a Contract between X and Y where Y is a minor who has no capacity to contract. It is Void Contract.
- ***Voidable:*** A Contract lacks free consent only, is called Voidable Contract. That means it is a Contract which is made under certain pressure either physical or mental. At the will of the suffering party, a voidable contract may become either Valid or Void in future. For example, there is a Contract between A and B where B has forcibly made A involved in the Contract. It is voidable at the will of A.
- ***Illegal:*** If the contract carries unlawful object it is called Illegal Contract.

  Example: There is a contract between X and Z according to which Z has to kill Y for a sum of ₹ 10000/- from X. It is an illegal contract.
- ***Unenforceable:*** A contract which has not properly fulfilled legal formalities is called unenforceable contract. That means unenforceable contract suffers from some technical defects like insufficient stamp etc. After rectification of that technical defect, it becomes enforceable or valid contract. For example, A and B have drafted their agreement on ₹ 10/- stamp where it is to be written actually on ₹ 100/- stamp. It is an unenforceable contract.

1.8 ILLEGAL AND VOID AGREEMENTS

Sections 25 to 30 refer to cases in which the agreement is only void. Section 23 points out the cases where the consideration of an agreement is unlawful and the agreement is also void. Thus, every illegal agreement is void, but every void agreement may not amount to illegal agreement.

An unenforceable contract is neither void nor voidable, but it cannot be enforced in the court because it lacks some item of evidence such as writing, registration or stamping or where the remedy has been barred by lapse of time. For instance, an agreement which is required to be stamped will be unenforceable if the same is not stamped at all or is under-stamped. In such a case, if the stamp is required merely for revenue purposes, as in the case of a receipt for payment of cash, the required stamp may be affixed on payment of penalty and the defect is then cured and the contract becomes enforceable. However, the technical defect cannot be cured and the contract remains unenforceable e.g., in the case of an unstamped bill of exchange or promissory note. In any case the contract may be carried out by the parties concerned; but in the event of breach or repudiation of such a contract, the aggrieved party shall not be entitled to the legal remedies.

1.8.1 Void Contracts and Illegal Contracts

All illegal Contracts are void, but all void contracts are not illegal: An illegal Contract will not be implemented by court. So, illegal contract is Void. A void contract may not be illegal because its object may be lawful.

The Contracts which are collateral to illegal contract are void, but the contracts which are collateral to void contract may be Valid: An illegal action makes not only itself Void but also the contracts connected to it. But contract collateral to void contract may attain Validity because the object of the main contract is lawful.

1.8.2 Void Contracts and Voidable Contracts

Becoming Valid: A Voidable Contract may become Valid at the option of suffering party. But a Void Contract can never and never become Valid.

Third Party Rights: In case of Voidable Contracts third party may attain rights on concerned property, if the third party gets the property before the Voidable Contracts gets declared as Void. But in case of Void Contract third party cannot get any right.

1.8.3 Distinction between Void Agreement and Voidable Contract

The following points of distinction are worth noting:

(1) ***Legality:*** A void agreement is without any legal effect and hence cannot be enforced by either party. A voidable contract, on the other hand, can be enforced by the party at whose option it is voidable.

(2) ***Enforceability:*** A void agreement is unenforceable from the very beginning, whereas a voidable contract becomes unenforceable only when the party at whose option the contract is voidable' rescinds it.

Examples: (i) *A* pays *B* ₹10,000 in consideration of *B*'s promise to sell him some goods. The goods had been destroyed at the time of promise. The agreement is void and thus unenforceable.

(ii) A, a doctor, by exercising undue influence over his patient *B* induces him to sell his car worth ₹ 1,50,000 for ₹ 1,00,000. It is a voidable contract at the option of *B*. If *B* rescinds the contract, it becomes unenforceable; but if he does not, then the contract is enforceable.

(3) ***Compensation:*** Under a voidable contract, any person who has received any benefit must compensate or restore it to the other party. The question of compensation in the event of non-performance of a void agreement does not arise, as it is unenforceable from the very beginning.

(4) ***Effect on Collateral Transaction:*** A voidable contract does not affect collateral transaction. But if the agreement is void on account of the object or consideration being illegal or unlawful, the collateral agreement will also become void.

1.8.4 Obligation of the Parties under a Void contract and a Voidable Contract

In the case of a void contract, since the transaction is either unenforceable from the beginning or so becomes impossible or illegal of execution, the parties thereto are exonerated of their obligations. Thus, none of the parties can seek performance from the other. In the case of a voidable contract, the party aggrieved may or may not opt to repudiate the transaction. Thus, where it prefers, in spite of his consent being not free, to abide by the transaction the other party shall also be subject to the obligations contemplated under the contract. The position shall be as if the contract was a valid contract. But where it chooses to opt out of the transaction, then all the parties shall be excused from the obligations under the contract.

Are All Unenforceable Contracts Void?

Section 2(j) does not declare every unenforceable contract void. A contract may be unenforceable either by substantive law or by procedural law or regulation. It is only that contract which is unenforceable by substantive law becomes void. In other words, 'unenforceable by law' means unenforceable by substantive law.

Example: (i) There is a contract with an alien enemy. It is illegal from its inception and therefore would be void under s.2 (g).

(ii) There is a contract with an alien friend but later on he becomes an alien enemy. Such a contract would be void under s.2.(j).

A contract may be unenforceable but not be void. Thus, a mere failure to sue within the time specified by the Limitation Act or an inability to sue by reason of the provisions of one of the orders under the Civil Procedure Code would not make the contract void.

1.8.5 Distinction between Void Agreement and Void Contract

A void agreement is unenforceable from the very beginning; whereas a void contract is valid at the time of its formation but becomes void later on.

1.9 PROPOSAL (OR OFFER) AND ACCEPTANCE [SS.3-9]

Offer is not only one of the essential elements of a contract but it is the basic building block also. An offer is synonymous with proposal. The offeror or proposer expresses his willingness "to do" or "not to do" (i.e., abstain from doing) something with a view to obtain acceptance of the other party to such act or abstinence [s.2 (a)]. Thus, there may be 'positive' or 'negative' acts which the offeror is willing to do.

Example: (i) Anna offers to sell a book to Begum. Anna is making an offer to do something, i.e., to sell a book. It is a positive act on the part of the offeror.

(ii) Amin offers not to file a suit against Bedi, if the latter pays Amin the amount of ₹ 10,000 outstanding. Here the act of Amin is a negative one i.e., he is offering to abstain from filing a suit.

An offer is made with a view to obtaining the assent of the offeree to the proposed act or abstinence. In Example (i) Anna is making an offer to sell a book with a view to obtaining the assent of Begum. Similarly, in Example (ii), Amin is making an offer to Bedi with a view to obtaining Bedi's assent thereto.

1.9.1 Modes of Making an Offer

An offer can be made by any act or omission of party proposing by which he intends to communicate such proposal or which has the effect of communicating it to the other (s.3). An offer can be either expressed or implied, and specific or general.

- ***Express offer:*** It means an offer made by words (whether written or oral). The written offer can be made by letters, telegrams, telex messages, advertisements, etc. The oral offer can be made either in person or over telephone.
- ***Implied offer:*** It is an offer made by conduct. It is made by positive acts or signs so that the person acting or making sign means to say or convey something. However, silence of a party can, in no case, amounts to offer by conduct.
- ***Offer by abstinence:*** An offer can also be made by a party by omission to do something. This includes such conduct or forbearance on one's part that the other person takes it as his willingness or assent.
- ***Specific and general offers:*** An offer can be made either to (i) A definite person or a group of persons, or to (ii) the public at large. An offer made either to a definite person or a group of persons is a specific offer. The specific offer can be accepted by that person to whom it has been made. Thus, if a real estate company offers to sell a flat to Amar at a certain price, then it is only Amar who can accept it. The offer made to the public at large is a general offer. A general offer may be accepted by any one by complying with the terms of the offer. The celebrated case of *Carlill v Carbolic Smoke Ball Co* (1813) 1 Q.B.256 is an excellent example of a general offer.
- ***Philosophy underlying general offers:*** General offer creates for the offeror a liability in favour of any person who happens to fulfill the conditions of the offer. It is not at all necessary for the offeree to be known to the offeror at the time. When the offer is made; he may be a stranger, but by complying with the conditions of the offer, he is deemed to have accepted the offer.
- ***Implied offer:*** An offer, implied from the conduct of the parties or from the circumstances of the case, is known as implied offer.

Some examples of different types of offers:

(i) A real estate company proposes, by a letter, to sell a flat to Rajiv at a certain price. This is an offer by an act by written words (i.e., letter). This is also known as an express offer.

(ii) If the company proposes, over telephone, to sell the flat to Rajiv at a certain price then this is an offer by an act (by oral words). This is an express offer.

(iii) A company owns a fleet of motor boats for taking people from Mumbai to Goa. The boats are in the waters at the Gateway of India. This is an offer by conduct to take passengers from Mumbai to Goa. Even if the in-charge of the boat does not speak or call the passengers, the very fact that the motor boat is in the waters near Gateway of India signifies company's willingness to do an act with a view to obtaining the assent of other(s) (i.e., would-be passengers). This is an example of an implied offer.

(iv) Akbar, a creditor, offers not to file a suit against Begum, a debtor, if the latter pays him the amount of ₹ 2000 outstanding. This is an offer by abstinence or omission to do something.

1.9.2 Difference between Offer and Invitation to Offer

An offer is to be distinguished from an invitation to offer. A prospective shareholder by filling up a share application form, usually attached to the prospectus, is making the offer. An auctioneer at the time of auction inviting offers from the bidders is not making an offer. The price lists, catalogues and inviting tenders and quotations are mere invitations to offer. Likewise a display of goods with a price tag on them in a shop window is construed an invitation to offer and not an offer to sell.

Example: In a departmental store, there is self-service. The customers pick up articles and take to the cashier's desk to pay. The customer's action in picking up a particular article is an offer to buy. As soon as the cashier accepts payment, a contract is entered into. However, there are certain exceptions to this. Thus, where a store advertises that it will give a free gift or a special discount to "the first 100 customers" or something like that, it may be anything that requires special effort on the part of the customer. If so, the store has made an offer which he may accept by being among the 100 customers. Similarly, sale promotion schemes requiring customers to do anything special are offers.

1.9.3 Essentials of a Valid Offer

- ***The terms of the offer must be definite, unambiguous and certain or capable of being made certain.*** If the terms of the offer are loose, vague, ambiguous or uncertain, it is not a valid offer.
- ***An offeree must have knowledge of the offer before he can accept it.*** The offer must be communicated to the other party. The communication of offer is complete only when it comes to the knowledge of the offeree. If the offer is lost on the way in transit it is no offer. This is true of specific as well as general offers.
- ***An offer cannot contain a term the non-compliance of which may be assumed to amount to acceptance.*** An offeror cannot say that if the offeree does not accept the offer within two days the offer would be deemed to have been accepted. Such a burden cannot be imposed on the offeree. It is for the offeree to accept the offer or not; and therefore, he may communicate his acceptance accordingly.
- ***If a person makes a statement without any intention of creating a binding obligation this does not amount to an offer.*** It is only a mere declaration of intention to offer. For example, an auctioneer, *L*, advertised that a sale of office furniture would take place at a particular place on a stated day. *H* travelled down about 100 km. to attend the sale but found the furniture was withdrawn from the sale. He claimed compensation from the auctioneer. ***Held***, that auctioneer was not liable.
- Where two parties make identical offers to each other in ignorance of each other's offer this does not result in a contract. Such offers are known as cross offers and neither of the two can be called an acceptance of the other.
- The offer must be made with a view to obtain acceptance thereto.
- The offer must be made with the intention of creating legal relationship. An offer of a purely social or domestic nature is not a valid offer.
- The offer must be communicated to the offeree before it can be accepted. This is true of both specific and general offers.

- If no time is fixed by the offeror within which the offer is to be accepted, the offer does not remain open for an indefinite period. Where no time is specified, then the offer is to be accepted within a reasonable time. Thus, if no time is specified then the offer lapses after a reasonable time. What is a reasonable time is a question of fact and would depend upon the circumstances of each case.
- An offer must be distinguished from a mere invitation to offer.

1.9.4 Irrevocable Offers

Generally, a proposer specifies a period within which the offeree must accept. Thus, if *A* makes an offer to *B* on 1 June, valid up to 6 June, but revokes it on 5 June, before its acceptance by B the revocation is effective, and the offeree has no remedy. However, the courts will bind an offeror to his promise to hold an offer open in exchange for a consideration given by the offeree. For instance, in the above case, if *B* had given some consideration to *A* to keep the offer open, then A could not revoke the same before the specified time. Sometimes such contracts are called "option contracts".

1.9.5 Revocation of Offer

There are many reasons due to which the offer lapses or is revoked such as: (i) An offer is revoked by the death or insanity of the proposer, if the fact of his death or insanity comes to the knowledge of the acceptor before acceptance. Therefore, if the acceptance is made in ignorance of the death, or insanity of the offeror, there would be a valid contract, (ii) An offer lapses by the death or insanity of the offeree before acceptance, (iii) An offer terminates when rejected by the offeror, (iv) An offer terminates when revoked by the offeror before acceptance by the offeree, (v) An offer terminates by not being accepted in the mode prescribed, or if no mode is prescribed, in some usual and reasonable mode (or manner), (vi) A conditional offer terminates when the condition is not accepted by the offeree, (vii) An offer terminates by counter-offer by the offeree.

1.9.6 Meaning of a Counter-offer

When in place of accepting the terms of an offer as they are, the offeree accepts the same subject to certain conditions or qualifications, he is said to make a counter offer. For example, an offer to sell rice was accepted by the offeree with an endorsement on the Sold and Bought Notes that yellow and wet grain will not be accepted [*Ali Shain v. Moothia Chetti,* 2 Bom L R 556]. *Held*, there was no contract.

1.9.7 Special Terms in a Contract

Many times, there are certain special terms, which form part of the offer, but they are not duly brought to the notice of the offeree (i.e., consumer or a customer or a client), at the time the offer is made. If these special terms are not brought to the customer's notice, then there is no valid offer. In case the offer is accepted, and the contract is formed, the customer is not bound by the special terms. The terms may be brought to the customer's notice either (i) by drawing his attention to them specifically or (ii) by inferring that a man of ordinary prudence could find them by exercising ordinary diligence.

The examples of the first case are where certain conditions are written on the back of a ticket for a journey or deposit of luggage in a cloak room and the words, "For conditions see back" are printed on the face of it. In such cases, the acceptor, i.e., the person buying the ticket is bound by whatever conditions are written on the back of the ticket whether he has read them or not.

An example of the second case is where the conditions forming part of the offer are printed in a language not understood by the offeree but his attention has been drawn to them in a reasonable manner. In such a case, the law imposes an obligation upon the offeree to ask for the translation of the conditions. If he fails to do so, it is presumed that he has constructive notice of these special terms and he will be bound by them.

However, if the special conditions forming part of an offer are contained in a document which is delivered after the contract is complete, then the customer is not bound by them. Such a document is considered a non-contractual document as it is not supposed to contain the conditions of the contract.

1.9.8 Acceptance of an Offer

When the person to whom the offer is made signifies his assent thereto, the offer is said to be accepted [s.2(b)]. Thus, acceptance is the act of giving consent to the proposal. The offeree is deemed to have given his acceptance when he gives his assent to the proposal. The acceptance of an offer may be expressed or implied. It is expressed when the acceptance has been signified either in writing or by words of mouth or by performance of some required act of the offeree. The acceptance by performing the required act may be exemplified with reference to *Carlill v. Carbolic Smoke Ball* Co. case (supra).

Examples: (i) A shopkeeper received an order from a customer – a household lady. He executed the order by sending the goods. The customer's order for goods constitutes the offer which was accepted by the shopkeeper by sending the goods. It is a case of acceptance by conduct. Here the shopkeeper is accepting the offer by the performance of the act (i.e., sending the goods).

(ii) *A* loses his dog and announces a reward of ₹ 500 to anyone who brings his dog to him. *B* need not convey his acceptance of the offer, which is a general one. If he finds the dog and gives it to *A*, he is entitled to the reward as he accepted the offer by doing the required act.

1.9.9 Implied Acceptance

Acceptance is implied when it is said to be gathered from the surrounding circumstances or the conduct of the parties.

Examples: (i) *A* enters into a bus to reach his destination and takes a seat. From the very nature of the circumstance the law will imply acceptance on the part of *A*.

(ii) *A*'s scooter goes out of order and he is stranded on a lonely road. *B*, the mechanic who observes this starts rectifying the fault. *A* allows *B* to do the same. From the nature of the circumstances *A* has given his acceptance to the offer of *B*.

Who can accept an offer?

We have mentioned earlier that a specific offer can be accepted only by the person to whom it is made. The rule of law is that if A wants to enter into a contract with B then C cannot substitute himself for B without A's consent. However in the case of a general offer it can be accepted by anyone by complying with the terms of the offer.

Examples: (i) *A* purchased *B*'s business. Prior to the purchase, *A* was working as the manager of *B*. *C*, to whom *B* owed a debt, placed an order with the latter for the supply of certain goods. *A* supplied the goods even though the order was not addressed to him. *C* refused to pay *A* for the goods because he, by entering into contract with *B*, intended to set-off his debt against *B*. Held, the offer could be accepted by *B* only and not by anyone else. [Boulton v. Jones 157 ER 232].

(ii) The case of *Carlill v. Carbolic Smoke Ball Co.* (*Supra*) illustrates that a general offer can be accepted by anyone by complying with the requirements of the offer.

1.9.10 Essentials of a Valid Acceptance

The following are the essentials of a valid acceptance: (i) It must be absolute and unqualified and according to the exact terms of the offer (s.7). (ii) It must be communicated to the offeror, (iii) It must be according to the mode, if any, prescribed by the offeror (s.7). (iv) It must be given within the time specified, if any, otherwise it must be given within a reasonable time, (v) It must be made before the offer lapses or is terminated, revoked or withdrawn. If the offer has already lapsed then there is nothing to accept, (vi) It must be given by the person to whom the offer is made. However, in the case of a general offer, acceptance can be given by any member of the public.

1.9.11 Meaning of the Phrase "Acceptance must be Absolute and Unqualified"

Acceptance must be according to the exact terms of the offer. An acceptance with a variation however slight is no acceptance and may amount to a mere counter offer which the original offeror may or may not accept. *A*, a furniture maker, offers to sell *B*, a dining table for ₹ 2,000. *B* replied, "I can pay ₹ 1,800 for it". The offer of *A* is rejected by *B* as the acceptance is qualified. However, *B* subsequently changes his mind and is prepared to pay ₹ 2,000. This also will be treated as a counter offer and it is up to *A* to accept the same or not.

Examples: (i) *A* offered to sell his land to *B* for ₹ 50,000. *B* replied purporting to accept and enclosed ₹ 10,000 promising to pay the balance of ₹ 40,000 by monthly instalments of ₹ 5,000 each. *Held,* that *B* could not enforce acceptance because his acceptance was not unqualified.

(ii) *A* offers to sell his house to *B* for ₹ 5,00,000. *B* replies, "I am prepared to buy your house for ₹ 5,00,000 provided you purchase my Maruti Car for ₹ 2,00,000". There is no acceptance on the part of *B*.

However, if some conditions are implied as a part of the contract and the offeree accepts the offer subject to those conditions the acceptance will be treated as valid.

Example: *A*, a real estate company, offers to sell a flat to *B* and *B* agrees to purchase it, subject to the title to the flat being approved by *B*'s solicitor. The acceptance by *B* is absolute and not qualified as it is presumed that *A* has a title to the property and it was not necessary for *A* to mention anything about the title.

Acceptance of an offer is "Subject to a contract" or "Subject to a formal contract", or 'Subject to a contract to be approved by solicitors". The significance of these words is that the parties do not intend to be bound and are not bound until a formal contract is prepared and signed by them. The acceptor may agree to all the terms of the offer and yet decline to be bound until formal agreement is drawn up.

Examples: (i) *C* accepted *E*'s offer to sell four items of antique furniture for ₹ 44,000 subject to a proper contract to be prepared by the vendor's solicitors. A contract was prepared by *C*'s solicitors and approved by *E*'s solicitors but *E* refused to sign it. *Held,* there was no contract as the agreement was only conditional [*Chillingworth v. Esche* (1924) 1 Ch. 97].

(ii) *E* bought a flat from a real estate company "subject to a contract". The terms of the formal contract were agreed and each party signed his part. *E* posted his part but the company did not post its part as it changed its mind in the meantime. *Held,* that there was no binding contract between the parties [*Eccles v. Bryant* (1948) Ch. 93].

A mere Mental Acceptance is no Acceptance

Acceptance must be communicated to the offeror. The communication of acceptance may be expressed or implied one. A mere mental acceptance is no acceptance. A mere mental acceptance means that the offeree is assenting to an offer in his mind only and therefore there is no communication of acceptance to the offeror.

Example: *A*, a supplier, sent a draft agreement relating to the supply of coal and coke to the manager of a railway company for his acceptance. The manager wrote the word 'approved' on the same and put the draft in the drawer of his table intending to send it to the company's solicitors for a formal contract to be drawn up. By an oversight, the draft agreement remained in the drawer. *Held*, there was no contract as the manager had not communicated his acceptance to the proposer.

Effect of Silence of the Offeree or his Failure to Reply

The acceptance of an offer cannot be implied from the silence of the offeree or his failure to reply.

Example: *A* offered by a letter to buy his nephew's T.V. set for ₹ 3,000, saying, "If I hear no more from you, I shall consider the T.V. set is mine at ₹ 3,000". The nephew did not reply at all, but he told an auctioneer who was selling his T.V. set, not to sell that particular T.V. set as he had sold it to his uncle. By mistake, the auctioneer sold the set. *A* sued the auctioneer for conversion. *Held*, *A* could not succeed as his nephew had not communicated acceptance and therefore there was no contract. However, if the offeree has by his previous conduct indicated that his silence means that he accepts then the acceptance of the offer can be implied from the silence of the offeree. Further, in the case of a general offer it is not necessary to communicate the acceptance if it is made by acting upon the terms of the offer [*Carlill v. Carbolic Smoke Ball Co, Supra*].

Acceptance must be According to the mode Prescribed [s. 7]

Where the offeror prescribes a particular mode of acceptance then the acceptor should follow that mode. In case no mode of acceptance is prescribed by the offeror, then the acceptance must be according to some usual and reasonable mode. If the offeror prescribes a manner in which the offer is to be accepted and the acceptance is not made in such manner, the offeror may, within a reasonable time, after the acceptance is communicated to him, insist that his offer shall be accepted in the prescribed mode and not otherwise, but if he fails to do so he is deemed to have agreed to the acceptance.

Example: *A* sends an offer to *B* through post in the usual course. *B* should make the acceptance in the "usual and reasonable manner" as no mode of acceptance is prescribed. He may accept the offer by sending a letter through post in the ordinary course within a reasonable time. However, if *A* had asked for an acceptance by telegram then *B* should accept the offer by telegram. In case *B* accepts the offer by a letter then *A* may insist that the acceptance should be in the prescribed mode. But if *A* (the offeror) does not insist within a reasonable time that the acceptance be in the prescribed mode, then he is bound by the acceptance though not made in the prescribed mode.

An Agreement to Agree in the Future (Futuristic Agreements)

Law does not allow making of an agreement to agree in the future. The parties must agree on terms of the agreement. The terms of the agreement must be either definite or capable of being made definite without further agreement of the parties.

1.10 COMPLETION OF COMMUNICATION OF OFFER AND ACCEPTANCE [S.4]

It is necessary to communicate offer to the offeree and the acceptance to the offeror. When is the communication considered to be completed? The communication of an offer is complete when it comes to the knowledge of the person to whom it is made. Where *A* proposes by a letter to sell his car to *B* at a certain price, the communication of the offer is complete when *B* receives the letter. The completion of communication of acceptance has two aspects, viz; (i) As against the offeror and (ii) As against the acceptor. The communication of acceptance is complete (i) As against the offeror when it is put into a course 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 of the offeror. Thus, in the above example, if *B* accepts *A*'s offer by sending a letter through post, then the communication of acceptance is complete (i) As against *A* when the letter is posted by *B*; and (ii) As against *B* when the letter is received by *A*.

1.10.1 Revocation of Offer and Acceptance [s.5]

It is possible for the offeror to revoke the offer before it is accepted by the offeree but not later. Similarly, the offeree may revoke acceptance, till the communication of acceptance is complete as against him but not later. Thus, in the above example *A* may revoke his offer at any time before or at the moment, when *B* posts his letter of acceptance, but not afterwards. *B* may revoke his acceptance at any time before or at the moment when the letter communicating reaches A, but not afterwards. The communication of a revocation (of an offer or an acceptance) is complete--- (i) As against the person who makes 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. In the above example, *A* may revoke his offer by telegram. The revocation is complete--- (i) As against *A* when the telegram is dispatched; (ii) As against *B* when *B* receives it. *B* may revoke his acceptance by a telegram. *B*'s revocation is complete as against *B*, when the telegram is dispatched, and as against A when it reaches him.

1.10.2 Contracts Over Telephone or through Telex, Fax/e-mail

One may enter into contracts either (i) When he is face to face with another person or (ii) Over telephone or (iii) through telex or (iv) through Postal. When one is face to face with another person, the contract comes into existence immediately after the negotiations are completed with the process of offer and acceptance. Contracts over telephone are just like contracts face to face. But the offeree must make it sure that his acceptance is received by the offeror otherwise there will be no contract, as communication of acceptance is not complete.

1.11 CAPACITY TO CONTRACT [SS.10-12]

1.11.1 Persons who are Competent to Contract

Any one cannot enter into a contract; he must be competent to contract according to the law. Every person is competent to contract if he (i) is 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 (s.11). Thus, there may be a flaw in the capacity of parties to the contract. The flaw in capacity may be due to minority, lunacy, idiocy, drunkenness, drug addiction or status. If a party to a contract suffers from any of these flaws the contract may not be a valid one. If the contract would have been allowed to be a valid one then it would result in one party being at a disadvantage in the bargaining process.

1.11.2 Capacity of a Minor to Enter into a Contract

Age of a person determines enough maturity to make a contract. The contract law defines maturity as the age of majority. That usually is 18 years. Does this mean that a minor is not competent to contract? No, a minor may make a contract, but he is not bound by the contract; however the minor can make the other party bound by the contract. Thus, a minor is not bound on a mortgage or a promissory note, but he can be a mortgagee, a payee, or an endorsee. He can derive benefit under the contract. However, an agreement with a minor cannot be ratified by him on his attaining majority so as to make him bound by the same. Further, if he has received any benefit under the contract, the minor cannot be asked to refund the same. In fact he is always allowed to plead minority and is not stopped to do so even where he had procured a loan or entered into some other contract by falsely representing that he was of full age. It is to be noted that if money lent to him or an item sold to him could be traced then the court may, on equitable grounds, ask the minor to return the same to the lender or the seller, as the case may be as a minor does not have the liberty to cheat. In the case of a fraudulent misrepresentation of his age by the minor, inducing the other party to enter into a contract, the court may award compensation to the other party under Ss.30 and 33 of the Specific Relief Act, 1963.

Further, a minor cannot be a partner in a partnership firm. However, he may with the consent of all the partners for the time being, be admitted to the benefits of partnership (s.36, the Indian Partnership Act, 1932). Also, a minor can act as an agent and bind his principal by his acts without incurring any personal liability.

Section 68 provides that a minor's estate is liable to a person who supplies necessaries of life to a minor, or to one whom the minor is legally bound to support, according to his station in life, not on the basis of any contract, but on the basis of an obligation resembling a contract. However, there is no personal liability of a minor for the necessaries of life supplied. The definition of a "necessary of life" depends entirely on the person and the situation. It probably will always include food and probably will never include a car. In order to entitle the supplier to be reimbursed from the minor's estate, the following must be satisfied: (i) The goods are 'necessaries', for that particular minor having regard to his conditions in life (or status or standard of living) and that purchase or hire of a car may be 'necessary' for a particular minor; (ii) The minor needs the goods both at the time of sale and delivery. What is required to consider are---the minor's actual requirements at the time of sale and at the time of delivery, where these are different.

A 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 a 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.

A minor's parents/guardians are not liable to his creditors for the breach of a contract by him whether the contract is for necessaries of life or not. However, the parents would be liable where the minor is acting as their agent.

The position of minors' contract may be summed up as follows:

- A contract with a minor is void, and a minor, therefore cannot bind himself by a contract. A minor is not competent to contract. In Mohiri Bibi vs. Dharmodas Ghosh the facts were as follows:

- Dharmodas Ghosh, a minor, entered into a contract for borrowing a sum of ₹ 20,000 out of which the lender paid the minor a sum of ₹ 8000. The minor executed a mortgage of his property in favour of the lender. Subsequently, the minor sued for setting aside the mortgage, the court ordered for setting aside the mortgaged. The mortgagee, prayed for refund of ₹ 8000 by the minor. Held, further that as a minor's contract is void, any money advanced to a minor cannot be recovered.
- *A minor can be a promisee or a beneficiary*: During his minority, a minor cannot bind himself by a contract, but he may enforce a contract for his benefit. Thus, a minor is incapable of making a mortgage, or a promissory note, but he is not incapable of becoming a mortgagee or a payee he can derive benefit under the contract.
- A minor's agreement cannot be ratified by the minor on his attaining majority as the agreement is void *ab initio* (From the beginning).
- If a minor has received any benefit under a void contract, he cannot be asked to refund the same (see Mohisi Bibi's case given above).
- A minor is always allowed to plead minority, and is not estopped to do so even where he had procured a loan or entered into some other contract by falsely representing that he was of full age.
- A minor cannot be a partner in a partnership firm. However, a minor may, with the consent of all the partners for the time being, he admitted to the benefits of partnership (section 36, the Indian Partnership Act; 1932).
- A minor's estate is liable to a person who supplies necessaries of life to a minor, or to one whom the minor is legally bound to support, according to his station in life. This liability of the minor is not on the basis of any contract, but on the basis of an obligation resembling a contract. However, there is no personal liability of a minor for the necessaries of life as supplied.
- A minor's parents/guardians are not liable to a minor's creditor for the breach of contract by the minor, whether the contract is for necessaries or otherwise. However, the parents are liable where the minor is acting as their agent.

1.11.3 Mental Incompetence Prohibits a Valid Contract

A person who is not of sound mind may not enter into a contract; he must be of sound mind so as to be competent to make a contract. A test of soundness of mind has been laid down by law. A person is said to be of unsound mind for the purpose of making a contract if at the time he makes it, is incapable of, understanding it and of forming a rational judgement as to its effect upon his interests. A person who is usually of unsound mind but occasionally of sound mind may make a contract when he is of sound mind (s.12).

Example: (i) A patient is in a lunatic asylum. He is, at intervals, of sound mind. He may contract during those intervals.

(ii) A sane person, who is delirious from fever or who is so drunk that he cannot understand the terms of a contract or form a rational judgement as to its effect on his interests, cannot contract whilst such delirium or drunkenness lasts.

The soundness of a person depends on two facts: (i) his capacity to understand the terms of the contract, and (ii) his ability to form a rational judgement as to its effect upon his interests. If a person is incapable of both, he suffers from unsoundness of mind. Idiots, lunatics and drunken persons are examples of those having an unsound mind. But whether a party to a contract, at the time of entering into the contract, is of

sound mind is a question of fact to be taken into account by a court. There is a presumption that a person is sane but this presumption is rebuttable. The person interested in proving the unsoundness of a person has to satisfy the court.

The liability for necessaries of life supplied to persons of unsound mind is the same as for minors.

A lunatic is a person who is mentally deranged due to some mental strain or other personal experience. However, he has some lucid intervals of mind. As regards contracts entered into during lucid intervals he is bound. However, he is not liable for contracts entered into while he is of unsound mind. In general his position is identical with that of a minor i.e., the contract is void but the same exceptions as discussed above (under minor's contracts) are relevant.

An **idiot** is a person who is of unsound mind, permanently. He does not have lucid intervals. He is incapable of entering into a contract and therefore a contract with an idiot is void. However, like a minor, his property, if any, shall be liable for necessaries of life supplied to him. Also he can be a beneficiary.

A person who is **drunk, intoxicated or delirious** from fever so as to be incapable of understanding the nature and effect of an agreement or form a rational judgement as to its effect on his interests cannot enter into valid contracts whilst such drunkenness or delirium lasts. Thus, an intoxicated person may get out of a contract provided he did not have mental capacity to understand what he was doing and to appreciate its effects on his interests at the time when he made the contract.

Sometimes a person may not be competent to contract because of his **status**. Such an incompetency to contract may arise from either political, corporate, legal status, etc.

1.11.4 Alien Enemy (Political Status)

An **alien** is a person who is a citizen of a foreign country. In Indian context, an alien is a person who is not a citizen of India. An alien may be – (i) an alien friend or (ii) an alien enemy. An alien friend, whose country is at peace with the Republic of India, has usually the full contractual capacity of a natural born subject. In case of contracts with an alien enemy (i.e., an alien whose country is at war with India) the position may be studied under two heads; (a) contracts during the war; and (b) contracts made before the war. During the subsistence of the war an alien can neither contract with an Indian subject nor can he sue in an Indian court except by licence from the Central Government. As regards to contracts which are against the public policy or are such which would benefit the enemy, stand dissolved. Other contracts (i.e., not against public policy) are merely suspended for the duration of the war, and are revived after the war is over provided they have not already become time-barred under the law of limitation. Further an Indian, who resides voluntarily or who is carrying on business in a hostile territory, would be treated as an alien enemy.

However, an alien friend, whose country is at peace with the Republic of India, has usually, the full contractual capacity of a natural born Indian subject. But he cannot acquire property on any Indian Ship, and also cannot be employed a Master or any other Chief Officer of such a ship.

1.11.5 Foreign Sovereigns and Ambassadors (Political Status)

Foreign sovereigns and accredited representatives of a foreign state or Ambassadors can enter into contracts and enforce those contracts in our courts. However, they enjoy some special privileges. They cannot be sued in our courts unless they choose to submit themselves to the jurisdiction of our courts. In fact they cannot be proceeded against in Indian courts without the sanction of the Central Government.

A company incorporated under the Companies Act, 1956, or a statutory corporation brought into existence by passing a Special Act of Parliament (corporate status). A company cannot go beyond its objects mentioned in its memorandum of association. The company's activities are confined strictly to the objects mentioned in its memorandum, and if they go beyond these objects, then such activities are *ultra vires* and void, and cannot be ratified even by the assent of the whole body of shareholders. Also, a statutory corporation cannot go beyond the objects mentioned in the Special Act of Parliament. Similarly, Municipal Corporations (local bodies) are disqualified from entering into contracts which are not within their statutory powers.

1.11.6 Insolvent Persons (Legal Status)

A person adjudicated as **insolvent** is incompetent to contract until he obtains a certificate of discharge from the court.

1.12 CONSENT AND FREE CONSENT

1.12.1 Meaning of Consent

We have seen earlier that an offer by one party is accepted by the other party. The consent of the offeree to the offer by the offeror is necessary. It is essential to the creation of a contract that both parties agree to the same thing in the same sense. When two or more persons agree upon the same thing in the same sense they are said to consent. According to section 13 of the Indian Contract Act this means *"that the people agree on the same thing and in the same sense"*. It also means that there is consent on the acceptance of an offer. **When there is no consent, there cannot be a contract.**

Examples: (i) '*A*' agrees to sell his Maruti car Delux model for ₹ 1.20 lakhs. '*B*' agrees to buy the same. There is a valid contract since '*A*' and '*B*' have consented to contract on the same subject matter.

(ii) *A* who owns two Maruti cars, offers to sell one, say, yellow-coloured, to *B* for ₹ 1.20 lakhs. *B* agrees to buy the car for the price thinking that *A* is selling the other car, red coloured. There is no consent and hence no contract. *A* and *B* have agreed not to the same thing but are thinking of different coloured cars.

(iii) *A* signed a promissory note which he was told was a letter of guarantee. He was held not liable on the promissory note, as there was no consent and consequently no agreement entered into by him.

1.12.2 Free Consent

For a contract to be valid it is not only necessary that the parties consent but also that they consent freely. Where there is consent but no free consent the contract is voidable at the option of the party whose consent was not free. Thus, free consent is one of the essentials of a valid contract.

Free Consent is one of the essential elements of a valid contract. The essence of this requirement is that a person should enter into an agreement with a free as well as an open mind and without any fear. If anyone has not allowed the other party the freedom of expression, the agreement will not be fair. No person under law is compelled to enter into a contract and be bound by any obligations pertaining to it without his/her free consent.

Section 10 of the Indian Contract Act states, *"that a valid contract should have the free consent of both the parties entering into the contract"*. This means that in a contract not only should there be consent but it should also be free consent.

"All agreements are contracts if they are made by the free consent of the parties."

1.13 ESSENTIALS OF CONSENT

Essentials of Consent are given below:

1. ***Parties must be Agreeing on the same thing:*** "Same thing" refers to the whole subject-matter of the agreement whether it consist wholly or in part of an act (ex. delivery of some material object) or promise to do or abstain from doing something. If the parties have different things in mind or the parties though agree upon a thing but do so in different sense, it is not said to be a real consent and agreement.
2. ***Parties must Agree in the same sense:*** If one of the parties to an apparent contract, by his own fault enters into it in a sense different from that in which it was understood by the other party he may be precluded from setting up that there was no agreement in the same sense.
3. ***Parties Expressions must be in agreement:*** The purpose of the great majority of contracts is to effect an exchange of promises, or of certain performances. To attain this purpose, there must be mutual expressions of assent to the exchange.

1.14 ESSENTIALS OF FREE CONSENT

A consent is said to be free when it is not caused by: (i) coercion, (ii) undue influence, (iii) fraud, (iv) misrepresentation or (v) mistake.

1.14.1 Meaning of Coercion (Ss. 15 and 72)

Coercion is – (i) the committing or threatening to commit any act forbidden by the Indian Penal Code or (ii) the unlawful detaining or threatening to detain any property to the prejudice of any person whatever with the intention of causing any person to enter into an agreement. [s.15].

Example: *A* threatens to kill *B* if he doesn't transfer his house in *A*'s favour for a very low price. The agreement is voidable for being the result of coercion.

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

Example: *A* threatens to kill *B* (*C*'s son) if *C* does not let his house to *A* and thereupon *C* gives his consent. This consent is no consent in the eye of law as the agreement is caused by coercion.

Is Threat to Commit Suicide Coercion?

The doubt arises because suicide, though forbidden by the Indian Penal Code, is for obvious reasons not punishable. A dead person cannot be punished. But, since s.15 declares that committing or threatening to commit any act forbidden by the Indian Penal Code is coercion, a threat to commit suicide should obviously be so regarded (suicide being forbidden).

Example: *A* obtained a release deed from his wife and son under a threat of committing suicide. The transaction was set aside on the ground of coercion [*Ammiraju v. Seshamma* (1917) 41 Mad.33].

Effect of Coercion on the Validity of Contract (s.19A)

When consent to an agreement is caused by coercion the agreement is voidable at the option of the party whose consent was so obtained. Thus, the aggrieved party can have the contract set aside if he so desires otherwise the contract is a valid one. However, a person, to whom money has been paid or anything delivered under coercion, must repay or return it to the other party (s.72).

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

1.14.2 Meaning of Undue Influence (s.16)

Undue influence consists in the improper exercise of power over the mind of one of the contracting parties by the other. A contract is said to be induced by undue influence where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

Example: A, a man enfeebled by disease or age, is induced by *B*'s influence over him as his medical attendant to agree to pay *B* an unreasonable sum for his professional services, *B* employs undue influence.

Presumption of Undue Influence as Regards Persons in Particular Relationships

After reciting the general principle of undue influence, s.16 lays down rules of presumption as regards persons in particular relations. It reads: A person is deemed to be in a position to dominate the will of another: (i) where he holds a real or apparent authority over the other or where he stands in a fiduciary relation to the other or (ii) where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily stress. Some of the relationships which raise a presumption of undue influence are: (a) parent and child; (b) guardian and ward; (c) doctor and patient; (d) spiritual guru and disciple; (e) lawyer and client; (f) trustee and beneficiary. However, the presumption of undue influence can be rebutted by showing that the party said to have been influenced had independent legal advice of one who had full knowledge of the relevant facts.

Example: A Hindu, well advanced in age, with the object of securing benefits to his soul in the next world, gave away his whole property to his spiritual guru. Undue influence was presumed.

There is no presumption of undue influence in the relationships between---(i) husband and wife; (ii) master and servant; (iii) creditor and debtor; (iv) landlord and tenant.

Party on whom lies the burden of proving that the contract (i) was or (ii) was not induced by undue influence [s.16 (3)]: The burden of proving that the contract is not induced by undue influence lies on the party who is in a position to dominate the will of the other. Thus, in cases (above given) where undue influence is presumed the onus of proof lies on parent, guardian, doctor, spiritual guru, lawyer, trustee. On the other hand, in relationships where undue influence is not presumed the party alleging undue influence must prove that it existed.

Consequences of undue influence (s.19A). An agreement caused by undue influence is voidable at the option of the party whose consent was obtained by undue influence. However, any such contract may be set aside either absolutely or if the party who was entitled to avoid it has received any benefit there under then upon such terms and condition as the court deems fit.

Example: *A*, a money lender, advanced ₹ 1,000 to *B*, a household lady, and by undue influence induced *B* to execute a bond with interest at 8 per cent per month then the court may set the bond aside ordering *B* to repay ₹ 1,000 with such interest as the court may deem just.

Extra precautions to be taken while entering into contract with a pardanashin (the lady who remains in parda) woman. *A pardanashin* woman is one, who according to the custom of her community, observes complete seclusion. The courts in India regard such women as being especially open to undue influence. When therefore an illiterate pardanashin woman is alleged to have dealt with her property and to have executed a deed, the burden of proving that there was no undue influence was on the party setting up the deed. The law demands that the person who deals with a pardanashin lady must show affirmatively and conclusively that the deed was not only executed by, but was explained to and was really understood by the lady.

Money lending transactions. In money lending transactions the rate of interest being high, or that the borrower is in urgent need of money is not an evidence of undue influence. These two facts do not by themselves show that there is undue influence. However, if the rate of interest is so high that the court considers it unconscionable, then the burden of proving that there was no undue influence lies on the creditor.

Example: *A*, being in debt to *B*, the money lender, contracts for a fresh loan at compound interest of 25 per cent the transaction may be held to be unconscionable and a reduced rate of simple interest may be awarded.

1.14.3 Meaning of Fraud [Ss.17 and 19]

Fraud means and includes any of the following acts committed by a party to a contract with an intent to deceive the other party thereto or to induce him to enter into a contract: (i) the suggestion as a fact of that which is not true by one who does not believe it to be true; (ii) active concealment of a fact by one having knowledge or belief of the fact; (iii) promise made without any intention of performing it; (iv) any other act fitted to deceive; (v) any such act or omission as the law specifically declares to be fraudulent.

Essential Elements or Conditions for a Fraud to Exist

For a fraud to exist the following are the essential elements:

- There must be a representation or assertion and it must be false. To constitute fraud there must be an assertion of something false within the knowledge of the party asserting it. Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud. To constitute fraud ordinarily there must be active misstatement of fact as the withholding of that which is not stated makes that is stated absolutely false.
- The representation or assertion alleged to be false must be of a fact. A mere expression of opinion, puffery or flourishing description does not constitute fraud.
- The representation or statement must have been made--- (a) knowingly or (b) without belief in its truth or (c) recklessly, carelessly whether it be true or false. In (a) and (b) there seems to be no difficulty since fraud is proved when it is shown that a false representation has been made knowingly or without belief in its truth. However, with regard to reckless misstatement it may appear difficult to say whether it amounts to fraud because the person making such statement does not himself definitely know that the statement is false. But if we carefully look into it we find that it does amount to fraud. Though the person making it is not sure of the truth of the statement yet he represents to the other party as if he is absolutely certain about its truth.

- The representation, statement, or assertion must have been made with the intention of inducing the other party to act upon it. For fraud to exist the intention of misstating the facts must be to cause the other party to enter into an agreement.
- The representation must in fact deceive. It has been said that a deceit which does not deceive is not a fraud. A fraud or misrepresentation, which does not cause the consent to a contract of the party on whom such fraud is practised or to whom such misrepresentation was made, does not render a contract voidable.
- The party subjected to fraud must have suffered some loss. It is a common rule of law that there is no fraud without damages. As such a fraud without damage does not give rise to an action of deceit.

Example: *A* informs *B* fraudulently that *A*'s estate is free from encumbrance. *B* therefore buys the estate. The estate in fact is subject to a mortgage. *B* may either avoid the contract or may insist on its being carried out and the mortgage deed redeemed.

1.14.4 Meaning of Misrepresentation (Ss.18-19)

Misrepresentation is also known as simple misrepresentation whereas fraud is known as fraudulent misrepresentation. Like fraud, misrepresentation is an incorrect or false statement but the falsity or inaccuracy is not due to any desire to deceive or defraud the other party. Such a statement is made innocently. The party making it believes it to be true. In this way, fraud is different from misrepresentation. The case of misrepresentation may be classified into the following three groups: (i) 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. (ii) 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. (iii) 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.

Example: (i) '*A*' chartered a ship to '*B*' which was described in the 'Charter Party' and was represented to him as being not more than 2,800 tonnage registered. It turned out that the registered tonnage was 3,045 tons. '*A*' refused to accept the ship in fulfilment of the charter party. He would be entitled to avoid the charter party by reason of the erroneous statement as to tonnage.

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

(iii) *H* sold *W* certain animals those were suffering from severe fever, the fact of which was known to him but he did not disclose to *W*, it was held that there was no fraud (*Ward v. Hobbs* (1878) A C 13).

(iv) *A* sold to *B* by auction a horse which *A* knew to be unsound. *A* said nothing to *B* about the horse's unsoundness. This was held not to be a fraud.

Silence may in itself be equivalent to speech. Silence may in itself amount to fraud where the circumstances are such that "silence is in itself equivalent to speech".

Example: (i) Where *B* says to *A*, "if you do not deny it I shall assume that the car does not overheat" *A* says nothing. Here *A*'s silence is equivalent to speech.

(ii) A prospectus issued by a company did not refer to the existence of a document disclosing liabilities. The impression thereby created was that the company was a

prosperous one which actually was not the case. *Held,* the suppression of truth amounted to fraud [Peek v. Gurney (1873) 6 H.L.377].

However, a mere expression of opinion, puffery or flourishing description does not amount to a fraud.

Example: (i) '*A*' a seller of a vintage car says that the car is a 'beauty'. It is merely A's opinion. But in case he says that the car is worth ₹ 5 lakhs whereas he paid only ₹ 2 lakhs for it, then he has misstated a fact which may amount to fraud or simple misrepresentation.

(ii) A company issued a prospectus giving false information about the unbounded wealth of Nevada. A person buys shares on the faith of such information. Later he wants to avoid the contract. He can avoid the contract since the false representation in the prospectus amounts to fraud (*Reese River Silver Minning Co v Smith* (1869) L.R. 4 H. [664]).

1.14.5 Consequences of Fraud and Misrepresentation [s.19]

The party aggrieved or wronged has two remedies viz., (i) he can avoid the performance of the contract (ii) 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. In case of fraud he has an additional remedy, i.e., he can sue for damages.

Exceptions to the principle that the party aggrieved or wronged by misrepresentation cannot claim damages. The directors of a company are liable in damages under s.62 of the Companies Act, 1956, even for misstatements, i.e., misrepresentation in the prospectus issued by the company inviting public for subscription. Also where there exists a confidential relationship between the parties (such as solicitor and client), and negligent representation is made by one to the other then the aggrieved party may claim damages.

1.14.6 Difference between Fraud and Misrepresentation

The following are the points of difference between the two:

- In case of fraud, the party making false or untrue representation makes it with the intention to induce 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.
- Both fraud and misrepresentation make a contract voidable at the option of the party wronged. But in case of fraud, the party defrauded gets the additional remedy of suing for damages caused by such fraud. In case of misrepresentation generally the only remedies are rescission and restitution.
- In case of fraud, the defendant cannot take the plea that the plaintiff had the means of discovering the truth or could have done so with ordinary diligence. In case of misrepresentation it could be a good defense.

Cases of fraud or misrepresentation in which the contract is not voidable. There are two exceptions to the principle that the party aggrieved or wronged can avoid the contract. Firstly, where the party whose consent was caused by fraud or misrepresentation had the means of discovering the truth with ordinary diligence. Secondly, where the party after becoming aware of the fraud or misrepresentation takes a benefit under the contract or in some way affirms it.

1.14.7 Meaning of 'Mistake' [Ss.20-21]

Mistake may be defined as an erroneous belief on the part of the parties to the contract concerning something pertaining to the contract. For example, *A* agrees to buy from *B* a certain house. It turns out that the house had been destroyed by fire before the time of the bargain though neither party was aware of the fact. The agreement is void. *A* cannot insist for possession of the house. The agreement is void as there is a mistake on the part of both the parties about the existence of the subject matter.

Different Kinds of Mistake

Broadly there are two kinds of mistake: (i) Mistake of fact and (ii) Mistake of law. Further mistake of fact may be either: (a) Bilateral or (b) Unilateral. The mistake of law may be (a) mistake of law of the land and (b) mistake of foreign law. When both the parties to the agreement are under a mistake of fact essential to the agreement, the mistake is called a bilateral mistake and the agreement is void. For example, *A* agrees to sell to *B* a specific cargo of goods supposed to be on its way from London to Mumbai. It turns out that before the day of the bargain the ship conveying the cargo had been cast away and the goods lost. Neither party was aware of the facts. The agreement is void.

Some typical cases of bilateral mistake invalidating the agreement. There may be a mistake concerning subject matter as to its (i) existence, (ii) identity, (iii) title, (iv) quantity, (v) price.

Example: (i) A, who owns two fiat cars, offers to sell his 'White fiat' for ₹ 80,000. B accepts the offer thinking A is selling his 'Brown Fiat'. There is a mistake as to the identity of the subject matter.

(ii) P wrote to H inquiring the price of rifle of a particular make and suggested that he might buy as many as 30. 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 dispatched 30 rifles. Held, there was no contract between the parties who were labouring under a mistake as to the quantity of the subject matter (Henkel vs. Pape (1870) 6 Ex.7).

(iii) Where a contract of lease of a house was agreed to at a lease amount of ₹ 2300 but in the written agreement the figure 3200 was inserted by mistake the contract was held to be void.

An erroneous opinion, however, as to the value of thing which forms 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 ₹ 10,000 while it is actually worth ₹ 5,000 only. Later he wants to avoid the agreement on the ground of mistake as to the price of the subject matter. The agreement cannot be avoided on the ground of mistake. It is only erroneous opinion as to the value of the subject matter and is not deemed a mistake as to a matter of fact.

1.14.8 Meaning and Effect of 'Unilateral Mistake'

There is a unilateral mistake where only one party to a contract is under a mistake as to a matter of fact. Generally speaking, such a contract is not invalid. Thus, where a person due to his own negligence or lack of reasonable care does not ascertain what he is contracting about, he must bear the consequences.

Example: *A* sold rice to *B* by sample, and *B* thinking that they were old rice, purchased them. In fact, the rice was new. *B* cannot avoid the contract.

Exceptional Cases in which Agreement is void even when there is a Unilateral Mistake

Firstly, where the unilateral mistake is as to the nature of the contract: In *Foster vs. Mackinnon* (1869) LR 4 C.P. 704, 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. The old man did not intend to enter into the contract relating to bill of exchange but through the fault of another and without any fault of his own made a mistake as to the nature of the contract. *Secondly*, where the unilateral mistake is 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. In *Cundy vs. Lindsay and Co.* (1878) 3 App. Cas. 459, one Blenkarn, knowing that Blenkiron & Co. were the reputed customers of Lindsay & Co. ordered some goods from Lindsay & Co. by imitating the signature of Blenkiran. These goods were then sold by Blenkarn to Cundy, an innocent purchaser. In a suit by Lindsay & Co. against Cundy for recovery of goods it was held that as Lindsay & Co. never intended to contract with Blenkarn there was no contract between them and as such even an innocent purchaser of the goods from Blenkarn did not get a good title and must return them or pay their price to Lindsay & Co. Similarly, in *Lake vs. Simmons* (1927) A.C.487, a lady *X* induced *Y* to deliver possession of two pearl necklaces falsely representing that she was the wife of baron *Z* and that she wanted them to be shown to her husband for approval. *Held*, *Y* intended to contract only with the wife of the baron and not with *X* herself. Hence the contract was void and *X* could not convey any title even to a *bona fide* buyer.

Example: *N* called in person at a Jeweller's shop and chose some jewels which the jeweller prepared to sell him as a casual customer. He tendered in payment a cheque which he signed in the name *G* – a person with credit. Thereupon *N* was allowed to take away the jewels which *N* pledged with *B* who took them in good faith. Here the contract between N and the jeweller is valid. The pledgee *B* has a good title. Although the jeweller believed the person to whom he was handing over the jewels was *G*, he in fact contracted to sell and deliver to the person who came into his shop.

Thirdly, a contract may be avoided where there is a unilateral mistake as to quality of performance.

Example: A held an auction for the sale of some lots of hemp and some lots of tow. *B* thinking that hemp was being sold, bid for a lot of tow for an amount which was out of proportion to it, and was only a fair price for hemp. *B* could avoid the contract.

Mistake of Law

It may be (i) mistake of law of the land, or (ii) mistake of foreign law. In the first case the rule is "*Ignorantia juris non-excusat*" (ignorance of the law excuses not).

Meaning of "ignorantia juris non excusat". It means ignorance of law is no excuse. A contract is not voidable because it was made by a mistake as to any law in force in India. Thus, where *A* and *B* make a contract grounded on the erroneous belief, that a particular debt is barred by the Limitation Act; the contract is not voidable. (s.21) Further, "A mistake as to a law not in India has the same effect as a mistake of fact".

Mistake of foreign law. The above maxim–"ignorance of law is no excuse" is inapplicable to foreign law. The mistake of foreign law is to be treated as a mistake of fact.

Consequences of mistake on contracts. Mistake renders the contract void and as such in case of a contract which is yet to be performed the party complaining the mistake may repudiate it i.e., need not perform it. If the contract is executed the party

who received any advantage must return it or make compensation for it as soon as the contract is discovered to be void.

1.15 CONSIDERATION [SS.2 (D), 23-25,185]

1.15.1 Meaning of Consideration

One of the essential elements of a valid contract is that it must be supported by consideration. In simple terms consideration is what a promisor demands as the price for his promise. The term consideration is used in the sense of *quid pro quo*, i.e., "something in return". This something or consideration need not be in terms of money. This "something" may even be some benefit, right, interest or profit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other party. Also a promise by one party may be consideration for the promise of other party. Thus, a person who makes a promise to do something usually does so as a return of equivalent of some loss, damage or inconvenience that may have been occasioned to the other party in respect of the promise. The benefit so received, or the loss, damage or inconvenience so caused is regarded, in law, as the consideration for the promise.

Section 2 (d) defines consideration as: "When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise".

Example: '*A*' agrees to sell his motorcycle to '*B*' for ₹ 20,000. Here *B*'s promise to pay the sum of ₹ 20,000 is the consideration for *A*'s promise to deliver the motorcycle, and *A*'s promise to deliver the motorcycle is the consideration for *B*'s promise to pay ₹ 20,000.

"No Consideration, No Contract" [Ss.10 and 25]

A promise without consideration cannot create a legal obligation. A person who makes a promise to do or abstain from doing something usually does so as a return of equivalent of some loss, damage, or inconvenience that may have or may have been occasioned to the other party in respect of the promise. The benefit so received or the loss, damage or inconvenience so caused is regarded in law as the consideration for the promise.

1.15.2 Exceptions to the Rule "No Consideration, No Contract"

There are some cases where contracts, even though not supported by consideration, are enforceable. These are:

- An agreement made without consideration is valid if it is expressed in writing and is registered under the law relating to registration of documents and is made an account of natural love and affection between parties standing in a near relation to each other.
- A promise without consideration is valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promisor or something the promisor was legally compellable to do. Thus, where *A* finds *B*'s purse and gives it to him, and *B* promises to give *A* ₹ 100, this a valid contract.
- A promise to pay wholly or in part a debt which is barred by the Limitation Act can be enforced if it is in writing and is signed by the debtor or his authorised agent. A debt barred by limitation cannot be recovered. Therefore, a promise to pay such a debt is, strictly speaking, without any consideration. But if a written promise to pay is made by the debtor then the same is enforceable by the creditor.

- The rule 'no consideration: no contract' does not apply to completed gifts.
- No consideration is required in the case of an agreement between a principal and an agent (s.185).

Example: An elder brother, on account of natural love and affection, promised to pay the debts of his younger brother. The agreement was put to writing and was registered. This was held to be a valid agreement, even though there was no consideration for the promise.

1.15.3 Rules Regarding Consideration

The following rules as regards consideration emerge from the definition given in s.2 (d):

(1) Consideration must move at the desire of the promisor and therefore an act done by the promise at the desire of a third party is not a consideration.

(2) Consideration may move either from the promisee or any other person. It is not necessary that the consideration must move from the promisee. It may move from any other person. In such a situation, the promisee can maintain a suit even if he is a stranger to the consideration. But he must not be a stranger to the contract.

Capacity of a stranger to consideration to file a suit. We have seen earlier that a stranger to a contract cannot maintain a suit. However, a stranger to consideration can maintain a suit. Consideration may be supplied either by promisee or any other person.

Example: A, a lady, by a deed of gift, transferred certain property to her daughter with a direction that the daughter should pay an annuity to *A*'s brother as had been done by *A*. On the same day, the daughter executed a writing in favour of *A*'s brother agreeing to pay the annuity. Afterwards, she declined to fulfill her promise saying that no consideration had moved from *A*'s brother to her. *A*'s brother was held entitled to recover the money (*Chinnayya vs. Ramayya*, 4 Mad 137).

(3) Consideration need not be adequate. How much consideration or payment must there be for a contract to be valid, is always the lookout of the promisor. Courts do not see whether a person making the promise has recovered full return for the promise. Thus, if *A* promises to sell his pen worth ₹ 80 for ₹ 20 only the inadequacy of the price in itself shall not render the contract void. But where *A* pleads coercion, undue influence or fraud, then the inadequacy of consideration will also be a piece of evidence to be looked into.

(4) Consideration must be real and competent. A consideration for a contract must be real and not illusory. Also, the consideration must be competent, i.e., it must be something to which law attaches some value.

Example: (i) *A* promises to discover treasure by magic. The agreement is void, being illusory.

(ii) *A* received summons to appear as a witness at a trial. *B*, a party to the suit, promises to pay *A* ₹ 1000 in addition to *A*'s expenses. The promise of *B* is not enforceable as *A* was under a legal duty to appear and give evidence. The agreement is void as it is without competent consideration.

(iii) *A* promises to pay an existing debt punctually if *B*, the creditor, gives him discount. *B* agrees to give discount. The promise to give discount is without consideration and cannot be enforced.

(5) Consideration must be legal. Illegal consideration renders a contract void.

(6) A consideration may be present, past or future. A consideration which moves simultaneously with the promise is called present (or executed) consideration. 'Cash

Sales' provides an excellent example of the present consideration. Where the consideration is to move at a future date is called future or executory consideration. It takes the form of a promise to be performed in the future.

Example: *A*, a shopkeeper, promises *B*, a household lady, to deliver certain items of grocery after three days. *B* promises to pay for it on delivery.

A past consideration is something wholly done, forborne or suffered before the making of the contract.

Example: *A* saves *B*'s life. *B* promises to pay *A* ₹ 10,000 out of gratitude. The consideration for B's promise is a past consideration, something done before making of the promise.

1.16 UNLAWFUL CONSIDERATION AND OBJECT [SS.23-24]

There are certain cases in which the consideration and the object of an agreement are unlawful, thereby making it unenforceable. Section 23 defines an illegal agreement as one the consideration or object of which--- (i) is forbidden by law; or (ii) defeats the provisions of any law; or (iii) is fraudulent; or (iv) involves or implies injury to the person or property of another; or (v) the court regards it as immoral or opposed to public policy.

(i) ***Where it is forbidden by law.*** A loan granted to the guardian of a minor to enable him to celebrate the minor's marriage in contravention of the Child Marriage Restraint Act is illegal and cannot be recovered (*Srinivas vs. Raja Ram Mohan* (1951) 2. M.L.J. 264). *A* promises to drop a prosecution which he has instituted against *B* for robbery and *B* promises to restore the value of the things taken. The agreement is void as its object is unlawful. (ii) ***Where it is of such a nature that if permitted it would defeat the provisions of any law.*** *A*, let a flat to *B* at a rent of ₹ 12,000 a month. With a view to reduce the municipal tax, *A* made two agreements with *B*. One by which the rent was stated to be ₹ 4,500 only and the other by which *B* agreed to pay ₹ 7,500 for services in connection with the flat. *Held, A* could not recover ₹ 7,500 since the agreement was made to defraud the municipal authority and thus void [Alexander vs. Rayson (1939) 1K.B.169]. (iii) ***Where it is fraudulent.*** *A*, being an agent for a landed proprietor, agrees for money without the knowledge of his principal to obtain for *B*, a lease of land belonging to his principal. The agreement between *A* and *B* is void as it implied a fraud by concealment by *A*, on his principal. (iv) ***Where it involves or implies injury to the person or property of another.*** An agreement between some persons to purchase shares in a company, with a view to induce other persons to believe contrary to the fact that there is a *bona fide* market for the shares, is void. (v) ***Where the court regards it as immoral or opposed to public policy.*** *A* who is *B*'s power of attorney promises to exercise his influence as such with *B* in favour of *C*, and *C* promises to pay ₹ 5,000 to *A*. The agreement is void being against public policy.

Examples. (i) *X* agrees to buy from a jeweller certain jewellery to be delivered to him after two months. In the meantime, the government enacts a law on gold control and prohibits dealings in gold. When the time for delivery of the jewellery comes the jeweller refuses to deliver the same. What can *X* do? He has no cause of action. The contract becomes void when the law is enacted. Thus, the contract was originally valid but becomes void later on by subsequent (supervening) illegality.

(ii) A dealer enters into a contract to sell a smuggled item to *X*. The import of such type of goods is illegal under the laws of the country. *A* refuses to deliver the item as promised. What are the rights of *X*? The contract is void.

1.16.1 Agreements Declared Void [Ss.26-30]

The Act declares certain agreements to be void. Some of them (such as the following) have already been explained: (i) agreements entered into through a mutual mistake of fact between the parties (s.20). (ii) agreements the object or consideration of which is unlawful (s.23); (iii) agreements, part of consideration of which is unlawful (s.24); (iv) agreements made without consideration (s.25). Some other agreements which are declared to be void are explained below.

1.16.2 Agreements against Public Policy (Ss.26-28)

An agreement which conflicts with morals of the time and contravenes any established interest of society is void as being against public policy. Some of the agreements which are against public policy and have been declared to be void by law. These are as follows:

(i) *Trading with enemy:* All contracts made with an alien (foreigner) enemy are illegal unless made with the permission of the government.

(ii) *Agreements for stifling prosecution.* The agreements for compounding or suppression of criminal charges and for offences of a public nature are illegal and void. *A*, knowing that *B* has committed a murder, obtains a promise from *B* to pay him e.g., (*A*) ₹ 10,000 in consideration of not exposing *B*. This is a case of stifling prosecution, and the agreement is illegal and void.

(iii) *Contracts in the nature of champerty and maintenance.* Where a person, having no interest, agrees to maintain a suit on behalf of another against a third party, it is known as maintenance. It tends to encourage speculative litigation. Champerty is a bargain whereby one party is to assist another in recovering property, and in turn, is to share in the proceeds of the action. Champerty and maintenance are not illegal but courts refuse to enforce such agreements when they are found to be extortionate and unconscionable and not made with the *bona fide* object of assisting the claims of the person unable to carry on litigation himself.

(iv) *Agreement for the sale of public offices and titles are void.* Thus, where *A* promises to pay *B* ₹ 5,000 if *B* secures him an employment in the public service the agreement is void.

(v) *Agreements in restraint of parental rights are void.*

(vi) *Agreements in restraint of marriage of any person other than a minor are void.*

(vii) *Marriage brokerage (such as dowry) or brocage contracts are unlawful and void.*

(viii) *Agreements in restraint of legal proceedings are void.*

(ix) *Agreements interfering with the course of justice are void.* Any agreement for the purpose of using improper influence of any kind with judges or officers of justice is void.

(x) *Agreements in restraint of trade are void.* Thus, every agreement by which one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

Example: (i) *A* promises to render services for the conduct of litigation in consideration of payment of 50 per cent of the amount recovered through court. The agreement is legally enforceable.

(ii) *A*, a financier, promises to spend ₹ 30,000 for the consideration that a part of the estate recovered through litigation will be conveyed to him, the value of which amounted to ₹ 90,000. Though the agreement *bona fide*, it would not be enforced, the reward being extortionate and unconscionable.

1.16.3 Agreement in Restraint of Trade

Section 27 provides that "every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind is, to that extent, void". All agreements in restraint of trade, whether general or partial, qualified or unqualified, are void. It is, therefore, not open to the courts to enter into any question of reasonableness or otherwise of the restraint [*Khemchand vs. Dayaldas*, (1942) Sind, 114].

Example: (i) 29 out of 30 manufacturers of combs in the city of Patna agreed with *R* to supply him with combs and not to anyone else. Under the agreement *R* was free to reject the goods if he found there was no market for them. *Held,* agreement amounted to restraint of trade and was thus void [Shaikh Kalu vs. Ram Saran Bhagat (1909) 13 C.W.N.388].

(ii) *J*, an employee of a company, agreed not to employ himself in a similar concern within a distance of 800 miles from Chennai after leaving the company's service. *Held*, the agreement was void [*Oakes & Co. v. Jackson* (1876) 1 Mad.134].

(iii) *A* and *B* carried on business of readymade garments in a certain locality in Calcutta. *A* promised to stop business in that locality if *B* paid him ₹ 900 which he had paid to his workmen as advances. *A* stopped his business but *B* did not pay him the promised money. *Held,* the agreement was void and, therefore, nothing could be recovered on it (*Madhab Chander v. Raj Coomar* (1874) 14 Beng L.R. 76].

Cases in which restraint of trade is valid. The following are the exceptions to the above rule that a restraint of trade is void:

1. *Sale of goodwill of a business.* The seller of the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer or any one deriving title to the goodwill from him carries on a like business, provided that such limits are reasonable (s.27).

Example: *S*, a seller of imitation jewellery, sells his business to *B* and promises not to carry on business in imitation jewellery and real jewellery. *Held*, the restraint with regard to imitation jewellery was valid but not regarding real jewellery [*Gold's Roll v. Goldman* (1915) 6 Ch. 292].

2. Partners' agreement. Partners may agree that: (i) A partner shall not carry on any business other than that of the firm while he is a partner [s.11(2) Indian Partnership Act, 1932]; (ii) a partner on ceasing to be a partner will not carry on any business similar to that of the firm within a specified period or within specified local limits. The agreement shall be valid if the restrictions are reasonable [s.3 (2) Indian Partnership Act, 1932]; (iii) partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits and such agreement shall be valid if the restrictions imposed are reasonable [s.54 Indian Partnership Act, 1932]; (iv) a partner may, upon the sale of the goodwill of a firm, make an agreement that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits; and such agreement shall be valid if the restrictions imposed are reasonable [s.55 Indian Partnership Act, 1932].

3. Restrictive trade agreements. The trade combinations and restrictive trade practices are not treated as void simply because they restrain some party or the other from freedom of occupation. For instance, if a few manufacturers of a particular product want to regulate the sale price, by an agreement, but it is not against the public interest, then such an agreement would not be void. Sometimes a restrictive trade practice or agreement may be in the public interest. Section 33 of the Monopolies and

Restrictive Trade Practices Act, 1969, states that every agreement falling within one or more of the categories mentioned therein shall be deemed, for the purpose of that Act, to be an agreement relating to restrictive trade practices and shall be subject to registration under s.35 of that Act. Further, s.37 empowers the Director General of Investigation and Registration to order either the modification, or the termination, of such agreements if they go against public interest.

4. Service agreements. An agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else or directly or indirectly take part in or promote or aid any business in direct competition with that of his employer is valid [*Charles v. MacDonald* (1899) 23 Bom. 103]. Like any other contract, damages can be claimed for breach of contract of service. Section 73 (first two paragraphs) provides that the party suffering by breach of contract is entitled to receive, from the party breaking the contract, compensation for loss or damage of the specified category.

5. Service bonds. These days it is a common practice to appoint management trainees. The organisations spend a lot of time, money and energy in training them in the management techniques. So, it will be very unfair to these organizations if trainees left for other organizations immediately after training. Therefore, a service bond is normally got signed by the trainee, containing a provision that he shall not leave the organization before the expiry of a specified period and further, that if he does so, then he shall have to pay a particular sum of money to the organization. This is just to indemnify the organization which has incurred some expenditure on the training of the trainee. But if the amount of the bond is excessive and disproportionate, the court has jurisdiction to reduce that amount.

This is because of the fact that essentially, a service bond is a species of contract and the principles of the law of contracts as to penal stipulations apply to such bonds. Section 74 says that only reasonable compensation can be recovered in case of breach of contract. If the amount specified in the contract is exaggerated, the court can reduce it.

1.16.4 Restraint of Legal Proceedings (s.28)

Every person has a right to have recourse to the usual legal proceedings. Therefore, s.28 renders void an agreement by which a party is restricted absolutely from enforcing his legal rights arising under a contract by the usual legal proceedings in the ordinary tribunals.

Example: A contract contains a stipulation that no action should be brought upon it in case of breach. Such a stipulation would be void because it would restrict both parties from enforcing their rights under the contract in the ordinary tribunals.

However, an exception to s.28 provides that an agreement to refer disputes to arbitration is valid as this stipulation itself would not have the effect of ousting the jurisdiction of the courts.

Example: (i) A contract whereby it is provided that all disputes arising between the parties should be referred to an arbitrator, whose decision shall be accepted as final and binding on both parties of the contract, is not invalid.

(ii) A contract contains a double stipulation. Firstly, any dispute between the parties would be settled by arbitration. Secondly, neither party would enforce his rights under the contract in a court of law. In such a situation, the first stipulation is valid, but the second one is void.

Ousting the jurisdiction of all other courts except one. The restriction imposed upon the right to sue should be absolute in the sense that the parties are precluded

from pursuing their legal remedies in the ordinary tribunals. Thus, where there are two courts, both of which have jurisdiction to try a suit, an agreement between the parties that the suit should be filed in one of those courts alone and not in the other, does not contravene the provisions of s.28, as it is not against public policy [*Hakam Singh* vs. *Gammon* (India) Ltd; A.I.R. 1971 S.C. 740].

Limitation of time. Section 28 renders void another kind of agreement, namely, whereby an attempt is made by the parties to restrict the time within which an action may be brought so as to make it shorter than that prescribed by the Limitation Act, 1963.

Example: A clause in an agreement provides that no action should be brought after two years. However, according to the Limitation Act, 1963, an action for breach of contract may be brought within three years from the date of the breach. The clause in the agreement is void, as it is opposed to the provisions of the Limitation Act, 1963.

1.16.5 Uncertain or Ambiguous Agreements (s.29)

Agreements, the meaning of which is not certain or capable of being made certain, are void.

Example: (i) '*A*' agrees to sell to '*B*' 100 tonnes of oil. There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.

(ii) *A*, who is a dealer in coconut oil only, agrees to sell to *B* "100 tonnes of oil". The nature of A's trade affords an indication of the meaning of the words, and that *A* has entered into a contract for the sale of 100 tonnes of coconut oil.

(iii) *A* agrees to sell to *B*, "his white Maruti car for ₹1.35 lakhs or ₹1.25 lakhs". There is nothing to show which of the prices was to be given. The agreement is void.

(iv) *A* agrees to sell to *B*, "100 quintals of rice at a price fixed by *C*". As the price is capable of being made certain, there is no uncertainty to make the contract void.

1.16.6 Wagering Agreements (s.30)

"A wagering agreement", says Sir William Anson, "is a promise to give money or money's worth upon the determination of an uncertain event". Cockburn C. J. defined it as, "A contract by '*A*' to pay money to '*B*' on the happening of a given event in consideration of '*B*'s promise to pay money to '*A*' on the event not happening. Thus, a wagering agreement is an agreement under which money or money's worth is payable, by one person to another on the happening or non-happening of a future, uncertain event. The essence of gaming and wagering is that one party is to win and the other to lose upon a future event, which at the time of the contract is of an uncertain nature – that is to say, if the event turns out one way *A* will lose but it turns out the other way, he will win. An agreement by way of wager is void.

Example: (i) *A* and *B* bet as to whether it would rain on a particular day or not – *A* promising to pay ₹ 100 to *B* if it rained, and *B* promising an equal amount to *A*, if it did not. This agreement is a wager.

(ii) *A* and *B* agree to deal with the differences in prices of a particular commodity. Such an agreement is a wager.

Wagering agreement void and not illegal. In India, unless the wager amounts to a lottery, which is a crime under s.294-A of the Indian Penal Code, it is not illegal but simply void. Thus, except in case of lotteries, the collateral transactions remains enforceable.

Example: *A* borrows ₹ 500 from *B* to pay to *C*, to whom *B* has lost a bet. The contract between *A* and *B* is valid.

Lotteries. 'Lottery' is an arrangement for the distribution by chance among persons purchasing tickets. The dominant motive of the participants need not be gambling. Where a wagering transaction amounts to a lottery, it is illegal under s.294-A of the Indian Penal Code. In *Sir Dorabji Tata v. Edward F Lance* (1918) I.L.R. 42 Bom. 676, where the Government of India had sanctioned a lottery, the Court held that the permission granted by the Government will not have the effect of overriding s.30 and making such a lottery legal. Its only effect was that the persons responsible for running the lottery could not be punishable under the Indian Penal Code.

However, in *H. Anraj vs. Govt of Tamil Nadu*, AIR 1986 SC 63, the Supreme court upheld lotteries with the prior permission of the Government as legal thereby conferring upon the winner of a lottery, a right to receive the prize and the sale of lotteries subject to payment of sales tax. A sale of lottery ticket confers on the purchaser thereof two rights (a) a right to participate in the draw and (b) a right to claim a prize contingent upon his being successful in the draw.

1.16.7 Exceptions (Transactions held 'not wagers')

The following transactions have been held not to be wagers:

1. Transactions for the sale and purchase of stocks and shares, or for the sale and delivery of goods, with a clear intention to give and take delivery of shares or goods, as the case may be. However, where the intention is only to settle in price difference, the transaction is a wager and hence void.
2. Prize competitions which are games of skill, e.g., picture puzzles, athletic competitions are not wagers. Thus, an agreement to enter into a wrestling contest in which the winner was to be rewarded by the entire sale proceeds of tickets, was held not to be wagering contract (*Babalalteb vs. Rajaram* (1931) *Odham's Press* (1936)1K. 416 it was held that a crossword puzzle in which prizes depend upon correspondence of the competitor's solution with a previously prepared solution kept with the editor of a newspaper is a lottery and therefore, a wagering transaction. According to Prize Competition Act, 1955, prize competitions in games of skill are not wagers provided the prize money does not exceed ₹ 1,000.
3. An agreement to contribute a plate or prize of the value of ₹ 500 or above to be awarded to the winner of a horse race (s.30).
4. Contracts of insurance are not wagering agreements even though the payment of money by the insurer may depend upon a future uncertain event. Contracts of insurance differ from the wagering agreements in the following respects:
   (a) It is only that person possessing an insurable interest who is permitted to insure life or property and not any person, as in the case of a wager.
   (b) In the case of fire and marine insurance, only the actual loss suffered by the party is paid by the insurance company, and not the full amount for which the property is insured. Even in the case of life insurance, the amount payable is fixed only because of the difficulty in estimating the loss caused by the death of the assured in terms of money, but the underlying idea is only indemnification.
   (c) Contracts of insurance are regarded as beneficial to the public and are, therefore, encouraged. Wagering agreements, on the other hand, are considered to be against public policy.

1.17 CONTINGENT CONTRACTS (SS.31-36)

1.17.1 Contingent Contract Defined (s.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: (i) *A* contracts to pay *B* ₹ 10,000 if *B*'s house is burnt. This is a contingent contract.

Essential Characteristics of a Contingent Contract are:

(1) The performance of a contingent contract depends upon happening or non-happening of some future event.

(2) 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.

Example: (i) *A* agrees to deliver 100 bags of wheat 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.

(ii) *A* promises to pay B ₹ 10,000 if he marries *C*, it is not a contingent contract.

(3) The contingent event should not be the mere will of the promisor.

Example. A promises to pay *B* ₹ 1,000, if he so chooses, it is not a contingent contract.

However, where the event is within the promisor's will but not merely his will, it may be a contingent contract.

Example: *A* promises to pay *B* ₹ 1,000, if *A* left Delhi for Mumbai, it is a contingent contract, because going to Mumbai is an event within *A*'s will, but is not merely his will.

1.17.2 Rules Regarding Enforcement of Contingent Contracts (Ss.32 to 36)

The rules regarding contingent contracts are summarised hereunder:

(1) Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened. And if the event becomes impossible such contract becomes void (s.32).

Example: (i) *A* makes a contract with *B* to buy *B*'s house if *A* survives *C*. This contract cannot be enforced by law unless and until *C* dies in A's life-time.

(ii) *A* makes a contract with *B* to sell a house to *B* at a specified price if *C*, to whom the house has been offered, refuses to buy it. The contract cannot be enforced by law unless and until *C* refuses to buy the house.

(iii) *A* contracts to pay *B* a sum of money when *B* marries *C*. *C* dies without being married to *B*. The contract becomes void.

(2) Contingent contract to do or not to do anything if an uncertain future event happens can be enforced when the happening of that event becomes impossible, and not before (s.33).

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

(3) If a contract is contingent upon as to how a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies (s.34).

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 *C* may afterwards marry *B*.

(4) Contracts contingent upon the happening of a specified uncertain event within a fixed time become void if, at the expiration of the time fixed, such event has not happened or if, before the time fixed, such event becomes impossible (s.35 para 1).

Example: *A* promises to pay *B* a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is destroyed within the year.

(5) Contracts contingent upon the non-happening of a specified event within a fixed time may be enforced by law when the time fixed has expired and such event has not happened, or, before the time fixed expired, if it becomes certain that such event will not happen (s.35 para II).

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 destroyed within the year.

(6) Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

Example: (i) *A* agrees to pay *B* ₹ 1,000 if two parallel straight lines should enclose a space. The agreement is void.

(ii) *A* agrees to pay *B* ₹ 1,000 if B will marry *A*'s daughter *C*. *C* was dead at the time of the agreement. The agreement is void.

1.18 RELATIONS RESEMBLING THOSE CREATED BY CONTRACTS

1.18.1 Meaning of Quasi Contracts

'Quasi Contracts' are so-called because the obligations associated with such transactions could neither be referred as tortuous nor contractual, but are still recognized as enforceable like contracts, in courts. According to Dr Jenks, quasi contract is "a situation in which law imposes upon one person, on grounds of natural justice, an obligation similar to that which arises from a true contract, although no contract, express or implied, has in fact been entered into by them". The principle underlying a quasi-contract is that no one shall be allowed unjustly to enrich himself at the expense of another, and the claim based on a quasi-contract is generally for money.

Example: *X* supplies goods to his customer *Y* who receives and consumes them. *Y* is bound to pay the price. *Y*'s acceptance of the goods constitutes an implied promise to pay. This kind of contract is called a tacit contract. In this very illustration, if the goods are delivered by a servant of *X* to *Z*, mistaking *Z* for *Y*, then *Z* will be bound to pay compensation to *X* for their value. This is a quasi-contract.

1.18.2 Cases which are Treated as Quasi Contracts

Following are the cases which are to be deemed quasi contracts:

(1) ***Claim for necessaries supplied to a person incapable of contracting or on his account.*** If a person, incapable of entering into a contract, or any one whom he is legally bound to support is supplied by another person with necessaries suited to his condition in life, the person who furnished such supplies is entitled to be reimbursed from the property of such incapable person (s.68).

Examples: (i) *A* supplies *B*, a lunatic, with necessaries suitable to his condition in life. *A* is entitled to be reimbursed from *B*'s property.

(ii) *A* who supplies the wife and children of *B*, a lunatic, with necessaries suitable to their conditions in life, is entitled to be reimbursed from *B*'s property.

The above section covers the case of necessaries supplied to a person incapable of contracting (say, a minor, lunatic, etc.) and to persons whom the incapable person is bound to support (e.g., his wife and minor children). However, following points should be carefully noted: (a) The goods supplied must be necessaries. What will constitute necessaries shall vary from person to person depending upon the social status he enjoys. (b) It is only the property of the incapable person that shall be liable. He cannot be held liable personally. Thus, where he doesn't own any property, nothing shall be payable.

(2) ***Reimbursement to a person paying money due by another in payment of which he is interested.*** 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. (s.69).

Example: *B* holds land in Bengal, on a lease granted by *A*, the Zamindar. The revenue payable by *A* to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue Law, the consequence of such sale will be the annulment of *B*'s lease. *B*, to prevent the sale and the consequent annulment of his own lease, pays the Government, the sum due from *A*. *A* is bound to make good to *B* the amount so paid.

In order that the Section may apply, it is necessary to prove that: (a) The person making the payment is interested in the payment of money, i.e., the payment was made *bona fide*, for the protection of his own interest. (b) The payment should not be a voluntary payment. It should be such that there is some legal or other coercive process compelling the payment. (c) The payment must be to another person. (d) The payment must be one which the other party was bound by law to pay.

(3) ***Obligation of a person enjoying benefits of non-gratuitous act.*** Where a person lawfully does anything for another person, 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 to restore the thing so done or delivered [s.70].

Example: (i) *A*, a tradesman, leaves goods at *B*'s house by mistake. *B* treats the goods as if his own. He is bound to pay for them.

(ii) *A* saves *B*'s property from fire. *A* is not entitled to compensation from *B*, if the circumstances show that he intended to act gratuitously.

In order that s.70 may apply, the following conditions must be satisfied: (a) the thing must be done lawfully; (b) the intention must be to do it non-gratuitously; and (c) the person for whom the act is done must enjoy the benefit of it.

(4) ***Responsibility of finder of goods.*** Ordinarily speaking, a person is not bound to take care of goods belonging to another, left on a road or other public place by accident or inadvertence, but if he takes them into his custody, an agreement is implied by law. Although, there is in fact no agreement between the owner and the finder of the goods, the finder is, for certain purposes deemed in law to be a bailee and must take as much care of the goods as a man of ordinary prudence would take of similar goods of his own. This obligation is imposed on the basis of a quasi-contract. Section 71, which deals with this subject, says: "A person who finds good belonging to another and takes them into his custody, is subject to the same responsibility as a bailee" (Chapter 6).

(5) ***Liability of a person to whom money is paid, or thing delivered by mistake or under coercion (s.72).*** A person to whom money has been paid, or thing delivered by mistake or under coercion, must repay or return it.

Example: (i) *A* and *B* jointly owe ₹ 1,000 to *C*. *A* pays the amount to *C*. Also, *B*, not knowing this fact, pays ₹ 1,000 to *C*. *C* is bound to repay the amount to *B*.

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

The term mistake as used in s.72 includes not only a mistake of fact but also a mistake of law. There is no conflict between the provisions of s.72 on the one hand and Ss.21 and 22 on the other. If one party under mistake, whether of fact or law, pays money to another party which is not due by contract or otherwise, that money must be repaid [*Sales Tax Officer, Benares v. Kanhaiyalal Makanlal Saraf,* (1959) S.C.J.53].

1.18.3 Quantum Meruit

The phrase '*quantum meruit*' means 'as much as merited' or 'as much as earned'. The general rule of law is that unless a person has performed his obligations in full, he cannot claim performance from the other. But in certain cases, when a person has done some work under a contract, and other party repudiated the contract, or some event happens which makes the further performance of the contract impossible, then the party who has performed the work can claim remuneration for the work he has already done. The right to claim quantum meruit does not arise out of the contract as the right to damages does; it is a claim on the quasi-contractual obligation which the law implies in the circumstances [*Patel Engg. Co. Ltd v. Indian Oil Corporation Ltd,* AIR (1975) Pat. 212].

The claim on '*quantum meruit*' arises in the following cases:

1. ***When a contract is discovered to be unenforceable (s.65).*** When an agreement is discovered to be void or becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from he received it.

Example: (i) *A* pays *B* ₹ 1,000 in consideration of *B*'s promising to deliver his dog. The dog is dead at the time of the promise. The agreement is void, but *B* must repay *A* the 1,000 rupees.

(ii) *A* contracts with *B* to deliver to him 250 kilos of rice before the 1st of May. *A* delivers 130 kilos only before that day and none after. B retains the 130 kilos after the 1st of May. He is bound to pay *A* for them.

(iii) *A*, a singer, contracts with *B*, the manager of a theatre, to sing at his theatre for two nights every week during the next two months, and *B* engages to pay her ₹ 100 for

each night's performance. On the sixth night, *A* willfully absents herself from the theatre and *B*, in consequence, rescinds the contract. *B* must pay *A* for the five nights on which she had sung.

2. *When one party abandons or refuses to perform the contract.* Where there is a breach of contract, the aggrieved party is entitled to claim reasonable compensation for what he has done under the contract.

Example: *C*, an owner of a magazine, engaged *P* to write a book to be published in instalments in his magazine. After a few instalments were published, the magazine was abandoned. *Held*, *P* could claim payment on quantum meruit for the part already published [*Planche v. Colburn* (1831) 8 Bing. 14].

3. *When a contract is divisible* and the party not in default, has enjoyed the benefit of the part performance, the party in default may sue on quantum meruit.

4. *When an indivisible contract is completely but badly performed.* When an indivisible contract for a lump sum is completely performed, but badly, the person who has performed can claim the lump sum less deduction for bad work.

Example: *A* agreed to decorate *B*'s flat for a lump sum of ₹ 75. *A* did the work but *B* complained for faulty workmanship. It cost *B* ₹ 204 to remedy the defect. *Held*, *A* could recover from *B* ` 750 less ` 204 [*Hoening v. Isaacs* (1952) AIR 11 E.R. 176].

Check Your Progress

Fill in the blanks:

1. The person making the proposal is called _____.
2. If considerations in both directions are to be moved after the contract, it is called_____.
3. A contract which has not properly fulfilled legal formalities is called_____.
4. An offer is synonymous with_____.
5. _____consists in the improper exercise of power over the mind of one of the contracting parties by the other.
6. The principle underlying a _ is that no one shall be allowed unjustly to enrich himself at the expense of another, and the claim based on a quasi-contract is generally for money.

1.19 LET US SUM UP

- That branch of law which determines the circumstances in which promises made by the parties to a contract shall be legally binding on them is governed by the Indian Contract Act, 1872.
- A contract is an agreement, enforceable by law, made between at least two parties by which rights are acquired by one and obligations are created on the part of another.
- Contract Act covers a wide range of area like: Formation of contracts, contingent contracts, performance of the contract, and consequences of breach of contract, sale of goods, indemnity and guarantee, bailment, agency and so on.
- The basic principle underlying law of contracts is that a stranger to a contract cannot maintain a suit for a remedy. The law entitles only those who are parties to

the contract to file suits for exercising their rights. This is known as 'privity of contract'.

- In connection with contracts, there are four types of classifications. Types of contracts in contract law are as follows: On the basis of Formation, On the basis of Nature of Consideration, On the basis of Execution and On the basis of Validity.
- An unenforceable contract is neither void nor voidable, but it cannot be enforced in the court because it lacks some item of evidence such as writing, registration or stamping or where the remedy has been barred by lapse of time.
- Offer is not only one of the essential elements of a contract but it is the basic building block also. An offer is synonymous with proposal.
- The communication of an offer is complete when it comes to the knowledge of the person to whom it is made.
- A person who is not of sound mind may not enter into a contract; he must be of sound mind so as to be competent to contract.
- The consent of the offeree to the offer by the offeror is necessary. It is essential to the creation of a contract that both parties agree to the same thing in the same sense. When two or more persons agree upon the same thing in the same sense they are said to consent.
- Free Consent is one of the essential elements of a valid contract. The essence of this requirement is that a person should enter into an agreement with a free as well as an open mind and without any fear.
- Misrepresentation is also known as simple misrepresentation whereas fraud is known as fraudulent misrepresentation. Like fraud, misrepresentation is an incorrect or false statement but the falsity or inaccuracy is not due to any desire to deceive or defraud the other party.
- The term consideration is used in the sense of *quid pro que*, i.e., "something in return". This something or consideration need not be in terms of money. It may be--- some benefit, right, interest or profit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other party.
- Section 23 defines an illegal agreement as one that the consideration or object of which (i) is forbidden by law; or (ii) defeats the provisions of any law; or (iii) is fraudulent; or (iv) involves or implies injury to the person or property of another; or (v) the court regards it as immoral or opposed to public policy.
- 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.
- 'Quasi Contracts' are so-called because the obligations associated with such transactions could neither be referred as tortuous nor contractual, but are still recognized as enforceable like contracts, in courts.

1.20 LESSON END ACTIVITY

(a) *M* agreed on Monday to sell his property to *N* by a written agreement which stated that 'this offer to be left over until Saturday 10 AM'. In the meantime, on Wednesday *M* enters into a contract to sell the property to *O*. *N* who was sitting in the next room, hears about the deal between *M* and *O*. On Friday, *N* accepts the offer and delivers to *M*, the letter of acceptance. Is *N*'s acceptance valid? Give reasons.

[**Hint:** *N*'s acceptance is valid; the acceptance being made before revocation of the offer by *M*].

(b) *X*, an old lady, by a deed of gift, made over certain property to her daughter *D*, with the specific directions that she should pay *P*, who is the sister of the old lady, a sum of ₹ 100 per month. The same day *D* entered into an agreement with *P* to pay her the agreed amount. *D*, now refuses to pay her aunt *P*, the above amount on the plea that no consideration had moved from *P* to *D*. *P*, therefore, sues *D*. Is the suit maintainable and can *D* be held liable to pay the amount?

[**Hint:** *D* can be held liable to pay the amount to *P*. Consideration may move even from a stranger-s.2 (d)]

1.21 KEYWORDS

Contract: It is an agreement enforceable by law.

Minor: It is a person who has not completed 18 years of age.

Free consent: Consent is said to be free when it is not caused by coercion or under influence fraud or misrepresentation.

Agreement: An agreement is a formal decision about future action which is made by two or more countries, groups, or people.

Promise: Commitment given by one party (the promisor) to another (the promisee) to carry out or refrain from carrying a specified act or acts.

Illegal Agreements: An illegal agreement, under the common law of contract, is one that the courts will not enforce because the purpose of the agreement is to achieve an illegal end.

Void Agreements: A void agreement is void *ab initio*, i.e., from the beginning while a voidable contract can be voidable by one or all of the parties.

Revocation of Offer: Revocation of offer is the withdrawal of an offer by the offeror so that it can no longer be accepted.

Counter-offer: When in place of accepting the terms of an offer as they are, the offeree accepts the same subject to certain conditions or qualifications, he is said to make a counter offer.

Consent: Express or implied approval, or voluntary agreement, compliance, or permission for some act, decision, or purpose. Consent obtained through coercion, fraud, or undue influence is invalid.

Coercion: Coercion may involve the actual infliction of physical pain/injury or psychological harm in order to enhance the credibility of a threat.

Misrepresentation: An assertion or manifestation by words or conduct that is not in accord with the facts.

1.22 QUESTIONS FOR DISCUSSION

1. What is a contract? Why must you, as a manager, know as to what constitutes a contract? What tests would you apply to ascertain whether an agreement is a contract?
2. Are there any essentials of a contract so as to make it enforceable by law?
3. Explain what do you understand by 'void', 'voidable', 'illegal' and 'valid' contracts. Briefly refer to the rights of parties under such agreements.

4. How safe are oral contracts?
5. Define offer and distinguish between offer and invitation to offer.
6. How is an offer made? Explain an implied offer, a specific offer, a general offer, a counter-offer?
7. If the special conditions forming part of an offer are contained in a document which is delivered after the contract is complete, is the other party (say a customer) bound by them?
8. What are the reasons due to which the offer lapses or is revoked? If no time is fixed by the offeror within which the offer is to be accepted does the offer remain open for an indefinite period of time?
9. When is an offer said to be accepted? In which way acceptance of offer may be made?
10. Comment: (i) "Acceptance must be absolute and qualified"? (ii) "A mere mental acceptance is no acceptance". (iii) "Acceptance must be according to the mode prescribed by the offeror"? (iv) "A mere mental acceptance not evidenced by words or conduct is in the eye of law no acceptance".
11. Discuss the rules regarding communication of offer and acceptance.
12. Who is competent to contract? What determines enough maturity to make a contract? Can anyone enter into a contract?
13. When does mental incompetence prohibit a valid contract? Is minor competent to contract?
14. What is coercion? State its effect on the validity of a contract.
15. What is undue influence? When is it presumed as regards persons in particular relationships?
16. On whom does lie the burden of proving that contract (i) was, or (ii) was not induced by undue influence?
17. What is fraud? What are the essential elements or conditions necessary for its existence?
18. What is "mistake" as it affects the validity of a contract? What are the consequences of a mistake on contracts?
19. What is meant by 'unilateral mistake'?
20. Are there any exceptions to the rule "No consideration, No contract".
21. The term consideration is used in the sense of '*quid pro quo*' or 'something in return'. Does this 'something' to be necessarily in terms of money? Illustrate your answer.
22. What are the cases in which consideration and object of an agreement are unlawful, thereby making it unenforceable?
23. What is an illegal agreement?
24. Certain agreements, which are against public policy, have been declared to be void by law. Enumerate them and illustrate.
25. Explain the meaning of a contingent contract.
26. Distinguish between a wagering agreement and a contingent contract.

27. What are quasi contracts? Enumerate the quasi-contracts dealt with under the Indian Contract Act, 1872.

28. What do you understand by quantum meruit? When does the claim on quantum meruit arise?

Check Your Progress: Model Answer

1. Promissory
2. Bilateral Contract
3. Unenforceable contract
4. Proposal
5. Undue influence
6. Quasi-contract

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UNIT 2

PERFORMANCE OF CONTRACTS

CONTENTS

2.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the meaning of performance of contracts and who must perform the Promise under a Contract
- Discuss the rules regarding the time, place and manner of performance of contracts
- Describe reciprocal promises and appropriation of payments
- Explain assignment of contracts

2.1 INTRODUCTION

A contract places a legal obligation upon the contracting parties to perform their mutual promises, and it carries on until the discharge or termination of the contract. The most natural and usual mode of discharging a contract is to perform it. A person who performs a contract in accordance with its terms is discharged from any further obligations. As a rule, such performance entitles him to receive the other party's performance.

Exact and complete performance by both the parties puts an end to the contract. In expecting exact performance, the courts mean that, performance must match contractual obligations. In requiring a contract to be complete, the law is merely saying that any work undertaken must be carried out to the end of the obligations.

A contract should be performed at the time specified and at the place agreed upon. When this has been accomplished, the parties are discharged automatically and the contract is discharged eventually. There are, however, many other ways in which a discharge may be brought about. For example, it may result from an excuse for non-performance. In certain cases attempted performance may also operate as a substitute for actual performance, and can result in complete discharge of the contract.

2.2 PERFORMANCE OF CONTRACTS

A contract creates obligations. 'Performance' of contract means the carrying out of obligations under it. The parties to contract must either perform or offer to perform their respective promises unless such performance is dispensed with or excused under the provisions of the Indian Contract Act, or some law (s.37).

The term 'Performance of contract means that both, the promisor, and the promisee have fulfilled their respective obligations, which the contract placed upon them. For example, A visits a stationery shop to buy a calculator. The shopkeeper delivers the calculator and A pays the price. The contract is said to have been discharged by mutual performance.

Section 27 of Indian contract Act says that *"The parties to a contract must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provisions of this Act, or any other law."*

Promises bind the representatives of the promisor in case of the death of the latter before performance, unless a contrary intention appears in the contract.

Thus, it is the primary duty of each contracting party to either perform or offer to perform its promise. For performance to be effective, the courts expect it to be exact and complete, i.e., the same must match the contractual obligations. However, where under the provisions of the Contract Act or any other law, the performance can be dispensed with or excused, a party is absolved from such a responsibility.

For example, A promises to deliver goods to B on a certain day on payment of ₹ 1,000. A expires before the contracted date. A's representatives are bound to deliver the goods to B, and B is bound to pay ₹ 1,000 to A's representatives.

2.2.1 Meaning of Offer to Perform

It may happen that the promisor offers performance of his obligation under the contract at the proper time and place but the promisee refuses to accept the performance. This is called as 'Tender' or 'Attempted Performance'. If a valid tender is made and is not accepted by the promisee, the promisor shall not be responsible for non-performance nor shall the promisor lose rights under the contract. However, since

the tender is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity to see that the thing offered is the thing contracted for.

2.2.2 Who must Perform the Promise under a Contract?

The promise may be performed by promisor himself or his agent or by his legal representative:

(i) In case, there was an intention of the parties that the promise must be performed by the promisor himself, such promise is to be performed by him only. Thus, where A promises to paint a picture for B, then A must perform this promise personally.

(ii) If there is no such intention of the parties, then the promisor may employ a competent person to perform the promise. If A has promised to deliver some items of grocery to B, A may perform this promise either personally delivering the items to B or causing it to be delivered to B through someone.

(iii) In case of death of the promisor, the legal representative must perform the promise unless a contrary intention appears from the contract. A promises to deliver goods to B on a certain day on payment of ₹ 1,000. A dies before that day. A's legal representatives are bound to deliver the goods to B, and B is bound to pay ₹ 1,000 to A's representatives.

(iv) Where, however, a contract involves personal skill, then it comes to an end with the death of the promisor.

Thus, where A promises to paint a picture for B by a certain day but dies before that day. The contract cannot be enforced by A's representatives or by B.

Performance of Joint Promises: The Act provides rules for devolution of joint liabilities and rights.

Devolution of Joint Liabilities: Section 42 requires that when two or more persons have made a joint promise, then, unless a contrary intention appears from the contract, all such persons jointly must fulfil the promise. In the event of death of any of them, his representative jointly with the survivor or survivors and in case of the death of all promisors, the representatives of all of them jointly must fulfil the promise.

Liabilities of Joint Promisors: When two or more persons make a joint promise, the promisee may, in the absence of an express agreement to the contrary, compel anyone or more of such joint promisors to perform whole of the promise. Thus, the liability of joint promisors is joint as well as several [s.43]. Thus, s.42 makes all the joint promisors liable on the promise jointly, whereas s.43 provides that any one of the joint promisors may be compelled to perform.

Example: A, B and C jointly promise to pay ₹ 3,000 to D, D may compel either A, or B or C or any two of them to pay him ₹ 3,000.

Right of Contribution Amongst Joint Promisors: Where, a joint promisor has been compelled to perform the whole promise, the joint promisor may compel every other joint promisor to contribute equally to the performance of the promise, unless a contrary intention appears from the contract. If any one of the joint promisors makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares.

Examples:

(i) A, B and C are under a joint promise to pay D ₹ 3,000. A is compelled to pay the whole amount of ₹ 3,000. A can recover each from B and C ₹ 1,000.

(ii) A, B and C jointly promise to pay D a sum of ₹ 3,000. C is compelled to pay the whole amount of ₹ 3,000. A is insolvent, but his assets are sufficient to pay ½ of his debts. C is entitled to receive ₹ 500 from A's estate and ₹ 1,250 from B.

(iii) A, B and C are under a joint promise to pay D ₹ 3,000. C is unable to pay anything and A is compelled to pay the whole amount of ₹ 3,000. A is entitled to receive ₹ 1,500 from B.

Release of joint promisor: Where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor or promisors neither does it free him from the responsibility to the other joint promisor nor promisors [s.44].

Devolution of joint rights (s.45): When a person has made a promise to two or more persons jointly, then unless a contrary intention appears from the contract, the right to claim performance rests with all the joint promisees and after the death of any of them, with the representatives of such deceased promisee jointly with the survivor or survivors; and after the death of the survivors also, with the representatives of all jointly. Thus, unlike the case of joint promisors whose liability is joint as well as several, the right of the promisees is only joint and thus any one of them cannot enforce performance unless so agreed.

Example: A, in consideration of ₹ 5,000 lent to him by B and C, promises B and C jointly that he will repay them that sum with interest on a day specified. B dies. The right to claim performance rests with B's representative jointly with C during C's life, and after C's death with the representatives of B and C jointly.

2.2.3 Contracts Which Need not be Performed

There are certain situations where contracts need not be performed. These are:

(i) The parties may mutually agree to substitute the original contract by a new one or to rescind it or alter it. A owes money to B under a contract. It is agreed between A, B and C that B shall henceforth accept C as his debtor, instead of A. The old debt of A to B is at an end and a new debt from C to B has been contracted.

(ii) The promisee may dispense with or remit wholly or in part the performance of the promise made to him or extend the time for such performance or accept any satisfaction for it. For instance, A promises to paint a picture for B. Later, B forbids A to do so. A is no longer bound to perform the promise. Or C owes D ₹ 5,000. C pays D ₹ 2,000 and D accepts it in satisfaction of his claim on C. This payment is a discharge of the whole claim.

(iii) The person at whose option the contract is voidable because of undue influence, coercion, fraud or misrepresentation can rescind it.

(iv) The promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise. For instance, A makes contracts with B to repair B's house. B neglects or refuses to point out to A the places in which his house requires repair. A need not perform.

2.3 TYPES OF PERFORMANCE

Performance, as an action of the performing may be actual or attempted.

2.3.1 Actual Performance

When a promisor to a contract has fulfilled his obligation in accordance with the terms of the contract, the promise is said to have been actually performed. Actual performance gives a discharge to the contract and the liability of the promisor ceases

to exist. For example, A agrees to deliver10 bags of cement at B's factory and B promises to pay the price on delivery. A delivers the cement on the due date and B makes the payment. This is actual performance.

Actual performance can further be subdivided into substantial performance, and partial Performance.

2.3.2 Substantial Performance

This is where the work agreed upon is almost finished. The court then orders that the money must be paid, but deducts the amount needed to correct minor existing defect. Substantial performance is applicable only if the contract is not an entire contract and is severable. The rationale behind creating the doctrine of substantial performance is to avoid the possibility of one party evading his liabilities by claiming that the contract has not been completely performed. However, what is deemed to be substantial performance is a question of fact to be decided in both the case. It will largely depend on what remains undone and its value in comparison to the contract as a whole.

2.3.3 Partial Performance

This is where one of the parties has performed the contract, but not completely, and the other side has shown willingness to accept the part performed. Partial performance may occur where there is shortfall on delivery of goods or where a service is not fully carried out.

There is a thin line of difference between substantial and partial performance. The two following points would help in distinguishing the two types of performance.

Partial performance must be accepted by the other party. In other words, the party who is at the receiving end of the partial performance has a genuine choice whether to accept or reject. Substantial performance, on the other hand, is legally enforceable against the other party.

Payment is made on a different basis from that for substantial performance. It is made on quantum meruit, which literally means as much as is deserved. So, for example, if half of the work has been completed, half of the negotiated money would be payable. In case of substantial performance, the party that has performed can recover the amount appropriate to what has been done under the contract, provided that the contract is not an entire contract. The price is thus, often payable in such circumstances, and the sum deducted represents the cost of repairing defective workmanship.

2.3.4 Attempted Performance

When the performance has become due, it is sometimes sufficient if the promisor offers to perform his obligation under the contract. This offer is known as attempted performance or more commonly as tender. Thus, tender is an offer of performance, which of course, complies with the terms of the contract. If goods are tendered by the seller but refused by the buyer, the seller is discharged from further liability, given that the goods are in accordance with the contract as to quantity and quality, and he may sue the buyer for breach of contract if he so desires. The rationale being that when a person offers to perform, he is ready, willing and capable to perform. Accordingly, a tender of performance may operate as a substitute for actual performance, and can effect a complete discharge.

In this regard, Section 38 of Indian Contract Act says:

"Where a promisor has made an offer of performance to the promisee, and the offer has not been accepted, the promisor is not responsible for non-performance, nor does

he thereby lose his rights under the contract. For example, A contracts to deliver to B, 100 tons of basmati rice at his warehouse, on 6 December 2015. A takes the goods to B's place on the due date during business hours, but B, without assigning any good reason, refuses to take the delivery. Here, A has performed what he was required to perform under the contract. It is a case of attempted performance and A is not responsible for non-performance of B, nor does he thereby lose his rights under the contract."

2.4 RULES REGARDING THE TIME, PLACE AND MANNER OF PERFORMANCE OF CONTRACTS [SS.46–50]

These rules are mentioned as follows:

(i) Where the time for performance has been specified and the promisor has undertaken to perform it without application by the promisee, the promisor must perform on the day fixed during the usual business hours and at the place at which the promise ought to be performed. A promises to deliver goods to B at his warehouse on 15th July. A offers to deliver the goods at B's warehouse but after the usual hours for closing it. The performance of A is not valid.

(ii) Where the time of performance is not specified and the promisor agrees to perform without a demand from the promisee, the performance must be made within a reasonable time. What is a reasonable time is, in each particular case, a question of fact.

(iii) Where a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, the promisee must apply for performance at a proper place and within the usual business hours. What is a proper time and place is, in each particular case, a question of fact.

(iv) When a promise is to be performed without application by the promisee and no place is fixed for its performance, the promisor must apply to the promisee to appoint a reasonable place for the performance of the promise, and perform it at such place. A undertakes to deliver 1,000 kilos of Jute to B on a fixed day. A must apply to appoint a reasonable place for the purpose of receiving it and must deliver it to him at such place.

(v) The performance of any promise may be made in any manner or at any time which the promisee prescribes or sanctions.

Examples:

(i) A owes B ₹ 2,000. B accepts some of A's goods in deduction of the debt. The delivery of the goods operates as a part payment.

(ii) B owes A ₹ 2,000. A desires B to pay the amount to A's account with C, a banker. B, who also banks with C orders the amount to be transferred from his account to A's credit and this is done by C. Afterwards and before A knows of the transfer, C fails. There has been a good payment by B.

(iii) A, a shopkeeper desires B, a customer who owes him ₹ 1,000 to send him a cheque for ₹ 1,000 by post. The debt is discharged as soon as B puts into the post a letter, containing the cheque addressed to A.

2.5 RECIPROCAL PROMISES [SS.51–54]

Reciprocal promise means a promise in return for a promise. Thus, where a contract consists of a promise by one party (to do or not to do something in future) in consideration of a similar promise by other party, it is a case of reciprocal promises. Reciprocal promises may be divided into three groups:

(i) Mutual and dependent

(ii) Mutual and independent

(iii) Mutual and concurrent

Rules concerning performance of different kinds of reciprocal promises are:

1. In the case of mutual and dependent promises, the performance of one party depends upon the prior performance of the other party. If the promisor, who must perform, fails to perform it, promisor cannot claim the performance of the reciprocal promise. On the other hand, the person must compensate the other party to the contract for any loss which such other party may sustain by the non-performance of the contract.

   Examples:

   (i) A forms a contract with B to execute certain builder's work for a fixed price, B supplying the necessary timber for the work. B refuses to furnish any timber and the work cannot be executed. A need not perform the contract. B is bound to compensate for any loss caused to A by the non-performance of the contract.

   (ii) X promises Y to sell him 100 units of a commodity, to be delivered next day and Y promises X to pay for them within a month. X does not deliver according to his promise, Y's promise to pay need not be performed. Also X must compensate Y.

2. In the case of mutual and independent promises, each party must perform his promise without waiting for the performance or readiness to perform on the part of the other. A promises B to deliver him goods on 10 July and B in turn promises to pay the price on 6 July. B's paying the price is independent of A's delivering the goods and even if B does not pay the price on 6 July, A must offer the delivery of the goods on 10 July. A can, of course, sue B for price and damages.

3. In the case of mutual and concurrent promises, the performance is to be simultaneous. Thus, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.

   Examples:

   (a) L and M contract that L shall deliver goods to M to be paid by instalments, the first instalment to be paid on delivery. L need not deliver, unless M is ready and willing to pay for the goods on delivery. And M need not pay for the goods unless L is ready and willing to deliver them on payment.

   (b) R and S contract that R shall deliver goods to S at a price to be paid by instalments, the first instalment to be paid on delivery. R need not deliver, unless S is ready and willing to pay the first instalment on delivery. And S need not pay the first instalment, unless R is ready and willing to deliver the goods on payment of the first instalment.

Reciprocal promise to do things legal and also other things illegal: Section 57 provides that where persons reciprocally promise, firstly, to do certain things which

are legal and secondly, under specified circumstances, to do certain things which are illegal, the first set of promises is a contract but the second set is a void agreement.

Example: X and Y agree that X shall sell Y a house for ₹ 1, 00,000 but that if Y uses it as a gambling house, the person shall pay X ₹ 5, 00,000 for it. The first set of reciprocal promises, namely, to sell the house and pay ₹ 1, 00,000 for it is a contract. The second set is for unlawful object, that Y may use the house as a gambling house and is a void agreement.

2.6 APPROPRIATION OF PAYMENTS [SS. 59–61]

Appropriation of payments means application of payments. When a debtor owes several debts in respect of which the payment must be made (to the same creditor), the question may arise as to which of the debts, payment is to be appropriated. In England, the law on the subject was laid down in Clayton's case. The rule in Clayton's case was stated as: "If a man owes another two debts upon distinct causes, and pays him a sum of money, the payer has a right to say to which account the money so paid is to be appropriated".

In India, the rules regarding appropriation of payments are contained in Ss. 59 to 61 which, in fact, have adopted with certain modifications the rules laid down in Clayton's case. The provisions of these sections are summarised hereunder:

Rule 1. Appropriation by debtor (s.59): Where a debtor, owing several distinct debts to one person, makes a payment to him with express intimation that the payment is to be applied to the discharge of some particular debt, the payment, if accepted, must be applied to that debt. Where, however, no express intimation is given but the payment is made under circumstances implying that it should be appropriated to a particular debt, the payment, if accepted, must be applied to that debt.

Examples:

(i) A owes B, among other debts, ₹ 1,000 upon a promissory note which falls due on 1st June. The person owes B no other debt of that amount. On the 1st June A pays B ₹ 1,000. The payment is to be applied to the discharge of the promissory note.

(ii) A owes B among other debts, the sum of ₹ 974. B writes to A and demand payment of his sum. A sends to B ₹ 974. This payment is to be applied to the discharge of the debt of which B had demanded payment.

Rule 2. Appropriation by creditor (s.60): Where the debtor has omitted to intimate and there are no other circumstances indicating to which debt payment is to be applied, the creditor may apply it at his discretion to any lawful debt actually due and payable to him by the debtor. The amount, in such a case, can be applied even to a debt which has become 'time-barred'. However, it cannot be applied to a disputed debt.

Example: A obtains two loans of ₹ 20,000 and ₹ 10,000, respectively. Loan of ₹ 20,000 is guaranteed by B. A sends the bank ₹ 5,000 but does not intimate as to how it is to be appropriated towards the loans. The bank appropriates the whole of ₹ 5,000 to the loan of ₹ 10,000 (the loan not guaranteed). The appropriation is valid and cannot be questioned either by A or B.

Rule 3. Where neither party appropriates (s.61): Where neither party makes any appropriation, the payment is to be applied in discharge of the debts in order of time, including time-barred debts. If the debts are of equal standing the payment is to be applied proportionately. This rule is generally applicable in case of running accounts between two parties, money being paid and withdrawn from time to time from the account, without any specific indication as to appropriation of the payment made. In

such a case debits and credits in the accounts will be set up against one another in order of their dates, leaving only final balance to be recovered from the debtor by the creditor.

Rule in Hallett's Estate Case: The rule in Hallett's Estate Case is an exception to the above Rule 3. The rule applies where a trustee had mixed up trust funds with his own funds. In such a case, if the trustee misappropriates any money belonging to the trust, the first amount so withdrawn by him would be first debited to his own money and then to the trust funds. Similarly, any deposits made by him would first be credited to trust fund and then to his own fund, whatever be the order of withdrawal and deposit.

Example: A trustee deposits ₹ 10,000 being trust money with a bank and subsequently deposits ₹ 50,000 of his own in the same account. Thereafter, this person withdraws ₹ 10,000 from the bank and misappropriates it. The said withdrawal will not be appropriated against the trust amount of ₹ 10,000 but only against his own deposit though this was made later than the first deposit thus leaving the trust fund intact.

2.7 ASSIGNMENT OF CONTRACTS

Assignment means transfer. When a party to a contract transfers his right, title and interest in the contract to another person or persons, the person is said to assign the contract. Assignment of a contract can take place by:

(i) Operation of law

(ii) An act of parties

The example of assignment by operation of law is by insolvency or death of the party to the contract. In the case of insolvency the Official Receiver (or Official Assignee) acquires the interest in the contract. In the case of death, the legal representative of the deceased, who was a party to the contract, gets the interest in the contract. In this type of assignment, the parties to the contract are not active; it is the law which operates. In the case of assignment by act of parties, the parties themselves make the assignment.

The rules regarding assignment of contracts are: Firstly, the obligations or liabilities under a contract cannot be assigned except by novation. Thus, if A owes B ₹ 10,000, the person cannot transfer his obligation to pay to C and compel B to collect money from C. However, if the promisee agrees to such an assignment this individual will be bound by it. In such a case a new contract is substituted for the old one. This is called 'novation'. Thus, in the above example, if B agrees to accept payment from C, the assignment will be valid and A shall stand discharged of his obligation to pay. Secondly, rights and benefits under a contract may be assigned. For example, where A owes B ₹ 10,000, B may assign his right to C. However, a right or benefit under a contract cannot be assigned if it involves personal skill, ability, credit or other personal qualifications. For instance, a contract to paint a picture personally cannot be assigned. Thirdly, the rights of a party under a contract may amount to actionable claims which can be assigned by a written document. Notice of the assignment is to be given to the debtor to make it valid.

Check Your Progress

Fill in the blanks:

1. Exact and complete performance by both the parties puts an end to the___ ___ ___.
2. It is the primary duty of each contracting party to either perform or offer to perform its_____.
3. If a valid tender is made and is not accepted by the_____.

Contd...

4. _____ is an offer of performance, which of course, complies with the terms of the contract.

5. In the case of _____promises, the performance of one party depends upon the prior performance of the other party.

6. Appropriation of payments means _____of payments.

2.8 LET US SUM UP

- The term 'Performance of contract means that both, the promisor, and the promisee have fulfilled their respective obligations, which the contract placed upon them.
- Performance, as an action of the performing may be actual or attempted.
- Where a contract consists of a promise by one party (to do or not to do something in future) in consideration of a similar promise by other party, it is a case of reciprocal promises.
- Reciprocal promises may be divided into three groups: Mutual and dependent, Mutual and independent and Mutual and concurrent.
- Appropriation of payments means application of payments. When a debtor owes several debts in respect of which the payment must be made (to the same creditor), the question may arise as to which of the debts, payment is to be appropriated.
- When a party to a contract transfers his right, title and interest in the contract to another person or persons, the person is said to assign the contract.

2.9 LESSON END ACTIVITY

A enters into a contract with B for supplying 800 tonnes of iron ore within 4 months. A fails to make the delivery in time owing to difficulty in transport. But he admitted the availability of iron ore in the market at a higher price. Can A take the plea of impossibility of performance? Give reasons.

[Hint: A cannot take the plea of impossibility of performance. s.56]

2.10 KEYWORDS

Performance of contract: It means the carrying out of obligations under a contract.

Promisee: A person to whom a promise has been made.

Actual Performance: When a promisor to a contract has fulfilled his obligation in accordance with the terms of the contract, the promise is said to have been actually performed.

Substantial performance: It is applicable only if the contract is not an entire contract and is severable.

Partial Performance: Partial performance may occur where there is shortfall on delivery of goods or where a service is not fully carried out.

Attempted Performance: Sometimes, when the performance of the contract becomes due, the promisor is ready and willing to perform his promise, and offers to perform the same, but the promise refused to accept the performance. This is known as attempted performance or tender.

2.11 QUESTIONS FOR DISCUSSION

1. Briefly explain performance of contracts.
2. Who must perform the Promise under a Contract?
3. Discuss the contracts which need not be performed.
4. Summarise the rules regarding the time, place and manner of performance of contracts.
5. What is a reciprocal promise. Into how many groups reciprocal promises may be divided? Summarise the rules concerning performance of different kinds of reciprocal promises.
6. Explain (i) Novation, (ii) assignment of contracts?
7. What are the different modes of discharge of contracts? Explain the discharge of contract by performance or tender.

Check Your Progress: Model Answer

1. Contract
2. Promise
3. Promisee
4. Tender
5. Mutual and dependent
6. Application

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BLOCK II

UNIT 3

BREACH OF CONTRACT AND INDEMNITY

CONTENTS

Contd...

3.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the meaning of performance of contracts and who must perform the Promise under a Contract
- Discuss the rules regarding the time, place and manner of performance of contracts
- Describe reciprocal promises and appropriation of payments
- Explain assignment of contracts

3.1 INTRODUCTION

Contract is made between the parties who are intended to bind together in a legal obligation i.e., to serve the interest of both the parties. The parties, in order to govern themselves and to safeguard their interest make their own terms and conditions. And when such terms and conditions are accepted by both the parties, there is an enactment of the contract i.e., the liability is imposed on the party to the contract and to function in accordance with the terms and conditions of the contract.

A contract to perform the obligation or to discharge the liability of a third party in case of its default is called contract of guarantee, (Section 126) Indian Contract Act, 1872. A contract where one party promises to save the other from any loss caused to him by the conduct of promissor himself or any other person is called contract of indemnity, (Section 124) Indian Contract Act, 1872.

3.2 BREACH OF CONTRACTS

A contract is a legally enforceable agreement between two parties. Each party to a contract promises to perform a certain duty or pay a specified amount.

A breach of contract means one party to the contract fails to fulfill her contractual obligations. A breach can occur if a party fails to perform within the time frame specified in the contract, does not perform in accordance with the terms of the agreement, or fails to perform whatsoever. If one party fails to perform while the other party fulfills her duties under the contract, the performing party is entitled to legal remedies for breach of contract.

When someone breaches a contract, the other party is no longer obligated to keep its end of the bargain. From there, that party may proceed in several ways: (i) the other party may urge the breaching party to reconsider the breach; (ii) if it is a contract with

a merchant, the other party may get help from consumers' associations; (iii) the other party may bring the breaching party to an agency for alternative dispute resolution; (iv) the other party may sue for damages; or (v) the other party may sue for other remedies.

3.2.1 What Constitutes a Breach of Contract?

A contract case usually comes before a judge because one or both parties claim that the contract was breached. A breach of contract is a failure, without legal excuse, to perform any promise that forms all or part of the contract. This includes failure to perform in a manner that meets the standards of the industry or the requirements of any express warranty or implied warranty, including the implied warranty of merchantability.

When a party claims a breach of contract, the judge must answer to the following questions:

1. Did a contract exist?
2. If so, what did the contract require of each of the parties?
3. Was the contract modified at any point?
4. Did the claimed breach of contract occur?
5. If so, was the breach subject to the contract?
6. Does the breaching party have a legal defense to the enforcement of the contract?
7. What damages were caused by the breach?

3.2.2 Types of Breaches

There are different types of breaches of contract:

Actual Breach and Anticipatory Breach

Most breaches of contracts are one of two types: actual or anticipatory. Actual breaches occur when a party fails to fulfil her obligations on the date performance is due, or when a party performs her obligations and the other party refuses to perform.

Anticipatory breach occurs when a party refuses to perform her obligations under the contract before the due date of performance. For example, if a party agrees to sell her car to a buyer in five days, but then reneges on day three, she is anticipatorily breaching the contract.

Minor Breach and Material Breach

A contract breach can either be minor or material. A minor breach, also known as a partial breach, is a failure to complete a minor, non-essential part of a contract. Although it is technically a breach, the contract can still be completed.

A material breach, on the other hand, is a substantial breach in contract terms usually excusing the non-breaching party from performing and giving her the right to sue for damages. For example, in a home purchase contract, a seller refusing to give the buyer the keys to the home after the buyer has completed all contract terms is a material breach.

3.3 REMEDIES FOR BREACH OF CONTRACT

As soon as either party commits a breach of the contract, the other party becomes entitled to certain reliefs. These remedies are available under the Indian Contract Act,

1872, as also under the Specific Relief Act, 1963. There are three remedies under the Specific Relief Act, 1963: (i) a decree for specific performance (s.10); (ii) an injunction (s.38-41); (iii) a suit on quantum meruit (s.30).

Remedies under the Indian Contract Act, 1872 are: (i) rescission of the contract (s.39) and, (ii) damages for the loss sustained or suffered.

3.3.1 Rescission of the Contract

When a breach of contract is committed by one party, the other party may treat the contract as rescinded. In such a case the aggrieved party is freed from all his obligations under the contract. Thus, where A promises B to supply one bag of rice on a certain date and B promises to pay the price on receipt of the bag. 'A' does not deliver the bag of rice on the appointed day, 'B' need not pay the price. A person, who rightfully rescinds the contract, is entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract.

3.3.2 Damages (s.75)

Another relief or remedy available to the promisee in the event of a breach of promise by the promisor is to claim damages or loss arising to him therefrom. Damages under s.75 are awarded according to certain rules as laid down in Ss.73-74.

Section 73 contains three important rules:

(i) Compensation as general damages will be awarded only for those losses that directly and naturally result from the breach of the contract.

(ii) Compensation for losses indirectly caused by breach may be paid as special damages if the party in breach had knowledge that such losses would also follow from such act of breach.

(iii) The aggrieved party is required to take reasonable steps to keep his losses to the minimum. It is the duty of the injured party to minimise loss. (British Westinghouse & Co. v Underground Electric etc. Co. (1915) A.C.673). He cannot claim to be compensated by the party in default for loss which is really not due to the breach but due to his own neglect to minimise loss after the breach.

Thus, the loss or damages caused to the aggrieved party must be such that either (i) it arose naturally or (ii) the parties knew, when they made the contract, was likely to arise. In other words, such compensation cannot be claimed for any remote or indirect loss or damage sustained by reason of the breach of the contract.

Section 74 provides that if the parties agree in their contract that whoever commits a breach shall pay an agreed amount as compensation, the court has the power to award a reasonable amount only, subject to such agreed amount.

Different Types of Damages

There are four types of damages:

1. ***Ordinary Damages:*** These damages are those which naturally arise in the usual course of things from such breach. The measure of ordinary damages is the difference between the contract price and the market price at the date of the breach. If the seller retains the goods after the breach, he cannot recover from the buyer any further loss if the market falls, nor is he liable to have the damages reduced if the market rises.

   Examples: (i) A contracts to deliver 10 bags of rice at ₹ 500 a bag on a future date. On the due date he refuses to deliver. The price on that day is ₹ 520 per bag. The measure of damages is the difference between the market price on the date of

the breach and the contract price, i.e., ₹ 200. (ii) A contracts to buy B's ship for ₹ 2,00,000 but breaks his promise. A must pay to B by way of compensation the excess, if any, of the contract price over the price which B can obtain for the ship at the time of the breach of promise.

The ordinary damages cannot be claimed for any remote or indirect loss or damages by reason of the breach. The ordinary damages shall be available for any loss which arises naturally in the usual course of things.

A railway passenger's wife caught cold and fell ill due to her being asked to get down at a place other than the railway station. In a suit by the plaintiff against the railway company, held that damages for the personal inconvenience of the plaintiff alone could be granted, but not for the sickness of the plaintiff's wife, because it was a very remote consequence.

What is the most common remedy for breach of contracts? The usual remedy for breach of contracts is suit for damages. The main kind of damages awarded in a contract suit is ordinary damages. This is the amount of money to compensate the aggrieved party. The idea is to compensate the aggrieved party for the loss he has suffered as a result of the breach of the contract.

2. ***Special Damages:*** These damages are claimed in case of loss of profit, etc. When there are certain special or extraordinary circumstances present and their existence is communicated to the promisor, the non-performance of the promise entitles the promisor to not only the ordinary damages but also damages that may result therefrom. The communication of the special circumstances is a prerequisite to the claim for special damages.

Examples: (i) 'A' a builder, contracts to erect and finish a house by the first of January, in order that B may give possession of it at that time to C, to whom B has contracted to let it. A is informed of the contract between B and C. A builds the house so badly that before the 1st of January it falls down and had to be rebuilt by B, who in consequence loses the rent which he was to have received from C, and is obliged to make compensation to C for the breach of his contract. A must make compensation to B for the cost of rebuilding the house, for the rent lost and for the compensation made to C.

(ii) A delivers to B, a common carrier, a machine to be conveyed without delay to A's mill, informing B that his mill is stopped for want of the machine. B unreasonably delays the delivery of the machine and A, in consequence, loses a profitable contract with the government. A is entitled to receive from B, by way of compensation, the average amount of profit which would have been made by the working of the mill during the time that delivery of it was delayed. But, however, the loss sustained through the loss of the government contract cannot be claimed.

(iii) X's mill was stopped due to the breakdown of a shaft. He delivered the shaft to Y, a common carrier, to be taken to a manufacturer to copy it and make a new one. X did not make known to Y that delay would result in a loss of profits. By some neglect on the part of Y the delivery of the shaft was delayed in transit beyond a reasonable time. As a result, the mill remained idle for a longer time than otherwise would have been, had the shaft been delivered in time. Held, Y was not liable for loss of profits during the period of delay as the circumstances communicated to Y did not show that a delay in the delivery of the shaft would entail loss of profits to the mill. [Hadley vs. Baxendale].

(iv) A contracts to sell and deliver to B certain cloth on the 1st of January to be used for making caps of a particular kind for which there is no demand except that particular season. The cloth was not delivered till the appointed time and it was too late to be used for that year's use. B is entitled to receive from A only ordinary damages, i.e., the difference between the contract price of the cloth and its market price at the time of delivery but not the profits which he expected to obtain by making caps, nor the expenses which he has incurred in making preparation for the manufacturing of caps.

3. ***Vindictive or Punitive Damages:*** These damages are awarded with a view to punish the defendant and not solely with the idea of awarding compensation to the plaintiff. These have been awarded (a) for breach of a promise to marry; (b) for wrongful dishonour of a cheque by a banker possessing adequate funds of the customer. The measure of damages in case (a) is dependent upon the severity of the shock to the sentiments of the promisee. In case (b), the rule is, smaller the amount of the cheque dishonoured, larger will be the amount of damages awarded.

4. ***Nominal Damages:*** These are awarded in cases of breach of contract where there is only technical violation of the legal right but no substantial loss is caused thereby. The damages granted in such cases are called nominal because they are very small, for example, a rupee. This small amount is awarded as a matter of course.

3.3.3 Meaning of Specific Performance

There are other remedies in a contract suit besides damages. The main one is specific performance. Where damages are not an adequate remedy, the court may direct the party in breach to carry out his promise according to the term of the contract. This is called specific performance of the contract. Some of the instances where court may direct specific performance are: a contract for the sale of particular house or some rare article (antique) or any other thing for which monetary compensation is not enough because the injured party will not be able to get an exact substitute in the market. However, specific performance may not be granted where---(i) monetary compensation is an adequate relief; (ii) the contract is of personal nature, e.g., a contract to paint a picture; (iii) where it is not possible for the court to supervise the performance of the contract, e.g., a building contract; (iv) the contract is made by an incorporated company beyond its object clause as laid down in its memorandum of association.

3.3.4 Remedy of Injunction

Injunction means an order of the court prohibiting a person to do something where a party is in breach of a negative term of contract (i.e., where he does something which he promised not to do), the court may by, issuing an order, prohibit him from doing so. Thus where N, a film star, agreed to act exclusively for a particular producer for one year but she contracted to act for some other producer, she could be restrained by an injunction to do so.

3.3.5 Remedy by Way of a Suit on Quantum Meruit

The phrase '*quantum meruit*' means as much as is merited (earned). The normal rule of law is that unless a party has performed his promise in its entirety, it cannot claim performance from the other. To this rule, however, there are certain exceptions on the basis of '*quantum meruit*'. A right to sue on a '*quantum meruit*' arises where a contract partly performed by one party has become discharged by the breach of other party.

3.4 LIQUIDATED DAMAGES AND PENALTY

Monetary compensation for a loss, detriment, or injury to a person or a person's rights or property, awarded by a court judgment or by a contract stipulation regarding breach of contract. Generally, contracts that involve the exchange of money or the promise of performance have a liquidated damages stipulation. The purpose of this stipulation is to establish a predetermined sum that must be paid if a party fails to perform as promised one.

Sometimes parties themselves at the time of entering into a contract agree that a particular sum will be payable by a party in case of breach of the contract by him. Such a sum may either be by way of 'liquidated damages' or it may be way of 'penalty'. The essence of liquidated damages is a genuine covenanted pre-estimate of the damages. Thus, the stipulated sum payable in case of breach is to be regarded as liquidated damages if it be found that parties to the contract conscientiously tried to make a pre-estimate of the loss which might happen to them in case the contract was broken by any of them. On the other hand, the essence of a penalty is a payment of money stipulated as "in terrorem" of the offending party. Thus, if it is found that the parties made no attempt to estimate the loss that might happen to them on breach of the contract but still stipulated a sum to be paid in case of a breach of it, with the object of coercing the offending party to perform the contract it is a case of penalty.

It is obvious that a term in a contract amounts to a penalty where a sum of money, which is out of all proportion to the loss, is stipulated as payable in case of its breach. Where the amount payable, in case of its breach, is fixed in advance whether by way of liquidated damages or penalty, the party may claim only a reasonable compensation for the breach, not exceeding the amount so named or, as the case may be, the penalty stipulated for. (s.74).

Examples: (i) A contracts with B to pay B ₹ 1,000 if he fails to pay B ₹ 500 on that day. A fails to pay ₹ 500 on that day. B is entitled to recover from A such compensation not exceeding ₹ 1,000, as the court considers reasonable. (ii) A contracts with B that if A practices as a surgeon within Calcutta, he will pay B ₹ 5,000. A, practices as a surgeon in Calcutta. B is entitled to such compensation not exceeding ₹ 5,000 as the court considers reasonable.

Whether payment of interest at a higher rate amounts to penalty? Whether an agreement to pay interest at a higher rate in the case of breach of a contract amounts to penalty shall depend upon the circumstances of each case. However, following rules may be helpful in understanding the legal position in this regard.

(i) A stipulation for increased interest from the date of default shall be a stipulation by way of penalty if the rate of interest is abnormally high. A gives B a bond for the repayment of ₹ 1,000 with interest at 12% p.a. at the end of six months with a stipulation that in case of default interest shall be payable at the rate of 75 per cent from the date of default. This is a stipulation by way of penalty and B is only entitled to recover from A such compensation as the court considers reasonable.

(ii) Where there is a stipulation to pay increased interest from the date of the bond and not merely from the date of default; it is always to be considered as penalty.

(iii) As regards compound interest, it is not itself a penalty. But it is allowed only in cases where the parties expressly agree to it. However a stipulation to pay compound interest at a higher rate on default is considered as a penalty.

(iv) An agreement to pay a particular rate of interest with stipulation that a reduced rate will be acceptable if paid punctually is not a stipulation by way of penalty.

Thus, where a bond provided for payment of interest at 12% p.a. with a provision that if the debtor pays interest punctually at the end of every year the creditor would accept interest at the rate of 9% p.a. Such a clause is not in the nature of penalty and hence interest @ 12% shall be payable.

Damages can be liquidated in a contract only if:

- the injury is either 'uncertain' or 'difficult to quantify';
- the amount is reasonable and considers the actual or anticipated harm caused by the contract breach, the difficulty of proving the loss, and the difficulty of finding another, adequate remedy; and,
- the damages are structured to function as damages, not as a penalty.

If these criteria are not met, a liquidated damages clause will be void.

3.4.1 Penalty

A penalty is a sum that is disproportionate to the actual harm. It serves as a punishment or as a deterrent against the breach of a contract. Penalties are granted when it is found that the stipulations of a contract have not been met. For example, a builder who does not meet his or her schedule may have to pay a penalty.

Liquidated damages, on the other hand, are an amount estimated to equal the extent of injury that may occur if the contract is breached. These damages are determined when a contract is drawn up, and serve as protection for both parties that have entered the contract, whether they are buyer and seller, employer and employee or other similar parties.

3.5 CONTRACT OF GUARANTEE

3.5.1 Purpose of Guarantee

The contracts of guarantee are among the most common business contracts and are used for a number of purposes. These are:

(i) The guarantee is generally made use of to secure loans. Thus, a contract of guarantee is for the security of the creditor.

(ii) The contracts of guarantee are sometimes called performance bonds. For example, in the case of a construction project, the builder may have to find a surety to stand behind his promise to perform the construction contract.

Also employers often demand a type of performance bond known as a fidelity bond from employees who handle cash, etc., for the good conduct of the latter. If an employee misappropriates then the surety will have to reimburse the employer.

(iii) Bail bonds, used in criminal law, are a form of contract of guarantee. A bail bond is a device which ensures, that a criminal defendant will appear for trial. In this way a prisoner is released on bail pending his trial. If the prisoner does not appear in the court as desired then the bond is forfeited.

In this lesson our primary concern is with the contracts of guarantee which are used for securing loan.

3.5.2 Definition and Nature of the Contract of Guarantee (s.126)

A contract of guarantee is defined as, "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 'surety'; the person for whom the guarantee is given is called the

'principal debtor', and the person to whom the guarantee is given is called the 'creditor'. A contract of guarantee may be either oral or in writing.

From the above discussion, it is clear that in a contract of guarantee there must, in effect, be two contracts, a principal contract between the principal debtor and creditor, and a secondary contract between the creditor and the surety. In a contract of guarantee there are three parties, viz., the creditor, the principal debtor and the surety. Therefore, there is an implied contract also between the principal debtor and the surety.

Example: When 'A' requests 'B' to lend ₹ 10,000 to C and guarantees that C will repay the amount within the agreed time and that on 'C' failing to do so, he will himself pay to 'B', there is a contract of guarantee.

The contract of surety, is not a contract collateral to the contract of the principal debtor, but is an independent contract. There must be a distinct promise on the party of the surety to be assumable for the debt. It is not necessary that the principal contract, between the debtor and the creditor, must exist at the time the contract of guarantee is made; the original contract between the debtor and creditor may be about to come into existence. Similarly, under certain circumstances, a surety may be called upon to pay though principal debtor is not liable at all.

Also, where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join (s.144).

3.5.3 Fiduciary Relationship

A contract of guarantee is not a contract "*uberrimae fidei*" (requiring utmost good faith). Nevertheless, the suretyship relation is one of trust and confidence and the validity of the contract depends upon good faith on the part of the creditor. A creditor must disclose all those facts which, under the circumstances, the surety would expect not to exist. So where guarantee is given for good conduct of an employee, the employer's failure to inform the surety of any breach on the part of employee, will discharge the surety. Similarly, where X guarantees the existing and future liabilities of A to B up to a certain amount which limit has already been exceeded, the contract of guarantee can be avoided on the ground of concealment of a materiel fact. However, it should be noted that it is no part of the creditor's duty to inform the surety about all his previous dealings with the debtor.

3.6 KINDS OF GUARANTEES

3.6.1 Oral or Written Guarantee

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

3.6.2 Specific and Continuing Guarantee

From the point of view of the scope of guarantee a contract of guarantee may either be specific or continuing. A guarantee is a "specific guarantee", if it is intended to be applicable to a particular debt and thus comes to end on its repayment. A specific guarantee once given is irrevocable.

Examples: (i) A guarantees the repayment of a loan of ₹ 10,000 to B by C (a banker). The guarantee in this case is a specific guarantee.

A guarantee which extends to a series of transactions is called a "continuing guarantee" (s.129).

(ii) A guarantees payment to B, a tea-dealer, to the amount of ₹ 10,000 for supplying of any tea from time to time to C. B supplies C with tea of the value above ₹ 10,000 and C pays B for it. Afterwards B supplies C with tea to the value of ₹ 15,000. C fails to pay. The guarantee given by A was a continuing guarantee and he is accordingly liable to B to the extent of ₹ 10,000.

A guarantee regarding the conduct of another person is a continuing guarantee. Unlike a specific guarantee which is irrevocable, a continuing guarantee can be revoked regarding further transactions (s.130). However, continuing guarantee cannot be revoked regarding transactions that have taken place recently.

Examples: (i) X guarantees repayment of advances made to A within 6 months subject to a maximum of ₹ 20,000. If ₹ 10,000 has been advanced by the end of 2 months, guarantee is irrevocable insofar as this advance of ₹ 10,000 is concerned.

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

The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions. (s.131).

3.6.3 A Guarantee may Either be for the Whole Debt or a Part of the Debt

Difficult questions arise in case of guarantee for a limited amount because there is an important distinction between a guarantee for only a part of the whole debt and a guarantee for the whole debt subject to a limit.

For instance, where X owes Y ₹ 50,000 and A has stood as surety for ₹ 30,000, the question may arise whether A has guaranteed ₹ 30,000 out of ₹ 50,000 or whether he has guaranteed the full amount of ₹ 50,000 subject to a limit of ₹ 30,000. This matter becomes important if X is adjudged insolvent and Y wants to prove in X's insolvency and also enforce his remedy against A. If A stood surety only for a part of the debt and if X's estate can pay only 25 paisa dividend in the rupee, then Y can get ₹ 30,000 the full amount of guarantee from A and ₹ 5,000 from X's estate, being ¼ of the balance, i.e., ₹ 50,000 - ₹ 30,000 = ₹ 20,000 which was not guaranteed. Since after paying ₹ 30,000 to Y, A can claim from X's estate, he will get ₹ 7,500 being ¼ of ₹ 30,000 paid by A to Y. If on the other hand, A had stood surety for the whole debt of ₹ 50,000 subject to a limit of ₹ 30,000 then Y can recover from A ₹ 30,000 and from X's estate ₹ 12,500, i.e., ¼ of ₹ 50,000. A will not get any dividend unless Y has been fully paid. This can happen only if X's estate declares a higher dividend.

3.7 RIGHTS AND OBLIGATIONS OF THE CREDITOR

3.7.1 Rights of a Creditor

1. The creditor is entitled to demand payment from the surety as soon as the principal debtor refuses to pay or makes default in payment. The liability of the surety cannot be postponed till all other remedies against the principal debtor have been exhausted. In other words, the creditor cannot be asked to exhaust all other remedies against principal debtor before proceeding against surety.

   The creditor also has a right of general lien on the securities of the surety in his possession. This right, however, arises only when the principal debtor has made default and not before that.

2. Where surety is insolvent, the creditor is entitled to proceed in the surety's insolvency and claim the *pro rata* dividend.

3.7.2 Obligations Imposed on a Creditor in a Contract of Guarantee

1. Not to change any terms of the original contract. The creditor should not change any terms of the original contract without seeking the consent of the surety. Section 133 provides, "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 the transactions subsequent to the variance".

   Example: A banker contracts to lend X ₹ 5,000 on March 4. A guarantees repayment. The banker pays X ₹ 5,000 on January 1. A in this case is discharged from his liability as the contract has been varied as much as the banker might sue X before March 4, but it cannot sue A as the guarantee is from March 4.

2. Not to release or discharge the principal debtor. The creditor is under an obligation not to release or discharge the principal debtor. Section 134 states: "The surety is discharged by a contract between the creditor and 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".

   Example: A gives a guarantee to banker C for repayment of the debt granted to B. B later contracts with his creditors (including C, the banker) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C and A is discharged from his suretyship.

3. Not to compound, or give time to, or agree not to sue the principal debtor. Section 135 provides, "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 use the principal debtor, discharges the surety, unless the surety assents to such contract".

   If the time for repayment is extended, the debtor may die or become insane or insolvent or his financial position may become weaker in the meanwhile, with one effect that the surety's remedy to recover the money in case the principal debtor defaults, may be impaired. However, there are certain exceptions. These are:

   a. Section 136 states that if the creditor makes an agreement with a third party, but not with the principal debtor, to give extension of time to the principal debtor, surety is not discharged even if his consent has not been sought.

   Example: C, the holder of an overdue bill of exchange, drawn by A as surety for B and accepted by B, contracts with M to give time to B. A is not discharged.

   b. Mere forbearance on the part of creditor to sue the principal debtor, or to enforce any other remedy against him, does not, in the absence of a provision to the contrary, discharge the surety (s.137).

   Example: B owes C (a banker) a debt guaranteed by A and the debt becomes payable, but C does not sue B for a year after debt becomes payable. A is not discharged from his suretyship.

   c. If the creditor releases one of the co-sureties, the other co-surety (or co-sureties) thereby is not discharged. The co-surety released by the creditor is also not released from his liability to the other sureties (s.138).

4. Not to do any act inconsistent with the rights of the surety (s.139). Where C lends money to B on the security of a joint and several promissory note made in C's favour by B and by A as surety for B, together with a bill of sale of B's furniture,

which gives power to C to sell the furniture and apply the proceeds in discharge of the note. Subsequently, C sells the furniture, but owing to his misconduct and wilful negligence, only a small price is realised, then A is discharged from liability on the note.

3.8 RIGHTS, LIABILITIES AND DISCHARGE OF SURETY

3.8.1 Rights of Surety

Rights of a surety may be classified under three heads: (i) rights against the creditor, (ii) rights against the principal debtor and (iii) rights against co-sureties.

Rights Against the Creditor

In case of fidelity guarantee, the surety can direct creditor to dismiss the employee whose honesty he has guaranteed, in the event of proved dishonesty of the employee. The creditor's failure to do so will exonerate the surety from his liability.

Rights Against the Principal Debtor

(a) ***Right of Subrogation.*** Section 140 lays down that where a surety has paid the guaranteed debt on its becoming due or has performed the guaranteed duty on the default of the principal debtor, he is invested with all the rights which the creditor has against the debtor. In other words, the surety is subrogated to all the rights which the creditor had against the principal debtor. So, if the creditor loses, or without the consent of the surety parts with any securities (whether known to the surety or not) the surety is discharged to the extent of the value of such securities (s.141). Further, the creditor must hand over to the surety, the securities in the same condition as they formerly stood in his hands.

(b) ***Right to be Indemnified.*** The surety has a right to recover from the principal debtor the amounts which he has rightfully paid under the contract of guarantee.

3.8.2 Rights against Co-sureties

(a) ***Right of Contribution.*** Where a debt has been guaranteed by more than one person, they are called co-sureties. s.146 provides for a right of contribution between them. When a surety has paid more than his share or a decree has been passed against him for more than his share, he has a right of contribution from the other sureties who are equally bound to pay with him.

Example: A, B and C are sureties to D for the sum of ₹ 3,000 lent to E. E defaults in making payment. A, B and C are liable, as between themselves to pay ₹ 1,000 each and if any one of them has to pay more than his share, i.e., ₹ 1,000 he can claim contribution from the others, for the amount paid in excess of ₹ 1,000.

If one of the sureties becomes insolvent, the solvent co-sureties shall have to contribute the whole amount equally.

(b) Where, the co-sureties have guaranteed different sums, they are bound under s. 147 to contribute equally, subject to the limit fixed by their guarantee and not proportionately to the liability undertaken.

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

(ii) In the above example, if D makes default to the extent of ₹ 40,000, A is liable to pay ₹ 20,000 and B and C ₹ 15,000 each.

3.8.3 Liability of Surety

Unless the contract provides otherwise, the liability of the surety is co-extensive with that of the principal debtor (s. 128). 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 the liability arises only on default by the principal debtor. But as soon as the principal debtor defaults, the liability of the surety begins and runs co-extensive with the liability of the principal debtor, in the sense that 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 even not bound to give notice of the default to the surety, unless it is expressly provided for.

Position of Surety in case of a Minor Principal Debtor: According to the decision of the Bombay High Court in Kashiba vs. Shripat I.L.R. 10 Bom., 1927, the surety can be held liable, though a minor debtor is not liable. But the later decisions of the Bombay High Court have taken a contrary view. In Manju Mahadeo vs. Shivappa Manju and in Pestonji Mody vs. Meherbai it was held that as under s.128, the liability of the surety is co-extensive with that of the principal debtor, it can be no more than that of the principal debtor and that the surety therefore cannot be held liable on a guarantee given for default by a minor. If a minor could not default, the liability of the guarantor being secondary liability does not arise at all. The same view has been endorsed by the Madras High Court in the case of Edavan Nambiar vs. Moolaki Raman (A.I.R. 1957 Mad. 164). It was held that unless the contract otherwise provides, a guarantor for a minor cannot be held liable.

3.8.4 Discharge of Surety

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

1. ***By Notice of Revocation (s.130).*** A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

   Example: A, in consideration of B's discounting, at A's request, bills of exchange for C, guarantees to B, for twelve months, the due payment for all such bills to the extent of ₹ 5,000. B discounts bill for C to the extent of ₹ 2,000. Afterwards, at the end of the three months, A revokes the guarantee. The revocation discharges A from liability to B for any subsequent discount. But A is liable to B for ₹ 2,000 on default of C.

2. ***By the death of surety (s.131).*** The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.

3. ***By variance in terms of the contract (s.133).*** 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.

Example: A becomes surety to C for B's conduct as a manager in C's bank. Afterwards B and C contract, without A's consent, that B's salary shall be raised and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent and is not liable to make up this loss.

4. ***By release or discharge of principal debtor (s.134).*** The surety is discharged by any contract between the creditor and 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.

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

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

5. ***By compounding with, or giving time to, or agreeing not to sue the principal debtor (s.135).*** 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. The surety shall, however, be not discharged if (a) he assents to such contract, (b) the contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor.

   Example: C, the holder of an overdue bill of exchange drawn by A as surety for B and accepted by B, contracts with M to give time to B. A is not discharged.

6. ***By creditor's act or omission impairing surety's eventual remedy (s.139).*** If the creditor does any act which is inconsistent with the right of the surety, or omits to do any act which his duty to the surety requires him to do and the eventual remedy of surety himself against the principal debtor is thereby impaired, the surety is discharged.

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

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

7. ***Loss of security.*** If the creditor loses or parts with any security given to him by the principal debtor at the time the contract of guarantee was made, the surety is discharged to the extent of the value of the security, unless the surety consented to the release of such security (s.141).

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

3.9 CONTRACT OF INDEMNITY

3.9.1 Meaning of Indemnity

Sections 124 and 125 provides for a contract of indemnity. Section 124 provides that a contract of indemnity is a contract whereby one party promises to save the other from loss caused to him (the promisee) by the conduct of the promisor himself or by the conduct of any other person. A contract of insurance is a glaring example of such type of contracts.

A contract of indemnity may arise either by (i) an express promise or (ii) 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. The contract of indemnity, like any other contract, must have all the essentials of a valid contract. There are two parties in a contraction of identity indemnifier and indemnified. The indemnifier promises to make good the loss of the indemnified (i.e., the promisee).

Example: A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of ₹ 200. This is a contract of indemnity.

3.9.2 Rights of the Indemnified (i.e., the Indemnity holder)

The Indemnity holder is entitled to recover from the promisor: (i) All damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies; (ii) All costs of suit which he may have to pay to such third party, provided in bringing or defending the suit (a) he acted under the authority of the indemnifier or (b) if he did not act in contravention of orders of the indemnifier and in such a way as a prudent man would act in his own case; (iii) All sums which may have been paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the indemnifier and was one which it would have been prudent for the promisee to make.

3.9.3 Rights of the Indemnifier

The Act makes no mention of the rights of indemnifier. However, his rights, in such cases, are similar to the rights of a surety under s.141, viz, 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.

3.9.4 Commencement of Indemnifier's Liability

Indemnity requires that the party to be indemnified shall never be called upon to pay. Indemnity is not necessarily given by repayment after payment. The indemnified may compel the indemnifier to place him in a position to meet liability that may be cast upon him without waiting until the promisee (indemnified) has actually discharged it.

Distinction between a Contract of Guarantee and a Contract of Indemnity: L.C. Mather in his book "Securities Acceptable to the Lending Banker" has very briefly, but excellently, brought out the distinction between indemnity and guarantee by the following illustration. In a contract in which A says to B, 'If you lend £20 to C, I will see that your money comes back' is an indemnity. On the other hand undertaking in these words, "If you lend £20 to C and he does not pay you, I will be a guarantee to it." Thus, in a contract of indemnity, there are only two parties, indemnifier and indemnified. In case of a guarantee, on the other hand, there are three parties, the 'principal debtor', the 'creditor' and the 'surety'. Other points of difference are:

1. The liability of a promisor is primary and independent in a contract of indemnity. In a contract of guarantee, the liability of the surety is secondary, the primary liability being that of the principal debtor.
2. In the case of guarantee, there is an existing debt or obligation, the performance of which is guaranteed by the surety. In case of indemnity the possibility of any loss happening is a contingency against which the indemnifier undertakes to indemnify.
3. In a contract of guarantee, after discharging the debt, the surety is entitled to proceed against the principal debtor in his own name while in case of indemnity, the indemnifier cannot proceed against third parties in his own name, unless there is an assignment in his favour.

3.10 FREEDOM TO CONTRACT

3.10.1 The Parties to a Contract, in a Sense, Make the Law for Themselves

The law of contract differs from other branches of law in a very important aspect. It does not lay down so many precise rights and duties which the law will protect and enforce; it contains rather a number of limiting principles subject to which the parties may create rights and duties for themselves and the law will uphold those rights and duties. So long as the parties to a contract do not transgress some legal provision, they can agree for any terms they like in regard to the subject matter of their contract and the law will give effect to their contract. Let us illustrate. 'A' agrees to sell his motorcycle worth ₹ 15,000 for ₹ 6,000 only to 'B'. The agreement gives rise to a legal obligation on the part of 'A' to deliver the motorcycle to 'B' and on the part of 'B' to pay ₹ 6,000 to 'A'. They may fix any terms as regards time of delivery and that of payment. The payment may be agreed to be made by instalments. Though the motorcycle is worth ₹ 15,000, it is being sold for ₹ 6,000 only. Assuming all the essential elements of a valid contract are present, the contract is enforceable by law. But many developments in the recent past have affected this freedom to contract.

3.10.2 Freedom to Contract is a Myth or an Illusion

The freedom of the parties is limited by two factors. There are certain laws for the protection of the employees, and an employer cannot, therefore, induce his employees to enter into any contract favourable to the employer. Further, the standard form of contract (with printed terms and conditions) is in vogue today, and several contracts entered into by laymen are not the result of individual negotiations. Thus, if a person is in need of electricity, or telephone connection, it is not possible for him to settle the terms of the agreement with the Electricity Board or the Telephone Corporation, etc. Each of them has their own printed contracts and the intending customer has either to accept on those terms, or go without electricity or telephone, as the case many be. In such a case, since one does not want to go without such necessary services, the individual is in effect compelled to accept all those standard terms. Thus, absolute freedom of contract is largely an illusion or mostly a myth.

The freedom to contract has been intervened in three ways, thereby making it a myth. These are:

(i) enactment of laws by the welfare states to protect the interests of those parties to the contract which have a weak bargaining power,

(ii) intervention by the courts, which refuse to enforce, and even rewrite terms in private contracts in order to protect the real or presumed victims of one sided or unfair or unconscionable contracts,

(iii) widespread adoption of 'form contracting' by business.

3.10.3 What is a Standard Form Contract?

A standard form contract is a document which is generally printed, containing terms and conditions, with certain blanks to be filled in. It is prepared by the business people. The customer has only to sign it. Therefore, from his standpoint, the freedom to contract is restricted. Many of the contracts now being entered into by consumers are not the result of individual negotiations; rather they are one-sided contracts. The consumer has to accept them or leave them. Rather than permit the form to be varied, the firm or industry imposing it simply refuses to deal with anyone who will not accept its terms. A contract thus is imposed by a party having a strong bargaining power on a party having a weak bargaining power. Hence, such a contract is known as a **contract of adhesion.** Most contracts for photocopier machines, insurance, automobiles, telephone, water and power connection and a host of other goods and services are contracts of adhesion. In fact, the process of dilution of the freedom of the parties to contract has started in a big way and a time might come when it shall only be a myth.

Additional terms implied into the contract. In general, the contents of a contract are determined by agreement between the parties. Nevertheless, there are various circumstances in which additional terms may be supplied into the agreement. These additional terms may be implied by (i) custom (ii) courts (iii) statute.

(i) ***By custom:*** A contract must always be examined in the light of its surrounding commercial context. The terms of a contract may have been negotiated against the background of the custom of a particular locality or trade. The parties automatically assume that their contract will be subject to such customs and so do not deal specifically with the matter in the contract.

(ii) ***By courts:*** The courts will be prepared to imply a term into a contract in order to give effect to the obvious intention of the parties. Sometimes the point at issue has been overlooked or the parties have failed to express their intention clearly. In these circumstances, the court will supply terms in the interests of 'business efficacy' so that the contract makes commercial common sense.

Certain standard terms have been implied by the common law in a number of business contracts. The courts will imply a term into a lease of furnished house that it will be reasonably fit for habitation at the start of the tenancy. A contract of employment is subject to a number of implied terms. An employer is under a legal duty to provide a safe system of work for his employees, while an employee is under a duty to obey legitimate orders and show good faith towards his employer. By implying a term into the contract, the court is imposing reasonable obligations which the parties would have no doubt included in their agreement, if they had troubled to think about the matter. These implied terms may be excluded by express agreement between the parties.

(iii) ***By statute:*** A term may be implied in a contract by an Act of Parliament. In many cases, these implied terms which began among the customs of merchants, were recognized by the courts and then included in the statute by codification. The best example of this process is provided by law relating to the sale of goods.

Check Your Progress

Fill in the blanks:

1. When a __ _____is committed by one party, the other party may treat the contract as rescinded.
2. _____as general damages will be awarded only for those losses that directly and naturally result from the breach of the contract.

Contd...

3. _____ means an order of the court prohibiting a person to do something where a party is in breach of a negative term of contract (i.e., where he does something which he promised not to do), the court may by issuing an order, prohibit him from doing so.
4. The person who gives the guarantee is called _____.
5. Sections 124 and 125 provide for a contract of_____.
6. The phrase _____means as much as is merited (earned).

3.11 LET US SUM UP

- As soon as either party commits a breach of the contract, the other party becomes entitled to certain reliefs. These remedies are available under the Indian Contract Act, 1872, as also under the Specific Relief Act, 1963. There are three remedies under the Specific Relief Act, 1963: (i) a decree for specific performance (s.10); (ii) an injunction (s.38-41); (iii) a suit on quantum meruit (s.30).
- The loss or damages caused to the aggrieved party must be such that either--- (i) it arose naturally or (ii) the parties knew, when they made the contract, was likely to arise. In other words, such compensation cannot be claimed for any remote or indirect loss or damage sustained by reason of the breach of the contract.
- What is the most common remedy for breach of contracts? The usual remedy for breach of contracts is suit for damages. The main kind of damages awarded in a contract suit is ordinary damages. This is the amount of money that would put the aggrieved party, in as good a position, as if. there had not been a breach of contract. The idea is to compensate the aggrieved party for the loss he has suffered as a result of the breach of the contract.
- There are other remedies in a contract suit besides damages. The main one is specific performance. Where damages are not an adequate remedy, the court may direct the party in breach to carry out his promise according to the term of the contract. This is called specific performance of the contract.
- The freedom to contract has been intervened in three ways, thereby making it a myth. These are: (i) enactment of laws by the welfare states to protect the interests of those parties to the contract which have a weak bargaining power, (ii) intervention by the courts, which refuse to enforce, and even rewrite terms in private contracts in order to protect the real or presumed victims of one sided or unfair or unconscionable contracts, (iii) widespread adoption of 'form contracting' by business.
- A contract of guarantee is defined as a contract to perform the promise, or discharge the liability of a third person in case of his default.
- There are different kinds of guarantee. These are: (i) oral or written guarantee; (ii) specific or continuing guarantee; (iii) the whole-debt or the part-debt guarantee;
- The rights of a surety may be classified under three heads, viz., (i) rights against the creditor, (ii) rights against the principal debtor, and (iii) rights against co-sureties.
- The liability of surety under a contract of guarantee comes to an end under certain circumstances. These are: (i) By notice of revocation; (ii) By the death of the surety; (iii) By variance in the terms of the contract; (iv) By the release or discharge of the principal debtor; (v) By compounding with, or giving time to, or agreeing not to sue the principal debtor; (vi) By creditor's act or omission impairing surety's eventual remedy; (vii) By loss of security by the creditor.

- A contract of indemnity is a contract whereby one party promises to save the other from loss caused to him, the promisee by the conduct of the promisor himself or by the conduct of any other person.

3.12 LESSON END ACTIVITY

Discuss an example related to liquidated damages and Penalty.

3.13 KEYWORDS

Nominal damages: These are awarded in cases of breach of contract where there is only technical violation of the legal right but no substantial loss is caused thereby.

Ordinary damages: Cannot be claimed for any remote or indirect loss or damages by reason of the breach.

Special damages: These damages are claimed in case of loss of profit.

Vindictive or punitive damages: These damages are awarded with a view to punish the defendant and not solely with the idea of awarding compensation to the plaintiff.

Specific Guarantee: It is a guarantee which is intended to be applicable to a particular debt; and comes to an end on its repayment.

Continuing Guarantee: It is a guarantee which extends to a series of transactions.

Contract of Indemnity: It is that contract whereby one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of any other person.

3.14 QUESTIONS FOR DISCUSSION

1. What are the different ways in which a breach of contract may arise?
2. Whether time is the essence of a contract or not?
3. What are the main types of remedies for breach of a contract?
4. State the principles on which damages are awarded for breach of contracts.
5. Give some examples of ordinary damages. Can ordinary damages be claimed for any remote or indirect loss or damage by reason of the breach?
6. Give some examples of special damages. Is it that the communication of the special circumstances a prerequisite to the claim for special damages?
7. What is meant by liquidated damages and penalty?
8. What is specific performance? Under what circumstances, it is (i) granted (ii) not granted?
9. What is a penalty clause? Why is it that the court will not enforce a penalty clause?
10. Explain (i) exemplary damages (ii) quantum meruit.
11. What do you understand by the contract of guarantee?
12. "The liability of a surety is secondary and co-extensive with that of principal debtor." Comment.
13. What is a 'continuing guarantee'? When can it be revoked?
14. Describe the rights of a surety against (i) co-sureties and (ii) the creditor.

15. Explain the circumstances under which a surety may be discharged from the liability by the conduct of the creditor.
16. Define the contract of 'Indemnity'. Describe the rights of the indemnifier and the indemnity-holder.
17. "Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay." Discuss.

Check Your Progress: Model Answer

1. Breach of contract
2. Compensation
3. Injunction
4. Surety
5. Indemnity
6. Quantum meruit

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UNIT 4

BAILMENT AND PLEDGE

CONTENTS

4.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the meaning and kinds of bailment
- Discuss the duties and rights of the bailor and the bailee
- Explain the duties and rights of a finder of lost goods
- Understand the meaning of pledge
- Describe the rights and duties of the pledgor and the pledgee

4.1 INTRODUCTION

At one time or the other, we enter into legal relationships, called bailment and pledge. Bailments are quite common in business. Traders often store their surplus goods in

warehouses; and utilise the services of cold storages for keeping their goods to be taken back as and when required: and factory owners often send machinery back to vendors for repairs. Also, goods are pledged for securing loans. The sections quoted in this lesson refer to the Indian Contract Act, 1872, unless otherwise stated.

4.2 DEFINITION OF BAILMENT AND ITS KINDS

4.2.1 Definition of Bailment (s.148)

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

The explanation to the earlier Section points out that delivery of possession is not necessary, where one person, already in possession of goods contracts to hold them as bailee.

The bailee is under an obligation to re-deliver the goods, in their original or altered form, as soon as the time of use for, or condition on which they were bailed, has elapsed or been performed".

Let's illustrate, (i) A delivers some clothes to B, a dry cleaner, for dry cleaning. (ii) A delivers a wrist watch to B for repairs. (iii) A lends his book to B for reading. (iv) A delivers a suit-length to a tailor for stitching. (v) A delivers some gold biscuits to B, a jeweller, for making jewellery. (vi) Delivery of goods to a carrier for the purpose of carrying them from one place to another. (vii) Delivery of goods as security for the repayment of loan and interest thereon, i.e., pledge.

From the definition of bailment, the following characteristics should be noted:

1. ***Delivery of goods:*** The essence of bailment is delivery of goods by one person to another for some temporary purpose. Delivery of goods may, however, be actual or constructive. Actual delivery may be made by handing over goods to the bailee. Constructive delivery may be made by doing something which has the effect of putting the goods in the possession of the intended bailee or any person authorised to hold them on his behalf (s.149).

   Examples: (i) A, holding goods on behalf of B, agrees to hold them on behalf of C, there is a constructive transfer of possession from C to A.

   (ii) A an owner of a scooter, sells it to B, who leaves the scooter in the possession of A. A becomes a bailee, although originally he was the owner.

   It needs to be noted that bailment is concerned with goods only. Current money, i.e, the legal tender (but not old and rare coins) is not goods. A 'deposit of money', therefore, is not bailment.

2. ***Bailment is Based on a Contract:*** In bailment, the delivery of goods is upon a contract that when the purpose is accomplished, they shall be returned to the bailor. For example, where a watch is delivered to a watch mechanic for repairing, it is agreed that it will be returned, after repair, on the receipt of the agreed or reasonable charges.

   Though bailment is usually based on a contract, there are certain exceptions, e.g., the case of a finder of lost goods. The finder of lost goods is treated as a bailee of the lost article, though obviously, there is no contract between the finder and the real owner (s.168).

3. ***Return of goods in specie:*** The goods are delivered for some purpose and it is agreed that the specific goods shall be returned. Return of specific goods (in specie) is an essential characteristic of bailment. Thus, where an equivalent and not the same is agreed to be returned, there is no bailment.

4. ***Ownership of goods:*** In a bailment, it is only the possession of goods which is transferred and not the ownership thereof, therefore the person delivering the possession of goods need not be the owner; his business is to transfer possession and not ownership.

4.2.2 Kinds of Bailments

Bailments may be, classified into six kinds as follows:

(i) ***Deposit:*** Delivery of goods by one person to another for the use of the former, i.e., bailor;

(ii) ***Commodatum:*** Goods lent to a friend gratis to be used by him;

(iii) ***Hire:*** Goods lent to the bailee for hire, i.e., in return for payment of money;

(iv) ***Pawn or Pledge:*** Deposit of goods with another by way of security for money borrowed;

(v) Delivery of goods for being transported, or something to be done about them, by the bailee for reward.

(vi) Delivery of goods as in (v) above, but without reward.

4.3 DUTIES AND RIGHTS OF BAILOR AND BAILEE

4.3.1 Duties of a Bailor

1. ***To disclose known faults in the goods (s.150):*** The bailor is bound to disclose faults in the goods bailed, to the bailee, of which the bailor is aware and which materially interfere with the use of them or expose the bailee to extraordinary risks. If he does not make such disclosure, he is responsible for the damage arising to the bailee directly from such faults.

   If the goods are bailed for hire or reward, the bailor is responsible for such damage whether he was or was not aware of the existence of such faults in goods bailed.

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

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

2. ***Liability for breach of warranty as to title:*** The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods or to give directions respecting them (s.164).

   Example: A gives B's car to C without B's knowledge and permission. B sues C and receives compensation. A, the bailor, is responsible to make good this loss to C, the bailee.

3. ***To bear expenses in case of gratuitous bailments:*** Regarding bailments under which bailee is to receive no remuneration, s.158 provides that in the absence of a

contract to the contrary, the bailor must repay to the bailee all necessary expenses incurred by him for the purpose of the bailment.

4. ***In case of non-gratuitous bailments:*** The bailor is held responsible to bear only extraordinary expenses.

   Example: A car is lent for a journey. The ordinary expenses like petrol, etc., shall be borne by the bailee but in case the car goes out of order, the money spent in its repair will be regarded as an extraordinary expenditure and borne by the bailor.

4.3.2 Duties of a Bailee

1. ***To take care of the goods bailed (s.151):*** 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.

   In case, bailee has taken the amount of care as described above, he shall not be responsible, in the absence of any special contract, for the loss, destruction or deterioration of the thing bailed (s.152).

2. ***Not to make unauthorised use of goods (s.154):*** In case the bailee makes unauthorised use of goods, i.e., uses them in a way not warranted by the terms of bailment, he is liable to make compensation to the bailor for any damages arising to the goods from or during such use of them.

   Examples: (i) A lends a car to B for his own driving only. B allows C, his wife, to drive the car. C drives with care, but the car is damaged in an accident. A is liable to make compensation to B for the damage done to the car.

   (ii) A hires a car in Calcutta from B expressly to drive to Varanasi. A drives with due care, but drives to Cuttack instead. The car meets with an accident and is damaged. B is liable to make compensation to A for the damage to the car.

3. ***Not to mix bailor's goods with his own (Ss. 155-157):*** If the bailee without the consent of the bailor, mixes the goods of the bailor with his own goods and the goods can be separated or divided, the bailee shall be bound to bear the expense of separation or division and any damages arising from the mixture.

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

   But in case goods are mixed in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

   Example: A bails a barrel of flour worth ₹ 450 to B. B without A's consent mixes the flour with flour of his own, worth only ₹ 250 a barrel. B must compensate A for the loss of his flour.

4. ***To return the goods bailed without demand (s.160):*** It is the duty of the bailee to return, or deliver according to the bailor's directions, the goods bailed, without demand, as soon as the time for which they were bailed has expired, or the purpose, for which they were bailed has been accomplished.

   If bailee fails to return the goods at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time (s.161).

5. ***To return any accretion to the goods bailed (s.163):*** In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

   Example: A leaves a cow in the custody of B to be taken care of. The cow gives birth to a calf. B is bound to deliver the cow as well as the calf to A.

4.3.3 Rights of a Bailee

1. The duties of the bailor are, in fact, if looked from the point of view of bailee, the bailee's rights. Thus, a bailee can sue bailor for (a) claiming compensation for damages resulting from non-disclosure of faults in the goods; (b) for breach of warranty as to the title and the damage resulting therefrom; and (c) for extraordinary expenses. Thus in the case of wrongful deprivation the bailee has a right to use the same remedies which the owner might have used in the like case.

2. ***Another right of bailee is the right of lien (Ss. 170-171):*** Lien is a right in one person to retain that which is in his possession, belonging to another, until some debt or claim is paid. Lien, thus presupposes two things; (i) The person vested with the right of lien is in possession of the goods or securities in the ordinary course of business. (ii) The owner (bailor in this case) has a lawful debt due or obligation to discharge to the person in possession of the said goods or securities (bailee in this case). Since, lien is available only until the debt or claim is satisfied, once the debt is satisfied or obligation discharged, the right of lien is extinguished. The property so retained has, then, to be returned to or kept at the disposal of the owner (i.e., bailor). Lien may be of two types: (i) General Lien and (ii) Particular Lien.

   General Lien means the right to retain goods not only for demands arising out of the goods retained but for a general balance of account in favour of certain persons. Particular Lien, on the other hand, means the right to retain the particular goods in respect of which the claim is due. Bailee's right of lien is particular in certain cases whereas general in other cases. Particular Lien is conferred upon a bailee by virtue of the provisions of s.170. It reads: "Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the service he has rendered in respect of them".

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

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

   The provisions of s.171 empower certain categories of bailees to exercise a general lien. These include: bankers, factors, wharfingers, Attorneys of High Court and policy brokers. These bailees can retain all goods of the bailor so long as anything is due to them, unless there is a contract to the contrary.

3. ***Right against wrongful deprivation of or injury to goods (Ss.180-181):*** If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or causes them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made and either the bailor or the bailee may bring a suit against the third person for such deprivation

or injury. Now, whatever is obtained by way of relief or compensation in such a suit shall, as between the bailor and the bailee, be dealt with according to their respective interest (s.181).

4.3.4 Rights of a Bailor

1. The bailor can enforce, by suit, all duties or liabilities of the bailee.
2. In case of gratuitous bailment (i.e., bailment without reward), the bailor can demand their return whenever he pleases, even though he lent it for a specified time or purpose. But if, on the faith of such bailment, the borrower has acted in such a manner that the return of the thing before the specified time would cause him (i.e., the bailee) loss exceeding the benefit derived by him from the bailment, the bailor must indemnify the borrower for the loss if he compels an immediate return (s.159).

4.4 TERMINATION OF BAILMENT

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

1. ***On the expiry of the stipulated period:*** Where bailment is for a specific period, it comes to an end on the expiry of the specified period.

   Example: A room cooler is hired by X from Y for a period of 6 months. On the expiry of 6 months X must return the cooler.

2. ***On the accomplishment of the specified purpose:*** In case, bailment is for specific purpose it terminates as soon as the purpose is accomplished.

   Example: (i) A suit length is given to a tailor to be stitched into a suit. The tailor is bound to return it as soon as the cloth is stitched into suit.

   (ii) A hires from B certain tents and crockery on marriage of his daughter. The same must be returned as soon as marriage is accomplished.

3. ***By bailee's act inconsistent with conditions of bailment:*** If the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment, the bailor may terminate the bailment (s.153).

   Example: A lets to B for hire, a horse for his own riding. B drives the horse in his carriage. A shall have the option to terminate the bailment.

4. ***A gratuitous bailment may be terminated at any time (s.159):*** However, if premature termination causes any loss to the bailee exceeding the benefit derived from the bailment, the bailor must indemnify. Further, a gratuitous bailment terminates by the death of either the bailor or the bailee (s.162).

4.5 FINDER OF LOST GOODS

Finding is not owning. A finder of lost goods is treated as the bailee of the goods found as such and is charged with the responsibilities of a bailee, besides the responsibility of exercising reasonable efforts in finding the real owner. However, he enjoys certain rights also. His rights are summed up hereunder:

1. ***Right to retain the goods (s.168):*** A finder of lost goods may retain the goods until he receives the compensation for money spent in preserving the goods and/or amount spent in finding the true owner. A finder, however, cannot sue for such compensation. But where, a specific reward has been offered by the owner for the

return of the goods lost, the finder may sue for such reward and may retain the goods until he receives it.

2. ***Right to sell (s.169):*** When a thing which is commonly the subject of sale is lost, if the owner cannot with reasonable diligence be found or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it. (i) when the thing is in danger of perishing or of losing the greater part of its value; (ii) when the lawful charges of the finder in respect of the thing found, amount to two-third of its value.

4.6 DEFINITION OF PLEDGE OR PAWN

Section 172, defines a pledge as the bailment of goods as security for payment of a debt or performance of a promise. The person, who delivers the goods as security, is called the 'pledgor' and the person to whom the goods are so delivered is called the 'pledgee'. The ownership remains with the pledgor. It is only a qualified property that passes to the pledgee. He acquires a special property and lien which is not of ordinary nature and so long as his loan is not repaid, no other creditor or 'authority' can take away the goods or its price. Thus, in Bank of Bihar vs. State of Bihar and Ors. (1971) Company Cases 591, where sugar pledged with the Bank was seized by the Government of Bihar, the Court ordered the State Government of Bihar to reimburse the bank for such amount as the Bank in the ordinary course would have realised by the sale of sugar seized.

Delivery essential: A pledge is created only when the goods are delivered by the borrower to the lender or to someone on his behalf with the intention of their being treated as security against the advance. Delivery of goods may, however, be actual or constructive. It is constructive delivery where the key of a godown (in which the goods are kept) or documents of title to the goods are delivered. The owner of the goods can create a valid pledge by transferring to the creditor the documents of title relating to the goods.

Example: A businessman pledged a railway receipt to a bank, duly endorsed. Later he was declared bankrupt. The Official Assignee contended that the pledge of the railway receipt was not valid. Held, that the railway receipts in India are title to goods and that the pledge of the railway receipt to the bank, duly endorsed, constituted a valid pledge of the goods.

Similarly, where the goods continue to remain in the borrower's possession but are agreed to be held as a 'bailee' on behalf of the pledgee and subject to the pledgee's order, it amounts to constructive delivery, and is a valid pledge.

Advantages of Pledge: To a creditor, pledge is perhaps the most satisfactory mode of creating a charge on goods. It offers the following advantages:

1. The goods are in the possession of the creditor and therefore, in case the borrower makes a default in payment, they can be disposed of after a reasonable notice.
2. Stocks cannot be manipulated as they are under the lender's possession and control.
3. In the case of insolvency of the borrower, lender can sell the goods and prove for the balance of the debt, if any.
4. There is hardly any possibility of the same goods being charged with some other party if actual possession of the goods is taken by the lender.

4.7 PLEDGE BY NON-OWNERS

The general rule is that it is the owner of the goods who can ordinarily create a valid pledge. However, in the following cases, even a pledge by non-owners shall be valid:

1. ***Pledge by a mercantile agent:*** Where a mercantile agent is with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he was expressly authorised by the owner of the goods to make the same. Such a pledge shall, however, be valid only if the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has no authority to pledge (s.178).

   A 'mercantile agent' as per s.2(9) of the Sale of Goods Act 1930, means a mercantile agent having, in the customary course of business as such agent, authority either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of goods. For a pledge by a mercantile agent to be valid the following conditions must be satisfied:

   (a) *Good faith*: The pledgee must have acted in good faith and must not have at the time of the pledge notice that the pawnor had no authority to pledge the goods. The onus of proving both these facts rests upon the person disputing the validity of the pledge.

   (b) *Acting in the ordinary course of business:* The mercantile agent must have acted in the ordinary course of his business. Therefore, if he does the business outside his business premises or out of business hours, such a transaction would fall outside this section.

2. ***Pledge by seller or buyer in possession after sale:*** Under s.30 of the Sale of Goods Act, a seller left in possession of goods after sale, and a buyer, who obtains possession of goods with the consent of the seller, before sale, can create a valid pledge. Once again, for the pledge to be valid the pledgee should have acted in good faith and without notice of previous sale of goods to the buyer or of the lien of the seller over the goods.

3. ***Pledge by a person in possession under a voidable contract (s.178-A):*** Where a person obtains possession of goods under a voidable contract the pledge created by him is valid provided: (a) the contract has not been rescinded before the contract of pledge and (b) the pawnee acts is good faith and without notice of the pawnor's defect of title.

4. ***Pledge by co-owner in possession:*** One of several joint owners of goods in sole possession thereof with the consent of the rest may make a valid pledge of the goods.

5. ***Pledge by a person having limited interest (s.179):*** Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of the interest. Thus, a pledgee may further pledge goods to the extent of the amount advanced thereon.

4.8 RIGHTS AND DUTIES OF A PLEDGOR AND A PLEDGEE

According to s.176 in case the pledgor fails to pay his debt or complete the performance of obligation at the stipulated time, the pledgee can exercise any of the following right: (i) bring a suit against the pledgor upon the default in redemption of the debt or performance of promise and retain possession of goods pledged as a

collateral security; or (ii) sell the goods pledged on giving the pledgor a reasonable notice of sale.

In case the goods pledged when sold do not fully meet the amount of the debt, the pledgee can proceed for the balance. If, on the other hand, there is any surplus, that has to be accounted for to the pledgor. Before sale can be executed, a reasonable notice must be given to the pledgor so that: (a) the pledgor may meet his obligation as a last chance; (b) he can supervise the sale to see that it fetches the right price.

Example: A trader pledged certain goods in favour of a bank. On default to return the loan, the bank sold the goods without giving a notice of sale to the trader as the loan agreement specifically excluded it. Held, that such an exclusion clause is inconsistent with the provisions of the Act and as such void and unenforceable.

However, the sale made by the pledgee without giving a reasonable notice to the pledgor is not void, i.e., cannot be set aside. The pledgee will be liable to the pledgor for the damages.

In addition to the rights mentioned in s.176, a pledgee has the following rights:

1. It is the duty of the pledgor to disclose any defects or faults in the goods pledged which are within his knowledge. Similarly, if the goods are of an abnormal character, say explosives or fragile, the pledgee must be informed. In case the pledgor fails to inform such faults or abnormal character of the goods pledged, any damage as a result of non-disclosure shall have to be compensated by the pledgor.
2. The pledgee has a right to claim any damages suffered because of the defective title of the pledgor.
3. A pledgee's rights are not limited to his interests in the pledged goods. In case damage to the goods or their deprivation by a third party, he would have all such remedies that the owner of the goods would have against them. In Morvi Mercantile Bank Ltd vs. Union of India, the Supreme Court held that the bank (pledgee) was entitled to recover not only ₹ 20,000 – the amount due to it, but the full value of the consignment, i.e., ₹ 35,000. However, the amount over and above his interest is to be held by him in trust for the pledgor.
4. ***Pawnee's right of retainer [s.173]:*** The pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest of the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged. However, s.174 provides that the pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged; but such contract, in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the pawnee.
5. A pledgee has a right to recover any extraordinary expenditure incurred for the preservation of the goods pledged (s.175).

Duties of a Pledgee: (1) The pledgee is required to take as much care of the goods pledged to him as a person of ordinary prudence would, under similar circumstances, take of his own goods, of a similar nature. (2) The pledgee must not put the goods to an unauthorised use. (3) The pledgee is bound to return the goods on payment of the debt. (4) Any accruals to the goods pledged belong to the pledgor and should be delivered accordingly. Thus, if the security consists of equity shares and the company issues bonus shares to the equity shareholders, the bonus shares are the property of the pledgor and not the pledgee.

Duties of a Pledgor: (1) He must disclose to the pledgee any material faults or extraordinary risks in the goods to which the pledgee may be exposed. (2) He is responsible to meet any extraordinary expenditure incurred by the pledgee for the preservation of the goods. (3) Where the pledgee has exercised his right of sale of goods, any shortfall has to be made good by the pledgor. (4) He is liable for any loss caused to the pledgee because of defects in his (pledgor's) title to the goods.

Rights of a Pledgor: (1) The pledgor has a right to claim back the security pledged on repayment of the debt with interest and other charges. (2) He has a right to receive a reasonable notice in case the pledgee intends to sell the goods, and in case he does not receive the notice he has a right to claim any damages that may result. (3) In case of sale, the pledgor is entitled to receive from the pledgee any surplus that may remain with him after the debt is completely paid off. (4) The pledgor has a right to claim any accruals to the goods pledged. (5) If any loss is caused to the goods because of mishandling or negligence on the part of the pledgee, the pledgor has a right to claim the same.

Check Your Progress

Fill in the blanks:

1. The _____ is under an obligation to re-deliver the goods, in their original or altered form.
2. In bailment, the delivery of goods is upon a contract that when the purpose is accomplished, they shall be returned to the_____.
3. Delivery of__ __is essential for effecting bailment.
4. _____is a right in one person to retain that which is in his possession, belonging to another, until some debt or claim is paid.
5. A _____is created only when the goods are delivered by the borrower to the lender or to someone on his behalf with the intention of their being treated as security against the advance.
6. The _____must not put the goods to an unauthorised use.

4.9 LET US SUM UP

- The contract of bailment is defined as the delivery of goods by one person to another for some purpose, upon an agreement that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them.
- The duties of a bailor are: (i) to disclose known faults in the goods; (ii) to account for breach of warranty as to title; (iii) to bear expenses in case of gratuitous bailment.
- The duties of a bailee are: (i) to take care of the goods bailed; (ii) not to make unauthorized use of goods; (iii) not to mix bailor's goods with his own; (iv) to return the goods bailed without demand; and (v) to return any accretion to the goods bailed.
- A contract of bailment terminates under certain circumstances. These are: (i) on the expiry of the stipulated period of bailment; (ii) on the accomplishment of the specified purpose; (iii) by bailee's act inconsistent with conditions of bailment.
- A pledge is the bailment of goods as security for payment of a debt or performance of a promise.

4.10 LESSON END ACTIVITY

Discuss the following cases with your classmates:

1. A customer entrusts certain important documents for safe custody to his bank. The bank keeps the documents in a wooden box. Later it is found that the documents were destroyed by white ants. What is the bank's liability to the customer? [*Hint:* Ss. 151-152.]

2. 'A' consigned goods by Railways. The consignment, at the time of delivery, was found damaged. After obtaining a certificate of damages from the Railway Officer, 'A' claimed from the Railways compensation of ₹ 2,300. The general Manager of the Railways sent him a cheque for ₹ 1,300 in full and final settlement. The cheque was encashed, but after a lapse of sometime. 'A' claimed that the payment had satisfied only a part of his claim and demanded payment of the balance. Discuss the claim of 'A' for payment of the balance amount. [*Hint:* A shall have no claim against Railways.]

4.11 KEYWORDS

Bailment: It 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.

Lien: It is a right in one person to retain that which is in his possession, belonging to another, until some debt or claim is settled.

Pledge: It is the bailment of goods as security for payment of a debt or performance of a promise.

4.12 QUESTIONS FOR DISCUSSION

1. Define bailment. What are the requisites of a contract of bailment? Explain.
2. Distinguish between 'gratuitous bailment' and 'bailment for hire'.
3. Comment:
   i. "Bailor is liable to the bailee for loss caused by faults in the goods bailed whether the bailor was aware of the same or not."
   ii. "Bailor must compensate the bailee for all expenses."
   iii. "Bailee's right of lien is a particular lien and does not extend to other goods of the bailor in his possession."
   iv. "The finder of lost goods has no right to file a suit for recovery of expenses incurred by him for finding out the true owner." Discuss.
4. Discuss the characteristics of a pledge.
5. What are the respective rights and duties of a pawnor and a pawnee?
6. When is a pledge created by non-owners valid?
7. When a pledgor fails to redeem his pledge, what rights does the pledgee have in the pledge?
8. "Every pledge is a bailment, but every bailment is not a pledge". Discuss.

Check Your Progress: Model Answer

1. Bailee
2. Bailor
3. Goods
4. Lien
5. Pledge
6. Pledgee

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BLOCK III

UNIT 5

CONTRACT OF AGENCY

CONTENTS

Contd...

5.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the meaning of the terms agent and agency
- Explain different type of agents
- Discuss various duties and rights of agents
- Describe different modes by which the contract of agency comes to an end
- Understand the power of attorney

5.1 INTRODUCTION

Before the Industrial revolution, business used to carry on largely by individual artisans in their homes and in small family operated shops. As population and trade expanded and division of labour and specialisation became the order of the day, there arose the necessity of distribution of goods. To meet the rising demand, manufacturers and shopkeepers began to hire others to work for them. These helpers or "servants" as they were called performed whatever physical tasks were assigned to them, under the close personal supervision of the "master". Today, the legal terms master-servant and employer-employee are used interchangeably. Over time, employers delegated a broader range of responsibilities to their employees – for example, by giving them authority to contract for raw materials, to sell finished products and even to employ other employees. In these expanded roles, the employees became known as agents and their employers were called principals. The Indian Contract Act, 1872, makes provisions as regards agency. Sections 182 to 238 deal with the subject of agency. In this lesson, the sections quoted refer to that Act unless otherwise specified.

5.2 DEFINITION OF AGENT AND AGENCY

5.2.1 Meaning of Agent and Agency (s.182)

Agent is "a person employed to do any act for another or to represent another in dealings with third person". Thus, an agent is a person who acts in place of another. The person for whom or on whose behalf he acts is called the 'Principal'. For instance, Anil appoints Bharat, a broker, to sell his Maruti Car on his behalf. Anil is the Principal and Bharat is his agent. The relationship between Anil and Bharat is called 'Agency'. This relationship is based upon an agreement whereby one person acts for another in transaction with a third person.

The function of agent is to bring about contractual relation between the principal and a third party. The agent is only a connecting link between the principal and the third party and is rightly called as '*conduit pipe*'. The acts of the agent, within the scope of the instructions, bind the principal as if he has done them himself. The phrase '*qui*

facit per alium facit per se' contains the principle of agency, which means, he who does through another does by himself. In simple words, the act of agent is the act of the principal.

Agent must be distinguished from a servant. A servant acts under the direct control and supervision of his master and is bound to carry out all his reasonable orders. Agent, on the other hand, though bound to exercise his authority in accordance with lawful instructions of the principal is not subject to his direct supervision and control. Agent, therefore, is not a servant; though a servant, may for some purposes, be his master's agent. Further, agent may work for several principals at the same time, a servant usually serves only one master.

No consideration is necessary to create agency (s. 185). The fact that the principal has consented to be represented by the agent is a sufficient detriment and consideration to support the promise of the agent to act in that capacity. However, in case no consideration has passed to the agent, he is not bound to do the agreed work, but once he begins, he must complete it to the satisfaction of the principal.

5.2.2 Who can Employ Agent?

Any person, who is of the age of a major according to the law to which he is subject and who is of sound mind, may employ agent (s.183). No qualifications as such are prescribed for a person to be agent except that he has attained majority and is of sound mind. Thus, a minor or a lunatic cannot contract through agent since they cannot contract themselves personally either. If agent acts for a minor or lunatic, he will be personally liable to the third party. Association or group of persons may also appoint agent; for instance, a partnership firm may, transact business through agent. Certain group of persons, because of the very nature of their organisation, must act through agent, e.g., a company, which is an artificial person and thus can transact business only through agent.

5.2.3 Who may be Agent?

Since agent is a mere connecting link or a 'conduit pipe' between the principal and the third party, it is immaterial whether or not the agent is legally competent to contract. Thus, there is no bar to the appointment of a minor as agent. However, in considering the contract of agency itself (i.e., the relation between principal and agent), the contractual capacity of the agent becomes important. Thus, no person who is not of the age of majority and of sound mind can become agent, as to be responsible to his principal (s.184). Thus, 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 the performance of his duties.

Example: Rahim appoints Kiran, a minor, to sell his car for not less than ₹ 90,000. Kiran sells it for ₹ 80,000. Rahim will be held bound by the transaction and further shall have no right against Kiran for claiming the compensation for having not obeyed the instructions, since Kiran is a minor and a contract with a minor is void *ab initio*.

5.3 DIFFERENT KINDS OF AGENCIES

A contract of agency may be created by an express agreement or by implication (implied agreement) or by ratification. Thus, there are different kinds of agencies.

5.3.1 Express Agency (s.187)

A person may be appointed as agent, either by word of mouth or by writing. No particular form is required for appointing agent. The usual form of a written contract of agency is the power of attorney on a stamped paper.

5.3.2 Implied Agency (s. 187)

Implied agency arises from the conduct, situation or relationship of parties. Implied agency, therefore, includes agency by estoppel, agency by holding out and agency of necessity.

5.3.3 Agency by Estoppel (s. 237)

When a person has, by his conduct or statements, induced others to believe that a certain person is his agent, he is estopped from subsequently denying it. The principal is precluded from denying the truth of agency which he himself has represented as a fact, although it is not a fact.

***Examples*:** (i) Prakash allows Anand to represent as his agent by telling Cooper that Anand is Prakash's agent. Later on, Cooper supplied certain goods to Anand thinking him to be Prakash's agent. Prakash shall be liable to pay the price to Cooper. By allowing Anand to represent himself as his agent, Prakash leads Cooper to believe that Anand is really his agent.

(ii) Anand owns a shop in Serampur, living himself in Calcutta and visiting the shop occasionally. The shop is managed by Bharat and he is in the habit of ordering goods from Cooper in the name of Anand for the purposes of the shop and of paying for them out of Anand's funds with Anand's knowledge. Bharat has an implied authority from Anand to order goods from Cooper in the name of Anand for the purposes of the shop.

5.3.4 Agency by Holding Out

Though part of the law of estoppel, some affirmative conduct by the principal is necessary in creation of agency by holding out.

Example: Puran allows his servant Amar to buy goods for him on credit from Komal and pay for them regularly. On one occasion, Puran pays his servant in cash to purchase the goods. The servant purchases good on credit pocketing the money. Komal can recover the price from Puran since through previous dealings Puran has held out his servant Amar as his agent.

5.3.5 Agency of Necessity (s.189)

This arises where there is no express or implied appointment of a person as agent for another but he is forced to act on behalf of a particular person.

Examples: (i) The Master of a ship, which is in distress and 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 as the agent of the owner by necessity.

(ii) A horse is sent by rail and at the destination is not taken delivery by the owner. The station master has to feed the horse. He has become the agent by necessity and hence the owner must compensate him.

The doctrine of agency by necessity also extends to cases where agent exceeds his authority provided (a) it was not reasonably possible to get the principal's instructions, (b) the agent had taken all reasonable and necessary steps to protect the interests of the principal and (c) he acted bona fide.

5.3.6 Agency by Ratification (Ss.196-200)

Where agent does an act for his principal but without knowledge of authority, or where he exceeds the given authority, the principal is not held bound by the

transaction. However, s.196 permits the principal, if he so desires, to ratify the act of the agent. If he so elects, it will have the same effect as if the act was originally done by his authority. Agency in such a case is said to be created by ratification. In other words, the agency is taken to have come into existence from the moment the agent first acted and not from the date of principal's ratification. The rule is that every ratification relates back and is equivalent to a previous command or authority.

Example: Lallan makes an offer to Badal, Managing Director of a company. Badal accepts the offer though he has no authority to do so. Lallan subsequently withdraws the offer, but the company ratifies Badal's acceptance. Lallan is bound by the offer. The ratification by the company relates back to the time Badal accepted the offer, thus rendering the revocation of the offer inoperative. An offer once accepted cannot be withdrawn.

However, for the rule of relation back to apply, the agent while accepting an offer should not show lack of authority, e.g., where he accepts, 'subject to ratification', the rule of relation back does not apply and revocation shall be valid, if communicated prior to such ratification.

Express and implied ratification (s.197). The ratification may be express or implied.

Examples: (i) Amar without Puran's authority lends Puran's money to Kamal. Later Puran accepts interest on the money from Kamal. Puran's conduct implies ratification of the loan.

(ii) Amar without Puran's authority buys certain goods for him. Afterwards, Puran sells those goods to Kamal. Puran's conduct ratifies the purchase made by Amar.

Requisites of a valid ratification. To be valid, a ratification must fulfil certain conditions. These conditions are:

(i) The agent must contract as agent; he must not allow the third party to imagine that he is the principal. A person cannot enter into a contract at his own and later shift it to another.

(ii) The principal must have been in existence at the time the agent originally acted. This condition is significant in case of a company. The preliminary contracts entered into by promoters of a company on its behalf cannot be ratified by the company after incorporation because, if permitted, ratification will relate back to the point of time when promoters originally acted and at that time the company was not in existence. How can a person, not in existence, be a party to a contract?

(iii) The principal must not only be in existence but must also have contractual capacity at the time of the contract as well as at the time of ratification. Thus, a minor on whose behalf a contract is made cannot ratify it on attaining majority.

(iv) Ratification must be made within a reasonable time. What is a reasonable time shall vary from case to case.

(v) The act to be ratified must be a lawful one. There can be no ratification of an illegal act or an act which is void *ab initio*.

(vi) The principal should have full knowledge of the facts (s.198).

(vii) Ratification must be of the contract as a whole. The principal cannot reject the burden and accept only the benefits.

(viii) Ratification of acts not within the principal's authority is ineffective. This again is basically relevant in case of companies. The acts of directors which are *ultra vires* the powers of a company cannot be ratified by the company.

(ix) Ratification cannot be made so as to subject a third party to damages or terminate any right or interest of a third person (s.200).

Examples: (i) Amar, not being authorised thereto by Bharat, demands on behalf of Bharat, the delivery of some property of Bharat, from Cooper, who is in possession of it. This demand cannot be ratified by Bharat, so as to make Cooper liable for damages for his refusal to deliver.

(ii) Amar holds a lease from Bharat terminable on three months notice. Cooper, an unauthorised person, gives notice of termination to Amar. The notice cannot be ratified by Bharat, so as to be binding on Amar.

5.3.7 Agency Coupled with Interest

Agency is said to be coupled with interest when authority is given for the purpose of securing some benefit to the agent. In other words, where the agent has himself an interest in the subject-matter of the agency, the agency is one coupled with interest.

Examples: (i) Agent is appointed to sell properties of the principal and to pay himself out of such sale proceeds the debt due to the agent. The authority of the agent is agency coupled with interest.

(ii) A consigns 100 bags of rice to B, who has made advances to him on such rice and desires B to sell the rice and to repay himself out of the price, the amount of his own advance. The authority of B is an authority coupled with interest.

(iii) A sells the goodwill and book debts of his business to B and appoints B as his agent to collect the debt.

It should be noted that, it is not the ordinary type of interest which every agent has such as the remuneration, but it is that special type of interest which agent possesses that makes it agency coupled with interest. In the case of agency coupled with interest, the agency cannot, unless there is an express contract, be terminated to the prejudice of such interest (s.202). It becomes irrevocable to the extent of such interest and does not terminate even by the insanity or death of the principal.

5.4 CLASSIFICATION OF AGENTS

Agents may be classified from different points of view. One broad classification of agents is: (i) mercantile or commercial agents and (ii) non-mercantile or non-commercial agents. Another classification of agents is: (1) general and (2) special.

5.4.1 Special and General Agents

A special agent is a person appointed to do some particular act or enter into some particular contract. A special agent, therefore, has only a limited authority to do the specified act. If he does anything beyond the specified act, he runs the risk of being personally liable since the principal may not ratify the same. A general agent, on the other hand, is one who is appointed to represent the principal in all matters concerning a particular business, e.g., manager of a firm or managing director of a company.

5.4.2 Mercantile or Commercial Agents

A mercantile or commercial agent may assume any of the following forms: broker, factor, commission agent, del credere agent, auctioneer, banker, Pakka and Katcha Adatias and indentor. A broker is a mercantile agent engaged to buy and/or sell property or to make bargains and contracts between the engager and third party for a commission (called brokerage). A broker has no possession of goods or property. He is merely a connecting link between the engager and a third party. The usual method

of dealing by a broker is to make entries of the terms of contract in a book, called the memorandum book and to sign them. He then sends the particulars of the same to both parties. The document sent to the seller is called the sold note and the one sent buyer is called the bought note. A factor is a mercantile agent who is entrusted with the possession of goods with an authority to sell the same. He can even sell the goods on credit and in his own name. He is also authorised to raise money on their security. A factor has a general lien on the goods in his possession. A factor, however, cannot barter the goods, unless expressly authorised to do. Also, he cannot delegate his authority.

A commission agent is agent who is employed to buy or sell goods or transact business. The remuneration that he gets for the purpose is called the commission. A commission agent is not liable in case the third party fails to carry out the agreed obligation. A commission agent may have possession of the goods or not. His lien in case of goods in his possession is a particular lien. A del credere agent is one who, in consideration of an extra remuneration, called a del credere commission, guarantees the performance of the contract by the other party. A del credere agent thus occupies the position of a guarantor, as well as of agent. He is normally appointed in case of deals with foreign nationals, about whom the principal may know nothing.

An auctioneer is agent appointed to sell goods by auction. He can deliver the goods only on receipt of the price. An auctioneer can recover the price from the highest bidder (i.e., the buyer) by filing a suit in his own name. In any case, an auctioneer can sell only by public auction and not by a private contract. His position differs from a factor inasmuch as the auctioneer has a particular lien, whereas the factor has a general lien.

Though the relationship between banker and customer is ordinarily that of debtor and creditor, he acts as his agent when he buys or sells securities on his behalf. Similarly, when he collects cheques, bills, interest, dividends, etc., or when he pays insurance premium out of customer's account, as per customer's mandate, he acts as his agent.

A Pakka adatia is a person who guarantees the performance of the contract, not only to his principal but also to the broker (shroff) on the other side. A peculiarity of pakka adatia is that he can himself perform the contract instead of offering it to the third party. A Katcha Adatia, on the other hand, does not guarantee the performance of the contract. However, he guarantees the performance on the part of the principal. Thus, he will be responsible to the other broker or shroff who contracts on behalf of the other party, in case of non-performance by his principal.

An indentor is a commission agent, who for a commission procures a sale or a purchase on behalf of his principal, with a merchant in a foreign country. Such agent gets commission at the rates mentioned in the indent.

5.4.3 Non-mercantile or Non-commercial Agents

Some of the agents in this category are: wife, estate agent, counsels (advocates), attorneys. The following principles provide guidelines as regards wife as agent of her husband:

(i) If the wife and husband are living together and the wife is looking for necessaries, she is agent. But this presumption may be rebutted and the husband may escape liability if he can prove that:

   (a) he had expressly forbidden his wife from purchasing anything on credit or from borrowing money,

   (b) goods, purchased were not necessaries,

(c) he had given sufficient money to his wife for purchasing necessaries, or

(d) the trader had been expressly told not to give credit to his wife.

(ii) Where the wife lives apart from the husband, through no fault of hers, the husband is liable to provide for her maintenance. If he does not provide further maintenance, she has an implied authority to bind the husband for necessaries, i.e., he would be bound to pay her bills for necessaries. But where the wife lives apart under no justifiable circumstances, she is not her husband's agent and thus cannot bind him even for necessaries.

5.4.4 Sub-agent and Substituted Agent (Ss. 190-195)

The general rule is that agent cannot appoint agent. The governing rule is enshrined in a maxim 'a delegate cannot further delegate'. Agent being a delegate cannot transfer his duties to another. The principle underlying the rule is that the principal engages agent ordinarily on personal consideration and thus may not have the same confidence in the person appointed by the agent. Hence, sub-agency is not generally recognised. However, s.190 deals with the circumstances as to when and how far agent can delegate his duties. Agent may appoint agent in the following circumstances: (i) where expressly permitted by the principal; (ii) where the ordinary custom of the trade permits delegation; (iii) the nature of agency is such that it cannot be accomplished without the appointment of a sub-agent; (iv) where the nature of the job assigned to the agent is purely clerical and does not involve the exercise of discretion, e.g., if Anthony is appointed to type certain papers, because of lack of time, he assigns the job to another equally competent typist Bharat, the delegation is valid; (v) in an unforeseen emergency.

Under the above-mentioned circumstances stipulated by s.190, if agent appoints another person in the matter of the agency, that other person may assume the position of either a sub-agent or a substituted agent. Section 191 states that a sub-agent is a person employed by and acting under the control of the original agent in the business of agency. Since the sub-agent is appointed by the act and under the control of the agent, there is no privity of contract between the sub-agent and the principal. The sub-agent, therefore, cannot sue the principal for remuneration and, similarly the principal cannot sue the sub-agent for any moneys due from him. Each of them can proceed against his immediate contracting party, viz, the agent except where the sub-agent is guilty of fraud. In that case the principal has a concurrent right to proceed against the agent and the sub-agent. A sub-agent properly appointed, however, can represent the principal and bind him for his acts as if he were agent originally appointed by the principal. But where agent, without having the authority to do so, has appointed a sub-agent, the principal is not represented by or responsible for the acts of such a sub-agent. The sub-agent can only bind the agent by contracts entered into with third parties.

Where agent appoints or names another person for being appointed as agent in his place, such person is called a substituted agent (s.194).

Examples: (i) Amar directs Bharat, his solicitor, to sell his estate by auction and to employ an auctioneer for the purpose. Bharat names Cooper, an auctioneer, to conduct the sale. Cooper is not a sub-agent, but is Amar's agent for the conduct of the sale.

(ii) Amar authorises Bharat, a merchant in Calcutta, to recover the money due to Amar from Cooper and Co. Bharat instructs Dalip, a solicitor to take proceedings against Cooper and Co., for the recovery of the money. Dalip is not a sub-agent but is a solicitor for Amar.

5.5 DUTIES AND RIGHTS OF AGENT

5.5.1 Duties of Agent

The duties of agent towards his principal are:

1. To conduct the business of agency according to the principal's directions (s.211). The duty of the agent must be literally complied with, i.e., the agent is not supposed to deviate from the directions of the principal even for the principal's benefit. If he does so, any loss occasioned thereby shall have to be borne by the agent, whereas any surplus must be accounted for to the principal.

   Examples: (i) Anil is directed by his principal to warehouse the goods at a particular warehouse. He warehouses a portion of the goods at another place, equally good but cheaper. The goods are destroyed by fire. Anil, the agent, is liable to make good the loss.

   (ii) A principal instructs his agent to deliver goods only against cash but the agent delivers them on credit. In such a case the agent would be liable for the price which the purchaser fails to pay.

   In the absence of instructions from the principal, however, the agent should follow the custom of the business at the place where it is conducted.

   Example: Amar, agent, engaged in carrying on for Bharat a business in which it is the custom to invest from time to time, at interest, the money which may be in hand, omits to make such investment. Amar must make good to Bharat the interest usually obtained by such investment.

2. The agent should conduct the business with the skill and diligence that is generally possessed by persons engaged in similar business, except where the principal knows that the agent is wanting in skill (s.212).

   Examples: (i) Where a lawyer proceeds under a wrong section of law and thereby the case is lost, he shall be liable to his client for the loss.

   (ii) Amar, agent for the sale of goods, having authority to sell on credit, sells to Bhagat on credit, without making the proper and usual enquiries as to the solvency of Bhagat. Bhagat, at the time of such sale, is insolvent. Amar has to compensate his principal in respect of any loss thereby sustained.

   (iii) Amar, an insurance broker, employed by Bharat to effect an insurance on a ship, omits to see that whether the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. Bharat is bound to make good the loss to Amar.

3. To render proper accounts (s.213). The agent has to render proper accounts. If the agent fails to keep proper accounts of the principal's business, everything consistent with the proved facts will be presumed against him. Rendering of accounts does not mean showing the accounts, but maintaining proper accounts supported by vouchers.

4. To communicate with the principal in case of difficulty (s.214). It is the duty of agent, in case of difficulty, to use all reasonable diligence, in communicating with his principal and in seeking to obtain his instructions. In case of emergency, however, the agent can do all that a reasonable man would, under similar circumstances, do with regard to his own business. He becomes agent by necessity.

5. Not to make any secret profits. Agent should deliver to the principal all moneys including secret commission received by him. He can, however, deduct his lawful expenses and remuneration.

6. Not to deal on his own account. Agent should not deal on his own account without first obtaining the consent of his principal. If he does so, the principal can claim from the agent any benefit which he might have obtained.

   Example: Pawan directs Amar, his agent, to buy a particular house for him. Amar tells Pawan that it cannot be bought, but buys the house for himself. Pawan may, on discovering that Amar has bought the house, compel him to sell it to Pawan at the price he bought.

   Further, in case agent deals on his own account, he shall cease to be entitled for his remuneration as agent.

7. Not entitled to remuneration for misconduct (s.220). Agent who is guilty of misconduct in the business of agency is not entitled to any remuneration in respect of that part of the business which he has misconducted.

   Examples: (i) Amar employs Bharat to recover ₹ 50,000 from Cooper and to lay it out on a good security. Bharat recovers the amount and lays out ₹ 30,000 on good security, but lays out ₹ 20,000 on security which he ought to have known to be bad whereby Amar loses ₹ 5,000. Bharat is entitled to remuneration for recovering ₹ 50,000; and for investing ₹ 30,000. He is not entitled to any remuneration for investing ₹ 20,000 and he must make good the ₹ 5,000 to Amar.

   (ii) Amar employs Bharat to recover ₹ 10,000 from Cooper. Through Bharat's misconduct the money is not recovered. Bharat is not entitled to any remuneration for his services and must make good the loss.

8. Not to disclose confidential information supplied to him by the principal.

9. To take all reasonable steps for the protection and preservation of the interests entrusted to him when the principal dies or becomes of unsound mind (s.209).

5.5.2 Rights of Agent

Agent has a number of rights. These are:

1. ***Right to remuneration (Ss.219-220).*** Agent is entitled to his agreed commission or remuneration and there might be no agreement, to a reasonable remuneration. But the remuneration does not become payable unless he has carried out the object of agency, except where there is a contract to the contrary. When the object of agency is deemed to have been carried out or the act assigned to the agent is completed would depend on the terms of the contract. Further, the transaction for which the agent claims remuneration should be the direct result of his services.

   Example: Pawar appoints Amar, a broker. Amar is entitled to his commission when he has procured a party who is willing to negotiate on reasonable terms and to desirous of entering into a contract with Pawar.

   Agent, however, is not entitled to any remuneration in respect of that part of the business which he has misconducted (s.220).

2. ***Right of retainer (s.217).*** Agent may retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business and also such remuneration as may be payable to him for acting as agent. This is known as agent's right of retainer. However, the right of retainer can only be claimed on moneys received by him in the business of agency. He cannot,

therefore, retain sums received by him in one business for his commission or remuneration in another business on behalf of the same principal.

3. ***Right of lien (s.221).*** In the absence of any contract to the contrary, agent is entitled to retain goods, papers and other property, whether movable or immovable of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or accounted for to him. This lien of the agent is a particular lien confined to all claims arising in respect of the particular goods and property. By a special contract, however, agent may get a general lien extending to all claims arising out of the agency. Since, the word 'lien' means retaining possession; it can be enjoyed by the agent only where the goods or papers are in actual or constructive possession of the agent. The right of lien will, therefore be lost where he parts with the possession of goods or papers. But if the possession is obtained from the agent by fraud or unlawful means, his lien is not affected by the loss of possession.

4. ***Right of stoppage in transit.*** The agent can stop the goods while in transit in two cases: (a) Where he has purchased goods on behalf of the principal either with his own funds, or by incurring a personal liability for the price, he stands towards the principal in the position of an unpaid seller. Like an unpaid seller, he enjoys the right of stopping the goods in transit if in the meantime the principal has become insolvent. (b) Where agent holds himself liable to his principal for the price of the goods sold, for example, del credere agent, he may exercise the unpaid seller's right of stopping the goods in transit in case of buyer's insolvency.

5. ***Right of indemnification (Ss. 222-224).*** The principal is bound to indemnify agent against the consequences of all lawful acts done by the agent in exercise of authority conferred on him.

   Examples: (i) John, at Singapore, under instructions from Amin at Calcutta, contracts with Cooper to deliver certain goods to him. Amin does not send the goods to John and Cooper sues John for breach of contract. John informs Amin of the suit and Amin authorises him to defend the suit. John defends the suit and is compelled to pay damages and costs and incurs expenses. Amin is liable to John for such damages, cost and expenses.

   (ii) Bharat, a broker at Calcutta, by the order of Amin, a merchant there, contracts with Cooper for the purchase of 10 casks of oil for Amin. Afterwards Amin refuses to receive the oil and Bharat sues Cooper. Bharat informs Amin, who repudiates the contract altogether. Bharat defends, but unsuccessfully and has to pay damages and costs and incur expenses. Amin would be liable to Bharat for such damages, costs and expenses.

   Section 223 further provides that agent shall have a right to be indemnified against consequences of acts done in good faith.

   Example: B, at the request of A, sells goods in the possession of A, but which A had no right to dispose of. B does not know this and hands over the proceeds of the sale to A. Afterwards C, the true owner of goods, sues B and recovers the value of the goods and costs. A is liable to indemnify B for what he has been compelled to pay to C and for B's own expenses, provided C has acted in good faith and he had no knowledge that the goods did not belong to A.

   However, it must be remembered that agent cannot claim indemnification for criminal act, even though the principal had agreed to do so (s.224).

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

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

6. ***Right to compensation for injury caused by principal's neglect (s.225).*** 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.

   Example: A employs B as a bricklayer in building a house and puts up the scaffolding himself. The scaffolding is unskillfully put up and B is in consequences hurt. A must make compensation to B.

5.6 PRINCIPAL'S DUTIES TO THE AGENT AND HIS LIABILITY TO THIRD PARTIES

5.6.1 Duties of a Principal

The rights of agent are in fact the duties of the principal. Thus a principal is (i) bound to indemnify the agent against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him (s.222); (ii) liable to indemnify agent against the consequences of an act done in good faith, though it causes an injury to the rights of third persons (s.223); (iii) bound to compensate his agent in respect of injury caused to such agent by the principal's neglect or want of skill (s.225).

The principal is, however, not liable for acts which are criminal in nature though done by the agent at the instance of the principal (s.224).

5.6.2 Liability of Principal to Third Parties

1. Agent being a mere connecting link binds the principal for all his acts done within the scope of his authority (s.226).

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

2. The principal is liable for the acts of the agent falling not only within the actual authority but also within the scope of his apparent or ostensible authority.

3. Where agent exceeds his authority and the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority, is binding as between him and the principal (s.227).

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

   However, where agent does more than he is authorised to do and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound by the transaction (s.228).

Example: Agent is authorised to draw a bill for ₹ 5,000 but he draws a bill for ₹ 10,000, the principal will not be liable even to the extent of ₹ 5,000.

4. The principal will be liable even for misrepresentations made or frauds committed by agent in the business of agency for his own benefit. But misrepresentations made or frauds committed by agents in matters beyond their authority do not affect their principals (s.238).

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

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

5. The principal remains liable to the third parties even where his name was not disclosed. The third parties, on discovering his name, can proceed against him on the contract.

6. The principal is bound by any notice or information given to the agent in the course of business transacted by him.

7. The liability of the principal continues even in cases where agent is held personally liable. Section 223 provides an option to the third parties to either sue the principal or agent or both.

5.6.3 Undisclosed Principal

Where agent, though discloses the fact that he is agent working for some principal, conceals the name of the principal, such a principal is called an undisclosed principal. The liability of an undisclosed principal is similar to that of a disclosed principal unless there is a trade custom making the agent liable. However, the undisclosed principal must exist and must also be the principal at the time the contract is made. He cannot be brought into existence as a principal after the contract has been concluded.

5.6.4 Concealed Principal

Where agent conceals not only the name of the principal but the very fact that there is a principal, the principal is called a concealed principal. In such a case, the third parties are not aware of the existence of the principal and regard the agent as the person contracting for himself. The third parties, thus, must look to the agent for payment or performance and the agent may sue or be sued on the contract. Legal position in this regard is as follows:

1. If the principal wishes to intervene, he may require the performance of the contract, but the other party has, as against him (principal), the same rights as he would have had as against the agent if the agent has been principal (s.231 para 1).

2. Para II of s.231 provides that in such a case, if the principal discloses himself before the contract is completed the other contracting party may refuse to fulfil the contract, if he can show that if he had known who was the principal in the contract, or if he had known that the agent was not the principal, he would not have entered into the contract.

3. If the principal requires performance of the contract, he can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

Example: A who owes ₹ 500 to B, sells 1,000 rupees worth of rice to B. A is acting as agent for C in the transaction, but B has no knowledge or reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set off A's debt.

4. In contracts with a concealed principal, the agent is, in the absence of a contract to the contrary, personally liable to the third party. The party may hold either the agent or principal or both liable (s.223).

   Example: A enters into a contract with B to sell him 100 bales of cotton and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both for the price of the cotton.

5.7 PERSONAL LIABILITY OF AGENT

Agent is only a connecting link between the principal and third parties. Being only a medium, he can, in the absence of a contract to the contrary, neither personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them (s.230).

From the above discussion, it may be inferred that agent can enforce contracts personally and be held bound for contracts entered into on behalf of his principal, if there is an agreement to the effect, express or implied. Section 230 enlists the following cases where a contract to this effect shall be presumed to exist: (1) where the contract is made by agent for the sale or purchase of goods for a merchant resident abroad; (2) where the agent does not disclose the name of his principal; (3) where the principal, though disclosed, cannot be sued, for instance, where principal is a minor. Besides, agent incurs a personal liability in the following cases:

1. ***Breach of warranty.*** Where agent acts either without any authority or exceeds his authority, he is deemed to have committed breach of warranty of authority in such a case. He will be held personally liable if his acts are not ratified by the alleged principal. Further, agent will be guilty of warranty of authority even where his authority is terminated without his knowledge, e.g., by death or lunacy of the principal.

2. ***Where the agent expressly agrees to be personally bound.*** This sort of stipulation may be provided particularly where principal does not enjoy much credit-worthiness and the third parties wish to ensure the payment or performance.

3. ***Where agent signs a negotiable instrument in his own name.*** In case agent signs a negotiable instrument without making it clear that he is signing it as agent only, he may be held personally liable on the same. He would be personally liable as the maker of the note, even though he may be described in the body of the note as the agent (s.28, Negotiable Instrument Act, 1881).

4. Agent with special interest or with a beneficial interest, e.g., a factor or auctioneer, can sue and be sued personally.

5. When agent is guilty of fraud or misrepresentation in matters which do not fall within his authority (s.238).

6. Where trade usage or custom makes agent personally liable.

7. Where the agency is one coupled with interest.

5.8 TERMINATION OF AGENCY

5.8.1 Circumstances under which Agency Terminates or Comes to an End (s.201)

1. ***On revocation by the principal.*** The principal may, by notice, revoke the authority of the agent at any time. Where the agent is appointed to do a single act, agency may be revoked any time before the commencement of the act. In case of a continuous agency, notice of revocation is essential to the agent as well as to the third parties who have acted on the agency with the knowledge of the principal.

   Where agency is for a fixed period of time and the contract of agency is revoked without sufficient cause, compensation must be paid to the agent (s.205). However, the agency is irrevocable in two cases: (i) Where the authority of the agent is one coupled with interest; i.e., the agent has an interest in the subject-matter of the contract. The principal cannot revoke the authority given to his agent after the authority has been partly exercised so far as regards such acts and obligations already done in the agency (s.204).

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

   (ii) A authorises B to buy 1,000 bales of cotton on account of A and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority to pay for the cotton.

   (iii) A authorises B to buy 1,000 bags of rice on account of A and to pay for it out of A's money remaining in B's hands. B buys 1,000 bags of rice in A's name, so as not to make himself personally liable for the price. A can revoke B's authority to pay for the rice.

2. ***On the expiry of fixed period of time.*** When the agency is for a fixed period of time, it comes to an end on the expiry of that time.

3. ***On the performance of the specific purpose.*** Where agent is appointed to do a particular act, agency terminates when that act is done or when the performance becomes impossible.

4. Insanity or death of the principal or agent. Death or insanity of the principal or the agent terminates the agency. But, agent, in such a case, should take all reasonable steps for the preservation of property, on behalf of the legal representatives of the principal (s.209).

5. An agency shall also terminate in case the subject matter is either destroyed or rendered unlawful.

6. ***Insolvency of the principal.*** Insolvency of the principal, not of the agent, terminates the agency.

7. ***By renunciation of agency by the agent.*** If principal can cause termination of agency by revocation, agent may renounce his agency by giving a sufficient notice to that effect. Where, however, agency is for a fixed period and the agency is renounced without a sufficient cause, the principal must be compensated (s.205).

5.8.2 When Termination of Agency Takes Effect?

1. The termination of the authority of agent does not, so far as regard the agent, takes effect before it becomes known to him (s.208).
2. As regards third parties, they can continue to deal with the agent till they come to know of the termination of the authority (s.208).

   Examples: (i) A directs B to sell goods for him and agrees to give B 5% commission on the price fetched by the goods. A afterwards, by a letter revokes B's authority. B, after the letter is sent, but before he receives it, sells the goods for ₹ 100. The sale is binding on A and B is entitled to five rupees as his commission.

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

   (iii) A directs B, his agent, to pay certain money to C. A dies and D takes out probate to his will. B, after A's death, but before hearing of it, pays the money to C. The payment is good as against D, the executor.
3. The termination of the authority of agent causes the termination of authority of all sub-agents appointed by him.

5.9 POWER OF ATTORNEY

5.9.1 Meaning

A power of attorney is defined by s.2(21) of the Stamp Act, as including "any instrument not chargeable with a fee under the law relating to court fees for the time being in force," which empowers "a specified person to act for and in the name of the person executing it". It is the Powers of Attorney Act, 1882, which deals with the subject, but does not define it. In common parlance, a power of attorney is an instrument or a deed by which a person is empowered to act for and in the name of the person executing it. The person executing the deed is known as the Principal or donor and the one in whose favour it is executed is the agent, or the power agent or the power of attorney agent.

Section 2 of the Powers Attorney Act, 1882, provides that the donee may execute any instrument in and with his own name and signature and his own seal, where sealing is required, by the authority of the donor of the power. And such an instrument shall be as effectual in law as if it had been executed by the donor.

As mentioned earlier, no consideration is necessary to create agency. Therefore, the deed of Power of Attorney may stipulate that the agent will not get any remuneration.

5.9.2 A Power of Attorney may be Special or General

If the deed conferring power by one to another relates to one single transaction, it is known as special power of attorney. If the deed conferring power relates to several transactions it is general power of attorney.

5.9.3 Registration

As a general rule, registration of power of attorney is not necessary but if it authorises the donee to recover the rents of an immovable property of the donor for the donee's

benefit, it would require registration. And so also a power creating a charge in favour of the donee upon an immovable property referred to therein.

Further s.32 (c) of the Registration Act, 1908, requires that where a document is presented for registration by the agent of a person entitled to present it for registration, such agent must be duly authorised by power of attorney executed and authenticated in manner as mentioned in s.33 of the Act.

Such a power of attorney is to be executed before and authenticated by a registrar or sub-registrar. Unregistered power executed in a foreign country before a notary public can be used by the agent for presentation of document for registration. The power of attorney, however, executed before a notary public in India will not enable the agent to present any document for registration under the Registration Act, 1908.

The power of attorney is required to be engrossed on non-judicial stamp paper. The amount of stamp duty varies with different types of powers as described in the Stamp Act and varies among different States of India. Section 4 of the Power of Attorney Act, 1882 provides that the original deed of power can be deposited in the High Court in whose jurisdiction the principal resides and a certified copy of the deed can be obtained from the High Court. Such certified copies are equal to originals and are binding on all.

Further, s.85 of the Indian Evidence Act provides that the Court shall presume that every document purporting to be a power of attorney and to have been executed before and authenticated by a Notary Public, or any Court, Judge, Magistrate, was so executed and authenticated.

Check Your Progress

Fill in the blanks:

1. The agent is only a connecting link between the principal and the third party and is rightly called as _____.
2. ____ ____agency arises from the conduct, situation or relationship of parties.
3. Agency is said to be _ ___ __ _when authority is given for the purpose of securing some benefit to the agent.
4. A ____ _____agent is agent who is employed to buy or sell goods or transact business.
5. The rights of agent are in fact the duties of the_____.
6. A _____ ____is an instrument or a deed by which a person is empowered to act for and in the name of the person executing it.

5.10 LET US SUM UP

- Agent is a person employed to do any act for another or to be represented another in dealings with third persons. The person for whom or on whose behalf he acts is called the principal. The function of an agent is to bring about contractual relation between the principal and a third party. Any person who is of the age of majority according to the law to which he is subject and who is of sound mind, may employ agent.
- A contract of agency may be created by an express agreement or by implication or by ratification. Agent, being a delegate, cannot transfer his duties to another. However, in certain situations, he may delegate his duties. The person so appointed by the agent may be either or sub-agent or a substituted agent.

- The duties of agent towards his principal are: (i) to conduct the business of agency according to the principal's direction is; (ii) to conduct the business with the skill and diligence that is generally possessed by persons engaged in similar business; (iii) to render proper accounts; (iv) to communicate with the principal in case of difficulty; (v) not to make secret profits; (vi) not to deal on his own account; (vii) not to claim remuneration if he is guilty of misconduct; (viii) not to disclose confidential information supplied to him by the principal.
- Agent has a number of rights. Some of the more important ones are: (i) right to remuneration; (ii) right of lien; (iii) right of stoppage in transit; (iv) right of indemnification; (v) right to compensation for injury caused by principal's neglect.
- The relationship of agency may be terminated in a number of ways. These are: (i) on revocation of agent's authority by the principal; (ii) on the expiry of the period for which the agency was created; (iii) on the performance of the specific purpose for which the agency was created; (iv) on the death or insanity of either the principal or the agent; (v) on the insolvency of the principal; (vi) on remuneration of agency by the agent.

5.11 LESSON END ACTIVITY

Discuss the following cases with your classmates:

1. P authorises A to buy 5 tables for him. A buys 5 tables and 2 chairs for a sum of ₹ 600. Discuss the position of P. [*Hint:* P may reject the purchases under s. 228. In any case, P may adopt the purchase by the act of ratification under. s.196.]
2. P employs A as his agent to sell 100 bags of sugar and directs him to sell at a price not less than 120 per bag. A sells the entire quantity at ₹ 110 per bag whereas the market rate on the date of sale was ₹ 115 per bag. Is P entitled to any damages and if so, at what rate? [*Hint:* Yes, P is entitled to damages @ ₹ 5 per bag. (Ss.211 and 212)]

5.12 KEYWORDS

Agent: He is a person who is employed to do any act for another or to represent another in dealings with third persons.

Principal: He is a person for whom or on whose behalf an agent works.

Sub-agent: He is a person who is appointed by an agent to work in the matter of agency, and therefore can bind the principal by his acts.

Undisclosed Principal: Where an agent, though discloses the fact that he is agent working for some principal, conceals the name of the principal, such a principal is called an undisclosed principal.

Concealed Principal: Where an agent conceals not only the name of the principal but the very fact that there is a principal, the principal is called a concealed principal.

Power of Attorney: It is an instrument or a deed by which a person is empowered to act for and in the name of the person executing it.

5.13 QUESTIONS FOR DISCUSSION

1. How is agency created?
2. What is 'agency by estoppel'? In what way does it differ from agency by holding out?
3. (a) Can a minor appoint agent? (b) Can a minor be appointed as agent by an adult? (c) Who is a del credere agent?
4. Explain clearly the meaning of 'agency by ratification'. What conditions must be fulfilled for a valid ratification? Explain the effects of a valid ratification.
5. Comment: (i) Every ratification relates back and becomes equivalent to a prior command. (ii) Agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act. (iii) Agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them.
6. Discuss the extent to which agent can delegate his authority. State the consequences where the agent properly employs a sale agent and when he appoints him without authority.
7. Discuss the rights of agent against his principal.
8. In what ways may a contract of agency be terminated by the act of the parties?
9. When is agency irrevocable?
10. How far is the principal bound when the agent exceeds his authority?

Check Your Progress: Model Answer

1. Conduit pipe
2. Implied
3. Coupled with interest
4. Commission
5. Principal
6. Power of Attorney

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UNIT 6

INDIAN PARTNERSHIP ACT, 1932

CONTENTS

Contd...

6.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the meaning, characteristics and formation of partnership
- Distinguish between partnership and company, JHF business, etc.
- Know what is partnership deed
- Describe the process of dissolution of partnership firm

6.1 INTRODUCTION

An individual or a group of persons may decide to start business. One of the first steps to be taken is to determine what kind of business organisation it will be. If only a single person starts a business, we call that business as a sole proprietorship. When a group of persons start a business it takes the form of partnership business, or a

company or a cooperative form of organisation. Though a business unit may be owned by any of these forms of organisation, usually one form is more suitable than others for a particular business enterprise. The choice will depend upon the considerations such as the type of the product, capital requirements, government control, legal requirements, competitive conditions in the chosen industry, level of taxation, ownership privileges and the like.

6.2 MEANING AND NATURE OF PARTNERSHIP

In this Act, (Indian Partnership Act 1932) unless there is anything repugnant in the subject or context:

- An "act of a firm" means any act or omission by all the partners, or by any partner or agent of the firm which gives rise to a right enforceable by or against the firm;
- "Business" includes every trade, occupation and profession;
- "Prescribed" means prescribed by rules made under this Act;
- "Third party" used in relation to a firm or to a partner therein means any person who is not a partner in the firm;
- Expressions used but not defined in this Act and defined in the Indian Contract Act, 1872, (9 of 1872) shall have the meanings assigned to them in that Act.

'Partnership' is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

A partnership is defined as, "the relationship between persons who have agreed to share profits of a business carried on by all or by any of them acting for all". If we analyse the definition, certain essential elements of partnership will emerge. These elements must be present so as to form partnerships which are discussed below.

1. ***Partnership is an association of two or more than two persons:*** There must be at least two persons who should join together to constitute a partnership, because one person cannot become a partner with himself. These persons must be natural persons having legal capacity to contract. Thus, a company (which is an artificial person) cannot be a partner. Similarly, a partnership firm cannot be a partner of another partnership firm. As regards maximum number of partners in a partnership firm, s.11 of the Companies Act, 1956, puts the limit at 10 in case of banking business and 20 in case of any other business.

2. ***Partnership must be the result of an agreement between two or more persons:*** An agreement presupposes a minimum number of two persons. As mentioned above, at least two persons must make an agreement to come to a partnership. Partnership is the result of an agreement between two or more persons (who are known as partners after the partnership comes into existence). Partnership is not a product of status as in the case of Hindu Undivided Family business (s.5). It also does not arise by operation of law as in the case of co-ownership. Similarly, it cannot arise by mere joint acquisition of property. Partnership can arise by contract only.

   The members of a HUF (coparcenary) carrying on a family business cannot be regarded as a partnership firm, because coparcenes or members of the family get a share in the business not by virtue of agreement but by virtue of status, i.e., by birth in the family. Of course, this does not mean that there can be no partnership between members of a JHF to carry on a family business in partnership. But where such a fact is alleged, it will have to be established by proper evidence.

Like any other contract, an agreement to constitute partnership must fulfil all the essentials of a valid contract. Also an agreement between the partners may be express or implied. Further, the partnership agreement executes a particular adventure or for a fixed period.

3. ***The agreement must be to carry on some business:*** The term 'business' includes every trade, occupation or profession [s. 2(b)]. Though the word 'business' generally conveys the idea of numerous transactions, a person may become a partner with another even in a particular adventure or undertaking (s. 8). Unless the person joins for the purpose of carrying on a business, it will not amount to partnership. Thus, partnership does not exist between members of a charitable society or a religious association or a building scheme. Similarly, a club is not a partnership.

4. ***The agreement must be to share profits of the business:*** The joint carrying on of a business alone is not enough; there must be an agreement to share profits arising from the business. Unless otherwise so agreed, sharing of profits also involves sharing of losses. But whereas the sharing of profits is an essential element of partnership, sharing of losses is not. Thus, a person may become a partner under a distinct understanding that he is not to share losses, but to share only the profits. Though sharing of profits is an essential feature of partnership, the mere fact that a person is given a share in the profits of the business does not necessarily make him a partner.

   Example: 'A', a trader, owed money to several creditors. He agreed to pay his creditors out of the profits of his business (run under the creditors' supervision) what he owed to them. Held, the arrangement did not make creditors partners with 'A' in business [Cox v. Hickman, (1860) 8 H.L.C., 268].

   Similarly, a servant or agent who receives a share of profits as his remuneration or the seller of goodwill of a business who is given a share of profits as consideration for the sale of goodwill are not by reason of such facts alone, partners.

5. ***Business must be carried on by all or any of them acting for all:*** Partnership is based upon the idea of mutual agency. Every partner assumes a dual role – that of a principal and of an agent. The foundation of the law of partnership is agency and it is therefore said that, "the law of partnership is a branch of the law of principal and agent". Each partner is an agent binding the other partners who are his principals and each partner is again a principal, who in turn, is bound by the acts of the other partners. Thus the question whether a person is or is not a partner depends on whether he can bind others by his acts or be bound by the acts of others. It is not necessary that partner must actively participate in the conduct of the business. Thus, it is possible to have a partnership, in which one or more of the partners have management and control and some other partner is a sleeping or a dormant partner.

6.2.1 Other Legal Characteristics of Partnership Form of Organisation

Certain other important legal characteristics of partnership organisation are:

1. ***Unlimited liability:*** The liability of each partner of the firm is unlimited in respect of the firm's debts. The liability of partners is joint and several and therefore even one of the partners can be called upon to pay the debts of the firm in case the firm's assets are insufficient.

2. ***No separate legal entity:*** The partnership firm has no independent legal existence apart from the persons who constitute it.

3. ***Utmost good faith:*** A partnership agreement is based on mutual confidence and trust of the partners. The partners must therefore be just and honest towards the other partners. They must disclose all facts and render true accounts relating to the business of the firm and not make any secret profits.

4. ***Restriction on transfer of interest:*** No partner can transfer his share to an outsider without the consent of all other partners.

5. ***Unanimity of consent:*** No change may be made in the nature of the business without the consent of all partners.

6.2.2 Formation of Partnerships

All the essential elements of a valid contract must be present in a partnership as it is based on an agreement. Therefore, while constituting a partnership. The following points must be kept in mind:

(i) The Act provides that a minor may be admitted to be benefits of partnership.

(ii) No consideration is required to create partnership. A partnership is an extension of agency for which no consideration is necessary.

(iii) The partnership agreement may be express (i.e., oral or writing) or implied and the latter may be inferred from the conduct or the course of dealings of the parties or from the circumstances of the case. However, it is always advisable to have the partnership agreement in writing.

(iv) An alien friend can enter into partnership, an alien enemy cannot.

(v) A person of unsound mind is not competent to enter into a partnership.

(vi) A company, incorporated under the Companies Act, 1956 can enter into a contract of partnership.

(vii) Section 5 provides that the following persons are not treated as partners: (a) The members of a HUF carrying on family business as such. (b) A Burmese Buddhist husband and wife carrying on business.

6.2.3 'Partners', 'Firm' and 'Firm Name' (s.4)

"Persons, who have entered into partnership with one another, are called individually 'partners' and collectively a 'firm' and the name under which their business is carried on is called the 'firm name'. In law, a 'firm' is only a convenient phrase for describing the two or more persons who constitute the partnership and the firm has no legal existence apart from those persons. Thus, if A, B and C are partners in a firm, the firm really means A, B and C taken together. Unlike a joint stock company which is a legal entity under the Companies Act, 1956, a firm has no separate existence apart from its partners. A firm is not a body corporate. The rights and obligations of the firm are in fact the rights and obligations of the partners comprising the firm. The legal position of a firm is that it cannot possess property and, therefore, it cannot be a debtor or a creditor. The rights which a partner enjoys and the duties which he owes, are enjoyed against and owed to the other partners and not to the firm; and if an action between the partners be necessary to enforce such rights and duties, the individual partners and not the firm are the parties to the action. A firm as such cannot be a member of a partnership. Further, as all the partners put together are known as 'a firm', the assets of the firm are joint property of the partners and the partners are personally liable for all the business obligations of the firm.

This is the legal position of partnership, but in business practice, there is a trend to approximate it to an entity with a separate existence from the partners. Thus, we do talk of the assets, liabilities and goodwill of the firm. Its financial statements are

prepared. Under s.25 of the Companies Act, 1956, a partnership firm may be a member of a company. Also the firm is recognised as a separate unit for tax purposes. Also under order 30 of the Civil Procedure Code, actions can be instituted by or against the firm in its firm name, whether by the partners or third parties.

Partners may choose any name as their firm's name provided it does not go against the rules relating to trade name or goodwill. That is to say, the name adopted should not be such as will mislead the public into confusing them with a firm of repute already in existence. Further, s. 58(3) provides that a firm name shall not contain any of the following words, namely: Crown, Emperor, Empress, Empire, Imperial, King, Queen, Royal, or words expressing or implying the sanction, approval or patronage of Government except with the written consent of the State Government.

A firm may carry the names of the partners who own it, such as: "Ram & Shyam", or "Ram & Son", or "Ram & Sons", or "Ram Brothers". Further, the use of "& Co." after the name of one of the partners (Ram & Co.) establishes *prima facie* the existence of a partnership. The name may be a fictitious one also, such as "Ideal Confectionery". Using a fictitious firm name instead of the partners' real names has an advantage. It enhances the future sale price of the business, including goodwill by ensuring that the firm will not have to substitute names of the new owner when the selling partners leave.

From the above discussion, one may infer that partnership is different from a firm. Partnership is merely an abstract legal relation between the partners. But a firm is a concrete thing signifying the collective entity for all the partners. Thus, partnership is an invisible tie which binds the partners together whereas a firm is the visible manifestation of that relationship between the partners who are bound together in a relationship of agency.

6.2.4 Test of Partnerships

The question whether a particular group of persons constitutes a partnership or not, is often a difficult one to decide. Section 6, in this regard, lays down that in determining whether a particular group of persons constitutes a partnership, it is necessary to consider the real relations between the parties as shown by all relevant facts taken together. Thus, the use of the word 'partner' does not make a partnership, when there is none. If all the relevant facts taken together show that all the essentials of partnership are present, the group of persons will be called partnership, otherwise not. Of the essentials of partnership, sharing of profits is an important criterion but is not conclusive. Section 6 has categorically laid down that receipt by a person of a share of the profits of a business does not of itself make him a partner with the persons carrying on the business. In particular, the receipt of share or payment by the following does not of itself make the receiver a partner with the persons carrying on the business. (i) a lender of money to persons engaged or about to engage in any business; (ii) a servant or agent as remuneration; (iii) the widow or child of a deceased partner, as annuity; or (iv) a previous owner or part-owner of the business, as consideration for the sale of the goodwill or share thereof.

In all the above cases, the element of agency, so necessary to constitute partnership, is absent. A creditor or the widow and children of deceased partners cannot bind the firm by any act done on behalf of the firm. Similarly, where two persons, who jointly own a house, let out the same to a tenant and divide the rents among themselves, they are only co-owners but not partners with respect to the house or rent, because the idea of representation of one person by the other is absent. Thus, the true test of partnership is agency and not sharing of profits.

6.2.5 Partnership Distinguished from Some Other Organisations

Partnership and co-ownership: Co-ownership means joint ownership. 'A' and 'B' jointly purchase a house, they are co-owners but not necessarily partners. The following points of distinction between the two may be noted.

Partnership	Co-ownership
1. It arises from contract.	1. It may, besides contract, arise by status, e.g., *A* and *B* inherit a house from their father.
2. It always implies a business.	2. It may exist without any business.
3. It involves sharing of profits and losses.	3. It does not always involve the sharing of profits or losses because it may exist without any business.
4. Each partner is the agent of other.	4. A co-owner is not the agent of the other co-owners.
5. A partner cannot transfer his interest without the consent of all other partners.	5. A co-owner may transfer his interest to a third party without the consent of other co-owners.
6. A partner can claim a share in the surplus assets of the firm, but not a share in the properties of the firm *in specie*.	6. A co-owner can claim division of the joint property in *specie*.

6.2.6 Partnership and Club

A club is an association of persons with the objective of promotion of some beneficial or social object such as promotion of health or providing recreation for its members. It does not have the objective of earning profits and if, during the course of its operations, it makes some surplus, then it is ploughed back for achieving its objectives. A member of a club is not liable to a creditor of the club. The club is generally brought into existence as an incorporated body either under the Societies Registration Act, or the Companies Act, 1956. Therefore, a member of a club is not agent of other members and the death or resignation of a member does not affect its existence.

A club differs from partnership inasmuch as there is no business and thus no motive of earning profits and sharing them.

6.2.7 Partnership and Company

Distinction between partnership and the company incorporated under the Companies Act, 1959, is as follows:

(i) ***Legal status:*** A partnership firm has no existence apart from its members. A company is a separate legal entity distinct from its members.

(ii) ***Mutual agency:*** Partnership is founded on the idea of mutual agency – every partner is an agent of the rest of the partners. A member of a company is not an agent of other members.

(iii) ***Liability of members:*** Liability of a partner is unlimited, i.e., even his own personal assets are liable for the debts of the firm. Liability of a member or shareholder of a limited company is limited to the extent of the amount remaining unpaid on shares held by him or the amount of guarantee as mentioned in the memorandum of association of the company.

(iv) ***Transfer of interest:*** A partner cannot transfer his interest without the consent of all other partners. A shareholder, subject to restrictions contained in the articles can freely transfer his share.

(v) ***Duration of existence:*** Unless there is a contract to the contrary, the death, retirement or insolvency of a partner results in the dissolution of the firm. A company enjoys a perpetual succession. Death or retirement or insolvency of a member does not affect the existence of a company.

(vi) ***Minimum membership:*** The minimum number of persons required to form a partnership is 2. The minimum number required to form a private company is 2 and in the case of a public company the minimum number should be 7.

(vii) ***Maximum membership:*** A partnership cannot be formed with persons exceeding 20. The number is limited to 10 in the case of a banking business. In the case of a public company there is no limit to the maximum numbers of members. However, a private company cannot have more than 50 members.

(viii) ***Audit:*** The audit of the accounts of a firm is not compulsory, whereas the audit share counts of a company is mandatory.

6.2.8 Partnership and Joint Hindu Family (JHF) Business

A JHF is a Hindu joint family carrying on a trade or business inherited from its ancestors. Section 5 lays down that the relation of partnership arises from contract and not from status and in particular the members of Hindu Undivided Family (HUF) carrying on a family business as such are not partners in such business. However, the Act does not prohibit the members of JHF to enter into partnership amongst themselves. The principal differences between a partnership and a JHF business are as follows:

(i) ***Creation***: Partnership is essentially the result of an agreement between the parties whereas a JHF is the result of status.

(ii) ***Admission***: In a partnership, new partners can be admitted only with the consent of all the existing partners, whereas in JHF business a person becomes a member merely by his birth in that family.

(iii) ***Female members:*** A female member of the family does not become a member of a JHF business, though she can join partnership business as a full-fledged partner.

(iv) ***Minor members:*** A minor cannot be a member of a partnership firm except that he may be admitted to the benefits of an already existing partnership firm. Minors, in the case of JHF, are members of the family business right from the moment of their birth.

(v) ***Death of a member:*** Death of a partner dissolves the firm, unless otherwise agreed to by the partners. The death of a member of a JHF business leaves the firm unaffected.

(vi) ***Mutual agency:*** Every partner is an agent of the rest of the partners and therefore, his acts bind the firm. In case of JHF business, it is the *Karta* who has the authority to contract and bind the family, other coparcenaries cannot do so.

(vii) ***Liability:*** Every partner is liable to an unlimited extent. In case of JHF business, only *Karta* is liable to an unlimited extent, the liability of other coparceners is limited to the extent of their share in the profits of the family business unless they took part in the act or transaction done by the *Karta*.

6.2.9 Illegal Partnership

A partnership can be formed for genuine business purposes which are not illegal or prohibited by law. Thus, if a partnership is formed to carry on smuggling activities which are prohibited by law, then such a partnership will be an illegal one. Section 11 of the Companies Act, 1956, defines an "illegal association". It provides that an

association of more than 10 persons in case of banking and more than 20 persons for other business, the object of which is the acquisition of gains, must be registered either under the Companies Act or any other law. If it is not so registered then the association shall be an illegal association. A partnership, being an association of persons, has to follow s.11 of the Companies Act, 1956. Therefore, a partnership cannot exceed the maximum limit of partners, i.e., 10 in the case of banking business and 20 in the case of non-banking business.

A partnership may be illegal in either of the following two ways: (i) by being formed to do an illegal business, e.g., to carry on a business of illicit liquor; or (ii) where the number of partners exceeds the maximum, limit. An illegal partnership can, however, be sued. But in case where a person contracts with such a firm knowing its illegal character, he cannot sue on such a contract.

6.2.10 Duration of Partnership

The duration of partnership may or may not be fixed. It may be constituted even for a particular adventure.

6.2.11 Partnership for a Fixed Period

In this case, the partnership is constituted for a fixed period of time. The partnership comes to an end at the expiry of the fixed period. However, s.17(b) provides that if the partners continue to carry on the business after the expiry of the fixed period, the rights and liabilities of partners remain the same as they were before the expiry of the fixed period and the partnership becomes a 'partnership at will'.

6.2.12 Partnership at Will

In accordance with s.7, a partnership is called a partnership at will where; (i) it is not constituted for a fixed period of time and (ii) there is no provision made as to the determination of partnership in any other way. Therefore such a partnership has no fixed or definite date of termination. Accordingly death or retirement of a partner does not affect the continuance of such a partnership. Section 43(1) provides that such a firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.

6.2.13 Particular Partnership

In accordance with s.8 a particular partnership is one which is formed for a particular adventure or a particular undertaking. Such a partnership is usually dissolved on the completion of the adventure or undertaking. For example, two auditors, engaged in a particular audit, may be regarded as partners in the firm created for doing such an audit.

6.2.14 Limited Partnership

In this type of partnership, the liability of certain partners is limited to the amount of capital which they have agreed to contribute to the business. In a limited partnership, there will be at least one general partner whose liability is unlimited and one or more special partners whose liability is limited. This type of partnership is prevalent in USA and European countries. In India, it is not available, though unsuccessful attempts have been made in the beginning of nineties to enact Limited Partnership Act.

6.3 REGISTRATION OF FIRMS (SS.58-59)

6.3.1 Application for Registration

Section 58 lays down the procedure for registration of partnership firms. A partnership firm may be registered at any time by post, or delivering to the Registrar of Firms of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating:

(1) The firm's name,

(2) The place or the principal place of business of the firm,

(3) The names of any other places where the firm carries on business,

(4) The date when each partner joined the firm,

(5) The names in full and addresses of the partners and the duration of the firm.

The statement must be signed by all the partners, or by their agents especially authorised in that behalf and duly verified. When the Registrar of Firms is satisfied that the provisions of s.58 have been duly complied with, he registers the firm by recording an entry of the statement in a register called the Register of Firms and shall file the statement (s.59). He then issues under his hand a Certificate of registration. Registration is effective from the date when the Registrar files the statement and makes entries in the Register of Firms.

When an alteration is made in the name of the firm or in the location of its principal place of business, s. 60 requires that the information be sent to the Registrar of Firms.

6.3.2 Miscellaneous Provisions as Regards to Registration

Sections 60-63, 67-68 and 70 contain following provisions having a bearing on registration of firms:

1. ***Alterations:*** Any alteration relating to the following matters in the case of a registered firm must be intimated to the Registrar of Firms: (a) alteration's in firm, name and principal place of business (s.60), (b) closing and opening of branches (s.61), (c) changes in the name and addresses of partners (s.62), (d) changes in the constitution of a registered firm (s.63), (e) election by a minor, on attaining majority, to continue as partner or severe his connection with the firm (s.63), (e) dissolution of the firm (s.63). The Registrar of Firms will incorporate these changes in the Register of Firms.

2. ***Penalty for false particulars.*** Section 70 provides that any person who signs any statement, amending statement, notice or intimation as regards a registered firm and as required under the Act should be true and complete. If any person knowingly, or without belief in its truth, furnishes false or incomplete information, he is punishable with imprisonment which may extend to three months or with fine or with both.

3. ***Rectification of mistakes.*** Section 64 empowers the Registrar of Firms to rectify any mistake in order to bring the entry in the Register of Firms relating to any firm in conformity with the documents relating to the firm filed with him. Further, on an application made by all the parties who have signed any document relating to a firm filed with the Registrar, he may rectify any mistake in such document or in the record or note thereof made in the Register of Firms.

4. ***Amendment of register by order of court.*** Section 65 provides that a court deciding any matter relating to a registered firm may direct the Registrar to amend any entry in the Register of Firms.

5. ***Inspection of register and filed documents.*** Section 66 provides that the Register of Firms shall be open to inspection by any person on payment of a fee as prescribed for the purpose. Further all the statements, notices and intimations filed with the registrar shall be open to inspection, subject to conditions and fee prescribed.

6. ***Grant of copies.*** Section 67 provides that the Registrar shall, on applications furnish to any person on payment of the prescribed fee a certified copy of any entry in the Register of Firms.

7. ***Rules of evidence.*** Section 68 provides that any statement, notice or intimation recorded with the Registrar by any person shall be a conclusive proof against him of any fact stated therein. Entries relating to a firm in the Register of Firms may be proved by producing certified copies of the entries.

6.3.3 Registration of Firms is Optional

The Act does not provide for compulsory registration of firms. It is optional and there is no penalty for non-registration. But at the same time s.69 has effectively, ensured registration of firms by introducing certain disabilities that an unregistered firm suffers from. The firm cannot, for example, sue any person for the price of the goods supplied by it. The disabilities associated with the non-registration of a firm are given by s.69.

It is to be reiterated that a partnership firm can be formed and brought into existence without any registration with whatsoever authority. In other words, registration with the Registrar of Firms does not create a partnership firm. A firm already in existence can get itself registered at any time to protect itself and the outsiders dealing with it.

6.3.4 Effects of Non-registration

Section 69 lays down the consequences of non-registration of a firm. There are:

(i) ***Suits between partners and firm:*** A partner of an unregistered firm cannot sue the firm or his present or past copartners for the enforcement of any right (a) arising from a contract or (b) conferred by the Partnership Act. He can do so if (a) the firm is registered and (b) he is or has been shown in the Register of Firms as a partner in the firm. Thus, if a partner of an unregistered firm is not paid his share of profits, he cannot claim it through a suit in the court. However, if a right is conferred upon a partner under any other law, he can enforce such a right. Thus, in the case of an unregistered firm, a partner can file a petition for enforcement of an arbitration clause included in the partnership agreement. Also an unregistered firm cannot file a suit against its own partners.

(ii) ***Suits between firm and third parties:*** No suit can be filed, if it is for more than ₹ 100, on behalf of an unregistered firm against any third party for the purpose of enforcing a right arising from a contract until the firm is registered and the name of the person filing the suit appear as a partner in the Register of Firms.

Example: An unregistered firm supplies goods worth ₹ 10,000 to Shyam. He refuses to pay the amount due. The firm has no legal remedy against him.

A suit can be brought only by or on behalf of a registered firm and that also by one whose name appears as a partner in the Register of Firms. Third parties are at full liberty to file suits against the firm and the partners.

(iii) ***Claim of set-off.*** An unregistered firm or any partner thereof cannot claim a set-off in a proceeding instituted against the firm by a third party to enforce a right arising from a contract, until the registration of the firm is affected.

Example: Shyam buys certain goods worth ₹ 20,000 from an unregistered firm Sunil & Co. The firm is already indebted for ₹ 25,000 to Shyam. The firm, being an unregistered firm, cannot compel Shyam to accept ₹ 5,000 as the final settlement, i.e., the difference between ₹ 25,000 and ₹ 20,000, the right of set-off being not available to the firm.

However, non-registration does not affect certain transactions. These are:

(a) The right of a third party to file suit against the firm and its partners.

(b) The right of a firm to enforce rights arising otherwise than from contracts.

Example: Gyan infringes the trade mark of Khosla & Co., an unregistered firm. The firm has a right to sue Gyan for the infringement of its trade mark.

(c) The enforcement of any right of a partner to sue for the dissolution of a firm or for accounts of a dissolved firm, or any right or power to realise the property of a dissolved firm.

(d) The powers of an Official Assignee (or Receiver) or Court under the Presidency Towns Insolvency Act, or the Provincial Town Insolvency Act, to realise the property of an insolvent partner.

(e) The rights of a firm or its members who have no place of business in the territories to which the Act extends.

(f) Any suit or claim of set off not exceeding ₹ 100 in value provided the suit is of such a nature that it has to be filed in the Small Causes Court. Proceedings incidental to such suits, e.g., execution of decrees, are also allowed.

6.4 PARTNERSHIP DEED OR AGREEMENT OR ARTICLES OF PARTNERSHIP

6.4.1 A Partnership can be Formed Either by Oral or Written Agreement

In France and Italy, the law requires all partnership agreements to be in writing. But in England, USA and India, written agreement is not compulsory. But in order to avoid misunderstanding and litigation, it is desirable to enter into a written agreement which is called Partnership deed or agreement. The partnership deed is required to be stamped according to the provisions of the Stamp Act, 1899. Each partner should possess a copy of the Deed. The Partnership Deed is not a public document (in the case of a company, a memorandum of association is a public document) and therefore binds only third parties so far as they have notice of it. A properly drawn up deed of partnership contains clauses on the following:

(i) Name of the firm.

(ii) Names and addresses of the partners.

(iii) Nature of partnership business.

(iv) The town and place where the business will be carried on.

(v) The commencement and duration of partnership.

(vi) All details to the amount of capital contributed by each partner.

(vii) The proportion in which the profits and losses are to be shared.

(viii) Loans and advances by partners and interest payable thereon.

(ix) The amounts that can be withdrawn by the partners and the rate of interest.

(x) Rate of interest, if any, allowed on capital contribution.

(xi) The duties, powers and obligations of all the partners.

(xii) Salary, if any, payable to the partners for managing the firm.

(xiii) Maintenance of accounts and audit.

(xiv) The basis of valuation of goodwill on the death or retirement of a partner or the introduction of a new partner.

(xv) Method of admitting a partner.

(xvi) The methods by which a partner may retire and the arrangement for the payment of dues of a retired or deceased partner.

(xvii) Method of operating a bank account.

(xviii) Arrangements in case a partner becomes insolvent.

(xix) Conduct and management of business.

(xx) Arbitration in matters of dispute among partners.

(xxi) The methods of revaluation of assets and liabilities on admission or retirement or death of a partner.

(xxii) Settlement in the case of dissolution of partnership.

(xxiii) Any other clause or clauses which may be found necessary in any particular kind of business.

6.4.2 Partnership Agreements and Contract Law

Section 3 provides that the unrepealed provisions of the Indian Contract Act, 1872 save insofar as they are inconsistent with the provisions of this Act, shall continue to apply to firms. Also s. 2(e) provides that "expressions used but not defined in this Act and defined in the Indian Contract Act, 1872, shall have the meanings assigned to them in that Act". As a partnership agreement is a contract, the provisions of the Indian Contract Act, 1872, are applicable to it.

Free consent: All partners must consent to the partnership agreement. Otherwise, they obviously lack the intent necessary to form the partnership. Alleged partners may assert all the flaws which mar free consent, such as fraud, coercion and undue influence.

Legal purpose: A partnership agreement must have a legal purpose. No court will enforce a partnership agreement for an illegal object. Suppose X and Y run a shop dealing in smuggled goods. No court will enforce their partnership agreement against one another or a debt owed to them by one of their clients.

Capacity: Section 11 of the Indian Contract Act, 1872, provides, inter alia, that every person "is competent to contract who is of the age of majority...." Thus a minor is not competent to contract. But a contract with a minor is void as against him but not as against the other party. Also we have noted that a minor may be appointed as an agent. Also s. 30(1) provides that with the consent of all the partners for the time being, a minor may be admitted to the benefits of partnership. Further, where a court declares a partner insane or a partner is shown to be of unsound mind, another partner may seek dissolution of the partnership. Because partnership requires mutual agency, a lunatic may not be a partner, since he cannot act as an agent.

Writing: A contract need not be in writing. Accordingly, a partnership agreement need not be in writing. It may be oral, written or implied from the parties' conduct. However, because disputes easily develop over oral agreements, parties should have a written agreement. No particular form need be used. As most partnership agreements are complex, so the help of a lawyer is advisable.

Right to select one's partner: No one can become a member of a partnership that is being formed, or join an already existing partnership without the consent of all the members of the firm. This is in accordance with the concept of *delectus personae* (latin for "choice of persons"). Each partner has been given the right to choose each of the other partners whose torts or other possible wrongdoings could cause great personal financial loss. Unless the partners have expressly agreed otherwise, the composition of the firm cannot be changed without the consent of the partners.

6.5 RELATIONS OF PARTNERS TO ONE ANOTHER

The relation of the partners of a firm to one another arises through an agreement between them. Such an agreement may be express or may be implied from the course of dealings between them. It may be varied by their consent and such consent may be expressed or may be implied by a course of dealings [s.11(1)]. Where there is no specific agreement or where the agreement is silent at a certain point, or where no agreement exists, the relations of partners to one another as regard to their rights and duties are governed by Ss.9-17 of the Act.

6.5.1 Rights of Partners

Subject to the contract between the partners, every partner has the following rights:

(i) To take part in the conduct of the firm's business [s.12(a)].

(ii) To express his opinion on any matter, but in case of difference of opinion regarding ordinary matters of the business, he is bound by the majority decision. However, no change can be made in the nature of the business without the consent of all the partners [s.12(c)].

(iii) To have access to and inspect and copy any of the books of the firm [s.12 (d)].

(iv) To share equally in the profits [s.13 (b)].

(v) To rank as a joint owner of the property of the firm. The property of the firm includes all property and rights and interest in property originally brought into stock of the firm, or acquired by purchase or otherwise, by or for the firm or for the purposes and in the course of the business of the firm and includes also the goodwill of the business.

(vi) To do, in an emergency, all such acts as are reasonably necessary to protect the firm from loss.

(vii) To claim interest @ 6 per cent per annum on any amount advanced by him beyond the amount of capital that he agreed to subscribe [s.13(c)].

(viii) To be indemnified by the firm in respect of liabilities incurred by him in the ordinary course of business [s.13 (e)].

6.5.2 Duties of Partners

Section 9 provides for general duties of partners.

(i) They are bound to:

(a) carry on the business of the firm to the greatest common advantage,

(b) be just and faithful to each other, and

(c) render true accounts and full information of all things affecting the firm to any partner or his legal representative.

(ii) Every partner shall indemnify the firm for loss caused to it by his fraud in the conduct of the business of the firm (s.10).

(iii) To attend diligently to his duties in the conduct of the firm's business without any remuneration [s.13 (a)].

(iv) If restrained by an agreement with other partners, a partner has a duty not to carry on any business other than that of the firm while he is a partner [s.11 (2)].

(v) If a partner carries on any business competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business [s.16 (b)].

6.5.3 Firm's Property

Sometimes it becomes necessary to distinguish the joint property of the partners (i.e., firm's property) from the personal property of the partners. For example, on the dissolution of a firm, the firm's debts are first paid out of the joint assets of the partners. Also, firm's property can be used only for the purposes of the business of the firm. A partner cannot treat the firm's property or a part thereof as his own. Further, he cannot assign his interest in firm's property to anyone. Furthermore, some personal property of one or more partners may be employed or used for the purpose of the firm.

Example: 'A' was the owner of a colliery. 'A' joined hands in partnership with 'B' for the purpose of working the colliery. They shared the profits of the venture. The colliery does not become the property of the firm; it continues to be A's personal property.

It is open to the partners to agree among themselves as to what shall be the property of the firm. Section 14 lays down rules for determining the intention of the partners for this purpose. Thus, in the absence an agreement to the contrary, the firm's property includes: (i) all property originally brought into the common stock of the firm; (ii) all rights or interests in the property, originally so brought; (iii) all property acquired, by purchase or otherwise, by or for the firm and all rights and interests in any property so acquired; (iv) all property acquired for the purpose and in the course of the business of the firm and all rights and interests in any property so acquired; and (v) goodwill of the business of the firm.

Section 14 further provides that, unless intention to the contrary appears, property and rights and interests in property acquired with money belonging to the firm are deemed to be property of the firm.

Example:

(i) A and B are the partners. A buys some shares in a company with money belonging to the firm. The shares constitute firm's property.

(ii) A and B are partners. They buy a property in the name of a fictitious person with money belonging to the firm. The property shall be deemed to be the firm's property.

(iii) 'A' is the owner of a colliery. He enters into partnership with 'B' for working the colliery. He sells the same to the firm. Colliery becomes the firm's property.

6.5.4 Firm's Goodwill

Section 14 further provides that the property of a firm, subject to the contract between the partners, includes the goodwill of the business. As it is a part of the partnership

property, it can be sold either separately or along with the other property of the firm (s.55 (1)].

Section 15 provides that subject to the contract between the partners, the property of the firm shall be held and used exclusively for the purposes of partnership.

6.5.5 Personal Profits Earned by Partners

Section 16 provides that if a partner derives any profit for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm. A partner can use the property of the firm for the purposes of business of the firm only and not for his personal advantage.

Profits earned by engaging in a competing business. Section 16 provides that no partner can carry on any business which is likely to compete with the business of the firm, except with the consent of the other partners. In case any partner is so engaged in a competing business, then he must account for the profits thereof to the firm and must also compensate the firm for any loss sustained by his carrying on such business. Further, s.53 provides that, not only during the continuance of the firm, but also after dissolution of the firm and during the winding up, a partner may be prohibited and can be restrained from carrying on a competing business in the name of the firm or using the property of the firm.

It is worth reiterating that s.12 of the Indian Contract Act, 1872, provides that an agreement in restraint of trade is void. But s.11 permits an agreement between partners that a partner shall not carry on business other than the business of the firm as long as he is a partner. In practice, such a clause generally appears in partnership agreements. In the absence of any such arrangements, partners are free to engage in any private business of their own, provided the same does not compete with the firm's business.

6.6 RELATIONS OF PARTNERS TO THIRD PARTIES

Subject to s.18 every partner is the agent of the firm for the purposes of the business of the firm.

6.6.1 Implied Authority of a Partner

A partner's authority may be express or implied. It is express, when it is fixed between the partners by mutual agreement. The agreement may, however, be oral or written. It is implied when the law impliedly gives certain powers to a partner, i.e., the law presumes that every partner has the power to do certain acts unless negative by an express agreement.

Sections 19 and 22 deal with the subject of implied authority of a partner. The two sections when read together provide that the act of a partner which is done to carry on in the usual way, business of the kind carried on by the firm, binds the firm, provided the act is done in the firm's name, or in any manner expressing or implying an intention to bind the firm. Such authority of a partner to bind the firm is called his implied authority. The implied authority of a partner thus extends only to such acts, which (i) are common in the type of business carried on by the firm and (ii) are done by him in the usual way of carrying on the firm's business. Thus, if it is usual to give credit to customers, in a particular business, the giving of credit by a partner to a customer will bind the firm. But if a usual act is done in an unusual manner, this must raise a suspicion as to the authority of a partner and the protection on the ground of implied authority may not be available.

In connection with a partner's implied authority, judicial decisions have made a distinction between a trading and a non-trading partnership. In the case of a trading firm a partner can borrow money on behalf of the firm [Saremal v. Kapurchand, 48 Bom. 176]; but in the case of a non-trading firm, unless the power to borrow is given expressly by the partnership deed, a partner cannot borrow money or pledge property of the firm, on behalf of the firm, so as to bind the firm. In case of trading firms, however, the implied authority of a partner extends also to drawing and accepting bills of exchange and making and endorsing promissory notes.

6.6.2 Matters in which there is no Implied Authority

Clause 2 of s.19 gives the negative rule. It enlists what does not fall within the implied authority of a partner. That is to say that the authority of a partner to bind the firm, which is implied by law, does not extend unless expressly provided by the partnership deed, to the following matters:

(i) The submitting of a dispute, relating the business of the firm for arbitration.

(ii) Opening of a bank account on behalf of the firm in the personal name of a partner. A partner can open a bank account in the name of the firm, but not in his own name unless so authorised by the other partners.

(iii) Compromising or relinquishing any claim or portion of a claim which the firm may have against a third party.

(iv) Withdrawal of a suit or proceeding filed on behalf of the firm.

(v) Admission of any liability in a suit or proceeding against the firm.

(vi) The acquisition of immovable property belonging to the firm.

(vii) Transfer of any immovable property belonging to the firm.

(viii) Entering into partnership on behalf of the firm.

Besides the above restrictions, the partners in a firm may, by contract between the partners, restrict the implied authority of any partner. But unless the outsider otherwise knows, he is not bound of the restriction by any such private contracts between the partners (s.20).

6.6.3 Liabilities of a Partner

Liability of a partner stems from not complying with his duties under the Partnership Act. Thus, in view of s.9, a partner shall be liable for (i) not carrying on the business of the firm to the greatest common advantage; (ii) not being just and faithful to other partners and (iii) failure to render true accounts and full information of all things affecting the firm to any partner or his legal representative.

Section 10 provides that every partner shall be liable to indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm. Also, every partner has (i) To account for and pay to the firm all profits made by him in any business competing with that of the firm [s.16 (b)]. (ii) To account for any profit, including secret profit, derived by a partner from any transaction of the firm, or from the use of the property or business connection of the firm or the firm's name [s.16 (a)]. (iii) To contribute equally towards the losses of the firm, in the absence of an agreement to the contrary. (iv) To indemnify the firm for any loss caused to it by his willful neglect in the conduct of the business of the firm (s.13). Section 25 makes every partner liable jointly with all other partners and also severally for all the acts of the firm done while he is a partner.

An 'act of the firm' is defined by s.2 (a) as "any act or omission by all the partners, or by any partner or agent of the firm, which gives rise to a right enforceable by or against the firm". Where a partner's implied authority is curtailed by an agreement between himself and other partners, an act of the partner within his implied authority, but beyond his actual authority would be binding on the firm, unless the third party knows of the curtailment of the implied authority. There is no difference between active partners and dormant partners as regards liability to third parties. A dormant partner is also liable to an unlimited extent for all the debts of the firm.

6.6.4 Liability of a Firm for Wrongful Acts of a Partner (Ss.26-27)

Where, by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party or any penalty is incurred, the firm is liable therefore to the same extent as the partner.

Also, the firm is liable to make good the loss where – (i) a partner acting within his apparent authority receives money or property from a third party and misapplies it, or (ii) a firm, in the course of its business, receives money or property from a third party and the money or property is misapplied by any of the partners while it is in the custody of the firm.

6.6.5 Implied Authority and Third Parties

The provisions concerning how far third parties are affected by the implied authority, its extension and curtailment are summarised at one place for the convenience of the readers.

(i) ***Extension and restriction of a partner's implied authority:*** Section 20 provides that the partners may, by contract between them, either extend or restrict the implied authority of any partner. In spite of any such restriction if a partner does, on firm's behalf, any act which falls within his implied authority, the firm will be bound unless the person with whom he is dealing is aware of the restriction or does not know or believe the partner to be a partner. Also a third party is not affected by a secret limitation of a partner's authority unless he has actual notice of it.

(ii) ***Acts in emergency:*** Section 21 provides that a partner can bind the firm by all his acts done in an emergency, with a view to protecting the firm from any loss, provided he has acted in the same manner as a man of ordinary prudence would have acted in the like circumstances. However, such acts bind the firm but do not form part of the partner's implied authority.

(iii) ***Effect of admission by partners:*** Section 23 provides that partners can make binding admission in relation to partnership transactions made in the ordinary course of business. Such an admission by a partner is evidence against the firm. An admission or representation by a partner will not, however, bind the firm if his authority on the point is limited and the other party has knowledge of the restriction.

(iv) ***Effect of notice to an acting partner:*** Section 24 provides that a partner who habitually acts in the business of the firm on any matter relating to the affairs of the firm operates as notice to the firm except in the case of a fraud on the firm committed by or with the consent of that partner.

(v) ***Liability of a partner for acts of the firm:*** Every partner is liable jointly with all the other partners and also severally, for all acts of the firm done while he is a partner (s.25).

(vi) ***Liability of the firm for wrongful acts of a partner:*** Section 26 provides that the firm is liable to the same extent as the partner for any loss or injury caused to a third party by the wrongful acts or omission of a partner, if they are done by the partner while acting (a) in the ordinary course of the business of the firm, or (b) with the authority of the partners. This section makes the firm liable for the torts committed by a partner.

(vii) ***Liability of firm for misapplication by partners:*** Section 27 provides that a firm is liable to make good the loss where (a) a partner acting within the scope of his apparent authority receives money or property from a third party and misapplies it, or (b) the firm in the course of its business receives money or property from a third party and the same is misapplied by any of the partners while it is in the custody of the firm.

6.6.6 Types of Partners

There are different types of partners. A person who deals with a firm may have to ascertain, at some time or the other (such as where the firm has made a default) as to not only who the partners are, but also to what extent each is liable. The liability is different for different classes of partners.

1. ***Actual, active or ostensible partner:*** Such a partner is a person who becomes a partner by an agreement, brings capital, actively participates in the functions and management of the business and shares its profits and losses. He finds himself and other partners, so far as third parties are concerned, for all the acts done by him in the ordinary course of the business and in the name of the firm. Such a partner must give a public notice of his retirement from the firm in order to absolve himself from the liability for the acts of the other partners done after his retirement.

2. ***Sleeping or dormant partner:*** A sleeping partner is one who does not take an active part in the business of the firm. Sometimes he is called as a financing partner as he contributes to the capital only but does not participate in the management of the business. Such a partner is liable like any other partner of the firm for the debts of the firm, even though his existence is kept a secret from the parties dealing with the firm. His position may well be compared with an undisclosed principal. But a sleeping partner, unlike other active or known partners, is not required to give public notice in order to absolve himself from liability for the acts of other partners after he ceases to be a partner. He is not liable for any act of the firm after he ceases to be partner even if he does not give a public notice. Also his insanity or any such other disability does not dissolve the firm.

3. ***Nominal partner:*** Sometimes persons lend their names and credit to the firm but neither contributes any capital nor takes active part in the management of the business. Such partners are called nominal partners. As the title suggests, such persons are partners only in name. His name is used as if he were a partner of the firm, though actually he is not. He is not entitled to share profits of the firm but is liable for all the acts of the firm as if he is the real partner.

4. ***Partner in profits only:*** If a partner is entitled to a certain share of profit without being liable for the losses, he is known as partner in profit only. He is not allowed to take part in the management of the firm, but is liable for all the acts of the firm.

5. ***Sub-partner:*** A sub-partnership comes into existence when one of the partners agrees to share the profits derived by him from the firm with a third person. This third person is called a 'sub-partner'. A sub-partner is not a partner in the eyes of

law and therefore, has no right against the firm. He is also not liable for the acts of the firm nor can he bind the firm by his acts.

6. ***Partner by estoppel or holding out:*** Sometimes a person who is not a partner in a firm may under certain circumstances, be liable for its debts as if he were a partner. Such a person may be either a partner by estoppel or a partner by holding out. If any person behaves in such a way that others consider him to be a partner, he will be held liable to those persons who have been misled and lent finance to the firm on the assumption that he is a partner. Such a person is known as a partner by estoppel. He is not a true partner of the firm is and also not entitled to any share in the profits of the firm.

   If any person declared that so and so is a partner in a firm, that concerned person immediately after coming to know of that should deny it. If he fails to deny, he will be liable to those persons who extend credit to the firm on the basis of his being a partner. Such a partner is known as a partner by holding out. Section 28 thus contemplates the following two situations: (i) A person who by words spoken or written or by conduct represents himself to be a partner in a firm. (ii) A person who knowingly permits himself to be represented to a partner in a firm. Such a person is liable as a partner in that firm to anyone who has, on the faith of any such representation, given credit to the firm. However, such a partner does not acquire any claim thereby on the firm.

   Examples:

   (i) A partner retires from a firm but does not give notice of his retirement. He is a partner by holding out.

   (ii) Kulkarni induces Sarabhai to believe that he (Kulkarni) is a partner of a firm known as K & Co. Sarabhai believing that Kulkarni is a partner, gives credit to K & Co. Kulkarni will be responsible for compensating Sarabhai. Kulkarni will not be heard to say that he is not a partner of K & Co.

   The doctrine of holding out, however, is not applicable in the following cases:

   (i) The liability of a partner by holding out does not extend to torts (i.e., civil wrongs) committed by other partners of the firm. (ii) The liability does not extend to bind the estate of a deceased partner, where after a partner's death the business of the firm is continued in the old firm's name [s.2 (28)]. (iii) There is no liability of the partner by holding out where he has been adjudicated insolvent (s.45).

7. ***Working partner:*** A partner, because of his special qualifications, may be assigned the management and control of business. Such a partner is known as 'working partner'. A working partner normally receives a fixed amount of salary, besides his share in the profits of the firm. Other partners, however, remain liable to the third parties for all his acts.

8. ***Incoming partner:*** Section 31 provides that subject to the contract between the partners and to the provisions of s.30 (which deals with the position of a minor partner) a person can be introduced as a partner into a firm with the consent of all the existing partners. Thus, a person who is admitted as a partner into an already existing firm with the consent of all the existing partners is called an 'incoming partner'. An incoming partner does not become liable for any acts of the firm done before his admission as a partner. However, where he specifically agrees to bear the past liabilities, he will be liable to the other partners for the same. Third parties, however, cannot hold him liable since there is no privity of contract between the new partner and the creditors.

9. ***Outgoing partner:*** A partner who leaves a firm in which the rest of the partners continue to carry on business is called an 'outgoing' or retiring partner. A partner

may retire: (i) with the consent of all the other partners; (ii) in accordance with an express agreement by the partners; or (iii) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire [s.32 (1)].

A retiring partner continues to remain liable to third parties for all the acts of the firm until public notice is given of his retirement. Such a notice may be given either by the retiring partner or by any member of the reconstituted firm. A partner who retires from a firm does not cease to be liable for the debts or obligations of the firm incurred before his retirement. A retiring partner will also be liable to third parties for the transactions of the firm begun but unfinished at the time of his retirement. A retiring partner may, however, be discharged from any liability to any third party for the acts of the firm done before his retirement if it is so agreed with the third party and the partners of the reconstituted firm. Such an agreement may be implied from the course of dealings between the firm and the third party after he had knowledge of the retirement.

Though a partner may retire, he cannot be expelled unless such a power is conferred by contract between partners and is exercised in good faith (s. 33). A retiring partner is entitled to have a share in the subsequent profits till his accounts are finally settled (s.37).

6.6.7 Minor as a Partner

Partnership, being a contract, a minor cannot enter into partnership, he being incapable of contracting. An agreement with or by a minor is void *ab initio*. However, if all the partners agree, a minor may be admitted to the benefits of an already existing firm. The rights and liabilities of a minor partner are defined by s.30 as follows:

(i) He has a right to such share of the property and of the profits of the firm as may be agreed upon between the partners.

(ii) He may have access to and inspect and copy any of the accounts of the firm.

(iii) Minor's share in the property and the profits of the firm is liable for the acts of the firm, but the minor is not personally liable for any such act.

(iv) He has no right, while he continues to be a partner, to file a suit against other partners for accounts or for payment of his share in the profits or the property of the firm. He can do so only when he wants to severe his connection with the firm.

(v) When he files a suit for severing his connection with the firm, his share shall be determined by valuation, according to the principles laid down in s.48, for making accounts of a dissolved partnership.

(vi) At any time within six months of his attaining majority, or of his obtaining the knowledge that he had been admitted to the benefits of partnership, whichever date is later, the minor may give public notice that he has elected to become or that he has elected not to become a partner of the firm. If he elects to be a partner, or if he fails to give public notice to the effect that he does not elect to be a partner, he would be liable for the debts of the firm contracted since the time he was admitted to the benefits of the partnership.

The mode of giving public notice is laid down in s. 72. The notice is to be published in the local Official Gazette and in at least one vernacular newspaper circulating in the district where the firm has its place or principal place of business. In the case of a registered firm, there is an additional compliance, i.e., a copy of the public notice is to be sent to the Registrar of Firms.

6.7 CHANGES IN A FIRM

The Act contemplates the following changes in a firm: (i) change in the duration of a firm; (ii) change in the nature of business or undertakings and (iii) change in the constitution of a firm.

A partnership may be entered into for a fixed period of time. When the fixed period is over, it comes to an end. However, the partners may carry on the business even after the expiry of the fixed period and the partnership becomes 'partnership at will'. Section 12 (c) provides that subject to contract between the partners no change may be made in the nature of the business without the consent of all the partners. Thus, a change in the nature of the business can only be brought about by the consent of all the partners.

A change in the constitution of a firm takes place when

(i) a new partner is introduced as a partner in a firm (s.31), (ii) a partner retires from a firm (s.32), (iii) a partner is expelled from a firm (s.33), (iv) a partner is adjudicated as an insolvent (s.34), (v) a partner dies (s.35), (vi) a partner transfers his interest in the firm by sale, mortgage or charge (s.29).

6.7.1 Rights and Liabilities of Incoming Partners

Section 31 provides that subject to a contract between partners and to the provisions regarding minors in a firm, no new partner can be introduced into a firm without the consent of all the existing partners. Such a partner enjoys all the rights as are conferred upon him by the Act and by the contract between him and the existing partners. The liability of a new partner ordinarily commences from the date when he is admitted as a partner, unless he agrees to be liable for obligations incurred by the firm prior to that date. But such an agreement is binding only on the partners and does not give the right to any creditor of the firm to sue the new partner for past debts of the firm. This is because there is no privity of contract between the creditor and the new partner. At the same time, the acts of the old partners cannot be ratified by the new partner. This is in accordance with s. 196 of the Indian Contract Act, 1872, which provides that for the purpose of ratification of agency, the principal must be in existence at the time when the act was done.

The new partner, however, would be liable for the acts of the old firm only if (i) the reconstituted firm after his admission assumes the liabilities of the old firm and (ii) the creditors accept the new firm as their debtor and discharge the old firm from its liability. The process of substituting the old firm by the new firm is done by what is known as novation. Novation is the technical term used in a contract for substituted liability, of course, not confined only to case of partnership.

6.7.2 Rights and Liabilities of a Retired Partner

An outgoing partner means a partner who has retired from a firm. The firm is reconstituted by the remaining partners. Section 32 contemplates three ways in which a partner may retire from the firm, viz., (i) he may retire at any time with the consent of all other partners; (ii) where there is an agreement between the partners about retirement, a partner may retire in accordance with the terms of that agreement; (iii) where the partnership is at will, a partner may retire by giving to his partners a notice of his intention to retire. Section 32 clearly comprehends a situation where a partner may retire without dissolving the firm.

Section 36 permits a retiring partner to carry on business competing with that of the firm and he may advertise such business, but subject to a contract to the contrary, he cannot use the name of the firm or represent himself as carrying on the business of the

firm or solicit customers of the firm after he has left. However, the partner may agree with his partners that on his retiring from the firm, he will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such an agreement will not be in restraint of trade if the restraint is reasonable. Section 53 provides for a similar rule to such an agreement in case of sale of the firm's goodwill. Further, the retiring partner has the right to receive his share of the property of the firm, including goodwill, as the amount due to him is to be construed as a debt payable by the firm.

Furthermore, s.37 provides that a retiring partner, where the continuing partners carry on the business of the firm with property of the firm without any final settlement of account with him, is entitled to claim from the firm such share of the profits made by the firm, since he ceased to be a partner, as is attributable to the use of his share of the property of the firm. In the alternative, he can claim interest at the rate of 6 per cent per annum on the amount of his share in the firm's property. However, if by a contract between the partners, an option has been given to the continuing partners to purchase the interest of the retired partner and the option is duly exercised, the retired partner or his estate will not be entitled to any further share of the profits.

Liability of the Retired Partner: Section 32 provides that a retired partner continues to be liable for all the acts of the firm done before his retirement unless he is discharged from his liability. He may be discharged from liability to any third party for the acts of the firm done before his retirement if (a) there is an agreement made by him with such third party and the remaining partners. (This implies the principle of novation); (b) there is an implied agreement to the above effect. Such an agreement may be implied by a course of dealing between such third party and the remaining partners, after the third party had knowledge of the retirement.

Further, s.32 provides that a retired partner, along with other partners at the time of his retirement, continues to be liable as partner to third parties for any act done by any of them after the retirement of the partner until a public notice is given of the retirement. This implies the principle of holding out. The public notice of the retirement of a partner may be given either by the retired partner or any of the partners of the reconstituted firm. A retired partner, however, is not liable for the acts of the firm done after his retirement, provided the persons dealing with the firm do not know that he was a partner as such. This in fact refers to the retirement of a sleeping or dormant partner.

6.7.3 Expulsion of a Partner

Section 33 provides that a partner may not be expelled from a firm by a majority of partners except in exercise, in good faith, of powers conferred by the contract between the partners. Thus, a partner may be expelled from the firm if (i) the power of expulsion is conferred by a contract between the partners, (ii) the power is exercised by a majority of the partners and (iii) the power is exercised in good faith. The test of good faith will be satisfied if (i) the expulsion is in the interest of the partnership, (ii) a notice of expulsion has been served on the partner and (iii) the partner to be expelled has been given an opportunity of being heard.

In case a partner is expelled without satisfying the conditions above mentioned, the expulsion would be irregular and he does not cease to be a partner. In such a situation, he may either claim re-instatement as a partner, or sue for the refund of his share of capital and profits in the firm. The rights and liabilities of an expelled partner are the same as those of a retired partner.

6.7.4 Insolvency of a Partner

Section 34 provides that where a partner in a firm is adjudicated insolvent, he ceases to be a partner on the date on which the order of adjudication is passed whether or not the firm is thereby dissolved. It is to be noted that ordinarily but not invariably, the insolvency of a partner results in dissolution of a firm but the partners may specifically provide that on such a contingency the firm shall not be dissolved.

Section 34 further provides that the estate of the insolvent partner is not liable for the acts of the firm done after the date of order of adjudication. It is not mandatory to give a public notice to the effect that a partner has been adjudged an insolvent. In any case the firm is not liable for any act of the insolvent partner after the date of order of adjudication.

6.7.5 Death of a Partner

Section 42(c) provides that a firm is dissolved by the death of a partner, in the absence of a contract to the contrary. Section 35 deals with a situation where after the death of a partner, the firm continues its business without dissolution and provides that the estate of the deceased partner is not liable for any act of the firm done after his death. Proviso to s.45 lays down an identical rule applicable to a case where the death of a partner has caused dissolution of the firm. A public notice of the death of a partner is not required.

6.7.6 Transfer of Partner's Interest

A partner may transfer his interest in the firm by sale, mortgage or charge. The transfer may be absolute or partial. But as the partnership relationship is based on mutual confidence, the assignee of a partner's interest cannot enjoy the same rights and privileges as the assignor. Section 29 provides that the transferee, during the continuance of the firm, is not entitled to (i) interfere in the conduct of business of the firm or (ii) require accounts of the firm, or (iii) inspect books of the firm.

The transferee of the partner's interest is entitled to receive share of profit of the assignor. However, he is bound to accept the profits as agreed to by the partners, i.e., he cannot challenge the accounts.

On the dissolution of the firm or if the transferring partner ceases to be a partner, the transferee will be entitled, against the remaining partners, to receive the share of assets of the firm to which the transferring partner is entitled. Also for the purpose of ascertaining that share, he is entitled to an account as from the date of dissolution.

6.7.7 Rights and Duties of Partners in Some Specific Situation

Section 17 contemplates rights and duties of partners under the following three specific situations: (i) where a change occurs in the constitution of a firm, (ii) where a firm constituted for a fixed term continues to carry on business after the expiry of that term and (iii) where a firm constituted to carry out one or more adventures carries out other adventures.

Subject to contract between the partners, where a change occurs in the constitution of the firm, the mutual rights and duties of the partners in the reconstituted firm remain the same as they were immediately before the change, as far as may be.

In case a partnership is created for a fixed term or for a particular adventure, it would naturally come to an end on the expiry of such term or on the completion of such adventure. But sometimes the partners continue the business even after the expiry of the term or completion of the adventure, without any new agreement. In such a situation, s.17 provides that the mutual rights and duties of the partners remain the

same as they were before the expiry so far as they may be consistent with the incidents of a partnership at will. Further, where a firm constituted for one or more adventures or undertakings, carries out other adventures or undertakings, the mutual rights and duties will remain the same. This is subject to the contract between the partners.

6.7.8 Revocation of Continuing Guarantee as a Result of Change in the Firm

Section 38 provides that a continuing guarantee given to a firm or to a third person in respect of the transactions of the firm is revoked as to future transactions from the date of any change in the constitution of the firm. This provision is subject to an agreement to the contrary and if the surety has not given his assent to the change. This provision is intended to protect the surety's interest.

6.8 DISSOLUTION

6.8.1 Dissolution of Firm and Dissolution of Partnership

Section 39 provides that the dissolution of partnership between all the partners of a firm is called the "dissolution of the firm". It follows that if the dissolution of partnership is not between all the partners, it would not amount to "dissolution of firm", but it would nevertheless be "dissolution of partnership". Thus, dissolution of firm always implies dissolution of partnership, but dissolution of partnership need not lead to dissolution of firm. Dissolution of partnership may involve merely a change in the relation of the partners and not the dissolution of the firm. For example, where A, B and C were partners in a firm and C died or was adjudged insolvent, the partnership firm would come to an end; but if the partners had agreed that the death, retirement, insolvency of the partner would not dissolve the firm on the happening of these contingencies, the 'partnership' would certainly come to an end although the 'firm' or as the Act calls it, a 'reconstituted firm', might continue under the same name. Thus, a reconstitution of a firm involves a change in the relation of partners whereas in the case of dissolution of firm, there is complete severance of relationship between all partners. Admission of a new partner amounts to reconstitution of the firm.

Examples:

(i) Ram, Rahim and Singh are partners of a firm RRS & Co. Singh retires or dies and the partnership deed provides that in the event of such a happening, the firm shall continue. Then the firm will be called a reconstituted firm, having two partners – Ram and Rahim. Now the relation between Ram and Rahim does not remain the same as it was between Ram, Rahim and Singh.

(ii) Ram, Rahim and Singh are partners in a firm. Robert is introduced as a new partner. Now the relation between Ram, Rahim, Singh and Robert will be different from the relation between Ram, Rahim and Singh. Thus, the firm consisting of the four partners is a reconstituted firm.

6.8.2 Another Classification of Methods of Dissolution

The different methods of dissolution are: (i) mutual agreement, (ii) notice, (iii) operation of law, (iv) the happening of a certain contingency and (v) a decree of a court.

Dissolution of partnership: It may be reiterated that the dissolution of partnership may lead to dissolution of firm. The dissolution of partnership takes place in any of the following circumstances:

(i) ***By the expiry of term:*** Where the partnership is for a fixed term, the firm gets dissolved at the end of the period, unless the partners have made a contract to the contrary [s.42(a)].

(ii) ***By the completion of adventure:*** Where a partnership has been constituted for carrying out a particular adventure, such partnership comes to an end on the completion of the adventure. This is in the absence of an agreement to the contrary [s.42(b)].

(iii) ***By the death of a partner:*** A partnership, whether at will or for a fixed period, is dissolved by the death of a partner, unless there is a contract to the contrary [s.42(c)].

(iv) ***By the insolvency of a partner:*** A partnership whether for a fixed period or at will is dissolved by the adjudication of a partner as an insolvent. This is subject to the contract to the contrary between the partners [s.42(d)].

(v) ***By the retirement of a partner:*** Where a partner retires from the partnership, then the partnership is dissolved, but not the firm necessarily. However, if there are only two partners and one of them retires then the dissolution of partnership would be dissolution of firm.

On the happening of the contingencies mentioned above the remaining partners may continue in the firm in pursuance of an express or implied contract to that effect. If they decide not to continue, the firm is dissolved automatically. These methods of dissolution are also known as "contingent dissolution" as the dissolution depends on the happening of a contingency and unless otherwise agreed, partnership will stand dissolved on the happening of any of the above mentioned events. Also dissolution under s. 42 is known as 'optional dissolution' because the partnership may continue if the partnership agreement so provides.

6.8.3 Dissolution of Firm

When the relationship existing between all the partners of the firm comes to an end, it is called dissolution of the firm. It naturally involves closing down the business. There is no question of 'reconstituted firm' in such a case. A firm may be dissolved in any of the following ways:

(i) ***By mutual consent:*** Section 40 provides that a firm may, at any time, be dissolved with the consent of all the partners. This applies to all cases whether the firm is for a fixed period or otherwise.

(ii) ***By agreement:*** Section 40 also provides for the dissolution of a firm in accordance with a contract between the partners. The contract providing for dissolution may have been incorporated in the partnership deed itself or in a separate agreement.

Though the same section provides for these two methods of dissolution, they are different. If all the partners give consent, the firm may be dissolved irrespective of what is contained in the partnership deed. But in dissolution by agreement, the partners have to follow the terms thereof, whether some of the partners consent or not. However, there is one commonality between these two methods. The dissolution in both of them is based on the general principle that a contract may be discharged by agreement – either an existing one or by consent later on.

(iii) ***By the insolvency of all the partners but one:*** If all the partners or all the partners but one become insolvent, there is dissolution of the firm. Section 41 calls this as compulsory dissolution.

(iv) ***By business becoming illegal:*** Section 41 provides that a firm is dissolved by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership. But, if the partnership relates to more than one adventure, the illegality of one or more of them does not prevent the lawful adventure from being carried on by the firm.

(v) ***Partners becoming alien enemies:*** Section 41 also covers cases of partnership between persons some of whom become alien enemies by a subsequent declaration of war. In such a case partnership is dissolved, because trading with an alien enemy is against public policy. Section 41 covers cases of compulsory dissolution of firm by operation of law.

(vi) ***By notice of dissolution of partnership at will:*** Section 43 provides that where the partnership is at will, a partner may give a notice in writing to the other partners of his intention to dissolve the firm. The notice must state the intention to dissolve the firm and be in writing. The firm is dissolved as from the date mentioned in the notice as the date of dissolution, or if no date is mentioned then from the date of communication of the notice.

Filing a suit for dissolution is not a notice as required by this section. In such a case, the date of dissolution will be the date of passing of the preliminary decree for dissolution [Banarsi Das v. Kanshi Ram, A I R (1983) S.C. 1165].

6.8.4 Dissolution by Court (s.44)

At the suit of a partner, the court may dissolve a firm on any of the following grounds:

(a) ***If a partner has become of unsound mind:*** The application in this case may be made by any of the partners or by the next friend of the insane partner. In the case of insanity of a dormant partner, the court will not order dissolution, unless a very special case is made out for dissolution.

(b) ***Permanent incapacity of a partner:*** The court may order for dissolution of partnership, if a partner becomes permanently incapable of performing his duties as a partner. The application for dissolution, in such a case, may be made by any of the partners and not by the incapacitated partner. However, where a partner is attacked with paralysis which, on evidence, is found to be curable, dissolution may not be granted.

(c) ***Misconduct of a partner affecting the business.*** If a partner is guilty of conduct which is likely to affect prejudicially the carrying on of the business of the firm, the court may order dissolution.

Examples:

(i) A partner of a mercantile firm is engaged in speculation in cotton. This act may be regarded a sufficient ground for dissolution of the firm.

(ii) A partner of a firm is travelling on the railway without a ticket and with intent to defraud. The court may grant dissolution. Also, the court may grant dissolution for conviction for an offence involving moral turpitude. Thus, a partner may misapply money of a client, or he may be involved in adultery. In any case, the suit for dissolution can only be brought by the other partners.

(d) ***Willful and persistent disregard of partnership agreement by a partner:*** If a partner willfully and persistently commits a breach of the partnership agreement regarding management, or otherwise conducts himself in such a way that is not reasonably practicable for the other partners to carry on business in partnership with him, the court may order dissolution. Continuous refusal by a partner to attend to his duties in the partnership business, the fact of hostility between the

partners which makes cooperation between them impossible, have been held to be sufficient reasons for dissolution. The suit for dissolution under this ground can be brought by a partner other than the guilty partner.

(e) ***Transfer of interest or share by a partner:*** If a partner transfers, in any way (e.g., by sale, mortgage or charge), his whole interest in the partnership to a third party (outsider) or allows his share to be charged in execution of a decree against him or allows the same to be sold for arrears of land revenue or for charges recoverable as land revenue, the court may dissolve the partnership. The transfer of a part of his share by a partner to any third party is not permissible unless otherwise agreed. A partner can, however, transfer even the whole of his share to a partner in the firm. because no new partner is introduced thereby.

(f) The court can also dissolve partnership where the business of the firm cannot be carried on save at a loss. The court can order dissolution even though the partnership is for a fixed period [Rehmat-un-nisa-v. Price, 42 Bom. 380].

(g) ***Just and equitable:*** The court can order dissolution on any other ground which in the opinion of the court is a fit ground for dissolution of partnership. Dissolution on this ground has been granted in case of deadlock in the management, disappearance of the substratum of the business, partners not on speaking terms, etc.

6.8.5 Consequences of Dissolution

On the dissolution of a firm, it becomes necessary to wind up the affairs of the firm, i.e, the assets are realised, the liabilities paid out and surplus, if any, distributed amongst the partners or their representatives according to their respective rights.

6.8.6 Settlement of Accounts (s.48)

Usually the Deed of Partnership contains an accounting clause according to which the final accounts between partners are settled. In the absence of such an agreement, s.48 provides as follows:

(i) The losses, including losses on capital, must be paid, first from profits, next out of capital and lastly, if necessary, by contribution of each partner in proportion to his share in profits.

(ii) The assets of the firm, including sums contributed by partners to make up deficiency of capital, shall be applied as follows: (a) in paying debts of the firm to outsiders; (b) in paying each partner rateably for advances made by him to the firm as distinct from capital; (c) in paying each partner, rateably, amount due for capital contribution and (d) the residue in paying each partner in accordance with his share in the profits of the firm.

(iii) If a partner becomes insolvent or otherwise cannot pay his share of the contribution, the solvent partners must share rateably the available assets (including their own contribution to the capital deficiency), i.e., the available assets will be distributed in proportion to their original capital. This is called the rule in Garner vs. distributed in proportion to their original capital. This is called the rule in Garner vs. Murray (1904)1 Ch. 57.

It is to be noted that the period of limitation according to the Limitation Act for a suit for accounts on dissolution is three years. If a partner fails to bring such a suit against one partner within the period, the whole claim is barred against the remaining partners also.

Sale of Goodwill after Dissolution: Section 55 provides that in settling the accounts of a firm after dissolution, goodwill shall, subject to contract between the partners, be

included in the assets and it may be sold either separately or along with other property of the firm.

Where the goodwill of a firm is sold after dissolution, a partner may carry on a business competing with that of the buyer and he may advertise such business but subject to agreement between him and the buyer, he may not (a) use the firm's name; (b) represent himself as carrying on business of the firm; or (c) solicit the custom of persons who were dealing with the firm before its dissolution.

Any partner may, upon the sale of goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits. Such an agreement shall be void if the restrictions imposed are unreasonable.

Restraint of trade by buyer of goodwill: Section 54 provides that partners may, upon or in anticipation of dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such an agreement shall be valid if the restrictions imposed are reasonable.

Examples: illustrating the ruling in Garner vs. Murray:

1. A, B and C were partners, sharing profits and losses equally, with capital contribution of ₹ 30,000, ₹ 15,000 and ₹ 3,000, respectively. On dissolution it is found that, after paying the debts of the firm and advances made by the partners, the assets are ₹ 21,000. Thus, the deficiency comes to ₹ 27,000 (i.e., total capital – assets), which is to be met by the partners equally. Now the total assets available are ₹ 48,000. This amount will be distributed rateably among the partners. However, in actual practice it will not be necessary for A and B to pay ₹ 9,000 each in cash but notional adjustment may be made so that C, whose capital contribution was only ₹ 3,000 will have to pay ₹ 6,000. Now the total assets available for distribution between A and B would be ₹ 21,000 + 6,000 = ₹ 27,000, A getting ₹ 21,000 and B ₹ 6,000.
2. Sometimes it so happens that one or more of the partners is insolvent and so cannot contribute anything towards the deficiency. Thus, in the above case if C is insolvent and nothing can be recovered from him, the assets will be distributed as follows: A and B will bring in their share of deficiency, increasing the assets from ₹ 21,000 to ₹ 39,000. The total assets would be distributed between A and B in their capital ratio, i.e., 2:1. A will get ₹ 26,000 and B ₹ 13,000. Thus, A on the whole will lose ₹ 13,000 and B ₹ 11,000. This settlement of accounts is in accordance with the rule laid down in Garner vs. Murray. From the calculations it is obvious that the remaining partners are suffering loss in accordance with the amount of capital contributed. Thus, A suffers more loss than B even though they are sharing profits and losses equally.
3. The principle enunciated above will also apply if C in the case mentioned in illustration above, though not insolvent, fails to contribute his share of the deficiency. Out of the total amount of ₹ 21,000, A will get ₹ 17,000 and B ₹ 4,000. The court will pass a decree for ₹ 4,000 in favour of A against C and for ₹ 2,000 in favour of B against C.

6.8.7 Rights and Liabilities of Partners on Dissolution

There are certain consequences of dissolution of a firm. Most of these consequences affect the rights and liabilities of partners. Therefore, the rights and liabilities of partners are discussed here.

Rights of a Partner on Dissolution

(i) ***Right to have business wound up:*** Section 46 provides that on a partnership being dissolved, any partner or his representative has a right against the other partners to have (a) the property of the firm applied in payment of debts of the firm and (b) the surplus distributed amongst the partners or their representatives according to their respective rights. The right of a partner is often called a partner's lien. The word 'lien' as used here is not to be interpreted in its technical sense, it is a convenient mode of referring to the right.

(ii) ***Rights to have the debts of the firm settled out of the property of the firm:*** Section 49 provides that where there are joint debts due from the firm and also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of the debts of the firm and if there is any surplus, then the share of each partner shall be applied first in the payment of his separate debts and the surplus if any in the payment of debts of the firm.

(iii) ***Right to personal profits earned after dissolution:*** Section 50 provides that if any partner earns any profit from any transaction connected with the firm after its dissolution, he must share it with the other partners and the legal representatives of the deceased partner.

(iv) ***Rights to return of premium on premature dissolution:*** Section 51 provides that where a partner has paid a premium on entering into partnership for a fixed term and the firm is dissolved before the expiration of that term, he shall be entitled to repayment of the premium or of such part thereof as may be reasonable (regard being had to the terms of and to the length of time during which he was a partner) unless the dissolution is (i) due to the death of a partner, or (ii) his own misconduct, or (iii) in pursuance of an agreement containing no provision for the return of the premium or any part of it.

(v) ***Right where partnership contract is rescinded for fraud or misrepresentation.*** Section 52 provides that in case a partner was induced to join the firm by the fraud of any partner, he may, on discovering the fraud, rescind the agreement and have refund not only of the premium but also of the capital paid. His rights are: (i) He has a lien on the surplus assets after the debts of the firm have been paid, for any sum paid by him to purchase a share in the firm and for any capital contributed by him. (ii) He is entitled to rank as a creditor of the firm in respect of any payment made by him towards the debts of the firm. (iii) He has a right to be indemnified by the partner guilty of fraud or misrepresentation against all the debts of the firm.

(vi) ***Rights to restrain partners from use of firm property:*** Section 53 provides that after a firm is dissolved, every partner or his representative may restrain any other partner or his representatives from carrying on a similar business in the firm's name or from using any of the property of the firm for his own benefit, until the affairs of the firm have been completely wound up. This right is subject to; (a) a contract to the contrary between the partners and (b) the right of a partner who has purchased firm's goodwill.

Liabilities of a Partner on Dissolution

(i) ***Liability for acts of partners done after dissolution and public notice.*** The first step in the process of dissolution is to give a public notice of dissolution. If it is not done then the partners continue to be liable to third parties for any act done by any of them which would have been an act of the firm if done before the dissolution. This principle, however does not apply in certain cases. In other words, the liability does not attach for the acts done after the dissolution of firm and no notice of dissolution be given. These are: (a) the estate of a deceased

partner, (b) the insolvent partner and (c) the sleeping or dormant partner who retires (s.53).

(ii) ***Continuing authority of partners for purposes of winding up.*** The commencement of dissolution does not at once terminate the authority of the partner. Section 47 provides that after the dissolution of a firm, the authority of each partner to bind the firm and the other mutual rights and obligations of the partners continue, so far as may be necessary to; (a) wind up the affairs of the firm and (b) complete transactions begun but not unfinished at the time of the dissolution. However, the proviso to s. 47 provides that the firm in dissolution would not be liable for the act of any partner who has been adjudicated insolvent. But, if a partner represents himself or knowingly permits himself to be represented as a partner of the insolvent partner, the firm is liable on the ground of 'holding out'.

6.8.8 Mode of Giving Public Notice (s.72)

A public notice is required to be given when (i) a partner retires or is expelled from a registered firm; (ii) a registered firm is dissolved; (iii) a minor, on attaining majority has to elect to become or not to become a partner in a registered firm.

The public notice relating to the above matters is given: (i) by notice to the Registrar of Firms under s.63 (regarding recording of changes in the constitution of a firm); (ii) by publication in the official gazette; (iii) by publication in at least one vernacular newspaper circulating in the district where the firm to which it relates has its place or principal place of business. In other cases where public notice has to be given, it is given by publication in (i) the official gazette and (ii) at least one vernacular newspaper circulating in the district where the firm to which it relates has its place or principal place of business. The consequences of not giving the public notice where it is required to be given under different provisions of the Act are as follows:

1. If a minor admitted to the benefits of partnership fails to give public notice within six months of his attaining majority or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, that he has elected to become or not to become a partner in the firm, he shall become partner in the firm on the expiry of the said six months and is liable as a partner of the firm [s.30 (5)].
2. If a retiring partner does not give a public notice of his retirement from the firm, he and the other partners shall continue to be liable as partners to third parties for any act done by any of them which would have been act of the firm done before the retirement [s.32 (3)].
3. If in case of expulsion of a partner from the firm, a public notice is not given, the expelled partner and the other partners shall continue to be liable to third parties dealing with the firm as in the case of a retired partner [s.33 (2)].
4. If on the dissolution of a registered firm, a public notice is not given, the partners shall continue to be liable to third persons of any act done by any of them which would have been an act if the firm of done before the dissolution [s.45 (1)].

Check Your Progress

Fill in the blanks:

1. An agreement presupposes a minimum number of _____ persons.
2. _____ does not have the objective of earning profits and if, during the course of its operations, it makes some surplus, then it is ploughed back for achieving its objectives.
3. _____ lays down the procedure for registration of partnership firms.
4. Partnership Deed is not a _____ document.
5. Clause 2 of s.19 gives the _____ rule.
6. A _____ partner is one who does not take an active part in the business of the firm.

6.9 LET US SUM UP

- Partnership is a time-honoured form of business organisation and one that is still much in use in India. A partnership is defined as "the relationship between persons who have agreed to share profits of a business carried on by all, or by any of them acting for all". The liability of each partner of the firm is unlimited in respect of the firm's debts.
- The partnership firm has no independent legal existence apart from the persons who constitute it. All the essential elements of a valid contract must be present in a partnership as it is based on an agreement.
- "Persons, who have entered into partnership with one another are called individually 'partners' and collectively a 'firm' and the name under which their business is carried on is called the 'firm name'. The duration of partnership may or may not be fixed. It may be constituted even for a particular adventure.
- All partners must consent to the partnership agreement. Otherwise, they obviously lack the intent necessary to form the partnership.
- Section 39 provides that the dissolution of partnership between all the partners of a firm is called the "dissolution of the firm". Dissolution of firm always implies dissolution of partnership, but dissolution of partnership need not lead to dissolution of firm.

6.10 LESSON END ACTIVITY

1. X is the sole owner of a firm. He admits Y as a partner on the following terms: (i) Y is not to bring in any capital, (ii) Y is not to be responsible for any loss, (iii) Y is to receive ₹ 2000 p.m. in lieu of profits, (iv) Y is to have all the powers of a partner. Discuss the legal position of Y. [Hint: He has all the powers of a partner – Ss. 4 and 12 taken together would have the effect that every partner shall be able to carry on the business of the firm. The true test is whether or not a partner can act as an agent of the other.]
2. A client of a solicitor's firm handed over some money to one of the solicitors to be invested in a specific security. The solicitor misappropriated the money. Is the firm liable to the client? [Hint: Yes. See s.26.]
3. Raman, a partner in a firm, was convicted for travelling by train without a ticket. Another partner applied to the court for dissolution of the firm. Would the court agree? [Hint: Yes, s.44. Raman has misconducted himself in such a way as to effect the good name of the firm adversely.]

4. A partnership firm, which was not registered, filed a suit against a third party. The suit was dismissed. Then the firm got itself registered and filed a suit against the third party. Is the suit competent? [Hint: Yes, the suit is competent. See s.58.]

6.11 KEYWORDS

Partnership: Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

Third Party: Third party used in relation to a firm or to a partner therein means any person who is not a partner in the firm.

Partnership Deed: The Partnership Deed is not a public document (in the case of a company, a memorandum of association is a public document) and therefore binds only third parties so far as they have notice of it.

Firm Name: The name under which the partnership business is carried on is called the "firm name".

6.12 QUESTIONS FOR DISCUSSION

1. What is a partnership?
2. Briefly state special features of a partnership on the basis of which its existence can be determined under the Indian Partnership Act?
3. Explain the procedure for getting a partnership firm registered. When is such a registration treated as complete?
4. State the effects of non-registration of a firm. What are the advantages of registration of a partnership firm?
5. Explain the following:
   (i) Partner by holding out, or by estoppel
   (ii) Dormant or sleeping partner
   (iii) Nominal partner
   (iv) Sub-partner
   (v) Working partner
   (vi) Incoming partner
   (vii) Outgoing partner
   (viii) Limited partnership.
6. What are the provisions of the Indian Partnership Act with regard to the admission of a minor into the partnership? What will be his rights and liabilities during his minority and after he has attained the majority?
7. Enumerate the rights and duties of partners inter se.
8. What is meant by the implied authority of a partner to bind the firm?
9. State the acts of a partner for which he does not have the implied authority to bind the firm.
10. Write a short note on 'liability of a firm for wrongful acts of a partner'.
11. Explain the conditions under which a partner may be expelled from the firm. State the consequences of such an expulsion.

12. In what circumstances is partnership dissolved: (i) automatically, (ii) compulsorily by the court?
13. What is meant by dissolution of a firm? Is it different from the dissolution of partnership?
14. Describe the mode of settling accounts of a firm after dissolution with special reference to a case where one of the partners has become insolvent and nothing is recoverable from his estate.

Check Your Progress: Model Answer

1. Two
2. Club
3. Section 58
4. Public
5. Negative
6. Sleeping

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UNIT 7

NEGOTIABLE INSTRUMENT ACT, 1881

CONTENTS

Contd...

7.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the meaning of a negotiable instrument
- Discuss the nature and requisites of negotiable instruments
- Describe the transfer of negotiable instruments and liability of parties
- Explain the meaning of promissory note, bill of exchange and cheque
- Know what is crossing of cheques
- Describe the liability of the paying banker
- Explain holder in due course and special rules for cheques and drafts
- Discuss the discharge of negotiable instruments

7.1 INTRODUCTION

In this lesson, we will study about the Negotiable Instruments Act, 1881. We will cover the topics like nature and requisites of negotiable instruments, their transfer and liability of parties as well as enforcement of secondary liability. After the study of this lesson we will be able to explain holder-in-due course, special provisions for cheques and drafts and the discharge of negotiable instruments.

The Negotiable Instruments Act was enacted, in India, in 1881. Prior to its enactment, the provision of the English Negotiable Instrument Act were applicable in India, and the present Act is also based on the English Act with certain modifications. It extends to the whole of India except the State of Jammu and Kashmir. The Act operates subject to the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. Simply stated, a negotiable instrument is one which entitles a person to a sum of money and which can be transferred from one person to another either by mere delivery, or by endorsement and delivery.

The term 'instrument' means 'any written document by which a right is created in favour of some person'. The word 'negotiable' has a technical meaning whereby rights in an instrument can be transferred by one person to another. Thus, a negotiable instrument is a document by which rights vested in a person can be transferred to another person in accordance with the provisions of the Negotiable Instruments Act, 1881.

The sections quoted in this lesson refer to the sections of the Negotiable Instruments Act, 1881, unless otherwise stated. The latest amendment to the Act was done in 1988 by the Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, 1988.

7.2 NEGOTIABLE INSTRUMENT

7.2.1 Meaning of a Negotiable Instrument

An 'Instrument' as referred to in the Act is a legally recognised written document, whereby rights are created in favour of one and obligations are created on the part of another. The word 'negotiable' means transferable from one person to another either by mere delivery or by endorsement and delivery, to enable the transferee to get a title in the instrument. According to s.13, a negotiable instrument means a promissory note, a bill of exchange or a cheque payable either to the order or to the bearer, whether the words, 'order', or 'bearer' appear on the instrument or not. Although s.13

mentions only three instruments, it does not prohibit any other instrument from being treated as a negotiable instrument provided it possesses the character of negotiability. An instrument may possess the characteristics of negotiability either by statute or by usage. Promissory note, bill of exchange and cheque are negotiable instruments by statute as they are so recognised by s.13. There are certain instruments which are recognised as negotiable instruments by usage. Thus, bank notes, bank drafts, share warrants, bearer debentures, dividend warrants, scripts and treasury bills are negotiable by usage. An instrument is called 'negotiable' if it possesses the following features:

(i) ***Freely transferable:*** Transferability may be by--- (a) delivery, or (b) by endorsement and delivery.

(ii) ***Holder's title free from defects:*** The term 'negotiability' means that not only is the instrument transferable by endorsement and/or delivery, but that its holder in due course acquires a good title notwithstanding any defects in a previous holder's title. A holder in due course is one who receives the instrument for value and without any notice as to the defect in the title of the transferor.

(iii) ***The holder can sue in his own name:*** Another feature of a negotiable instrument is that its holder in due course can sue on the instrument in his own name.

(iv) A negotiable instrument can be transferred infinitum, i.e., can be transferred any number of times, till its maturity.

(v) ***A negotiable instrument is subject to certain presumptions:*** An instrument, which does not have these characteristics, is not negotiable, but is assignable, i.e., the transferee takes it subject to all equities and liabilities of the transferor.

Example: One G, by means of a fraud, obtained a cheque from F. The cheque was made payable to G on order. G gave the cheque to W in payment of his own debt, but forgot to endorse it. W had no notice of the fraud then, but before he could obtain G's endorsement, he was given notice of the fraud. W does not get a good title to the cheque. In the case of a cheque payable to order, the title passes by endorsement and delivery. As there was no endorsement by G on the cheque, therefore W did not get any title.

The following instruments are not negotiable instruments as they do not possess the features mentioned above: share certificate, bill of lading, dock warrant, I.O.U., postal order.

7.2.2 Essential Elements of a Negotiable Instrument

After discussing the characteristics of different negotiable instruments, it is with profit that we can sum up the essential elements of a negotiable instrument. These are as follows:

1. It must be in writing, which includes, typing, computer printout or engraving.
2. The instrument must be signed by the person who is the maker (in the case of a promissory note) or a drawer (as in the case of a bill of exchange or a cheque).
3. There must be an unconditional promise (as in the case of a promissory note) or order (as in the case of a bill of exchange or cheque) to pay.
4. The instrument must involve payment of a certain sum of money only and nothing else.
5. The instrument must be payable at a time which is certain to arrive. If it is payable 'when convenient' the instrument is not a negotiable one. However, if the time of payment is linked to the death of a person, it is nevertheless a negotiable instrument as death is certain, though the time thereof is not.

6. In case of a bill or cheque, the drawee must be named or described with reasonable certainty.

7. The instrument must be such or in such a state that it can be transferred like cash by mere delivery (as in the case of a bearer instrument) or by delivery and endorsement (as in the case of an order instrument).

Forms in which an Instrument must be Payable so as to Constitute a Negotiable Instrument

(i) Pay A; (ii) Pay A or order; (iii) Pay to the order of A; (iv) Pay A and B; (v) Pay A or B; (vi) Pay A or bearer; (vii) Pay bearer.

7.3 IMPORTANT CONCEPTS AND TERMS

7.3.1 Ambiguous Instrument (s.17)

An ambiguous instrument is one which may be construed either as a promissory note or as a bill of exchange. Regarding such instruments, s.17 provides that the holder may, at this election treat it as either and the instrument shall be thenceforward treated accordingly. Thus, a bill of exchange drawn by a person upon himself may be construed as a promissory note.

7.3.2 Amount Stated Differently in Figures and Words (s.18)

If the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid.

7.3.3 Inchoate Stamped Instruments (s.20)

An inchoate instrument means an instrument that is incomplete in certain respects. Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein but not exceeding the amount covered by the stamp. The person so signing shall be liable upon the instrument in the capacity in which he signed the same, to any holder in due course for such amount. But a person other than a holder in due course cannot recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereunder.

7.3.4 Parties Standing in Immediate Relationship

The drawer of a bill stands in immediate relation with the acceptor. The maker of a note, bill or cheque stands in immediate relation with the payee, and the endorser with his endorsee. Other signors may by agreement stand in immediate relation with a holder.

7.3.5 Presumptions as to Negotiable Instruments

Sections 118-119 enlist the following presumptions as to negotiable instruments:

1. ***As to consideration:*** Every negotiable instrument is deemed to have been made, drawn, accepted, endorsed, negotiated or transferred for consideration. In Marimuthu Kounder vs. Radhakrishan and Others, AIR 1991 Ker. 39, the Kerala High Court observed that the presumption as to existence of consideration for negotiable instruments is not irrebuttable. When once the court finds that the

defendant has executed the promissory note, then the burden is on the defendant to prove that there is no consideration. True, the initial burden rests on the plaintiff, who has to prove that the promissory note is executed by the defendant. If there is an admission by the defendant, certainly there is no burden on the plaintiff to prove the execution of the promissory note. Further, the court observed that where execution is admitted or proved, a presumption is raised in favour of the consideration having been passed and the burden to prove lack of consideration is then with the defendant.

2. ***As to date:*** Every negotiable instrument bears the date on which it is made or drawn.
3. ***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.
4. ***As to transfer:*** Every transfer of a negotiable instrument was made before the date of its maturity in case of an instrument payable otherwise than on demand.
5. ***As to the order of endorsements:*** The endorsements appearing on it were made in the order in which they appear thereon.
6. ***As to lost instruments:*** Where an instrument has been lost or destroyed, that it was duly stamped and the stamp was duly cancelled.
7. ***As to holder-in-due course:*** The holder of the instrument is a holder in due course.
8. ***As to dishonour:*** If a suit is filed upon an instrument which has been dishonoured, the court shall, on proof of the protest, presume the fact of dishonour unless it is disproved.

7.3.6 Capacity of Parties to the Negotiable Instrument

The capacity of a party to draw, accept, make or endorse a negotiable instrument is coextensive with his capacity to enter into contract. Thus, s.11 of the Indian Contract Act, 1872, if negatively interpreted prohibits minors, persons of unsound mind and persons forbidden under any other Act like insolvency to make a valid contract. Thus, a person who is competent to contract "may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque" (s.26).

7.4 PROMISSORY NOTES AND BILLS OF EXCHANGE

7.4.1 Definition

A promissory note is an instrument in writing (not being a bank or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of a certain person or to the bearer of the instrument (s.4). The following are two illustrations of promissory notes.

Where A signs instruments in the following terms: (i) "I promise to pay B or order ₹ 500." (ii) "I acknowledge myself to be indebted to B in ₹ 1000, to be paid on demand, for value received."

But, the following are NOT promissory notes: (i) "Mr B, I.O.U. (I owe you) ₹ 1000." (ii) "I am liable to pay you ₹ 500". (iii) "I promise to pay B ₹ 500 and all other sums which shall be due to him." (iv) "I promise to pay B ₹ 500, first deducting thereout any money which he may owe me." (v) "I promise to pay B ₹ 1500 on D's death, provided he leaves me enough to pay that sum." (vi) "I promise to pay B ₹ 500 seven

days after my marriage with C." (vii) "I promise to pay B ₹ 500 and to deliver to him my white Maruti Car 1 January next."

7.4.2 Essentials of a Promissory Note

From the definition, it is clear that a promissory note must have the following essential elements:

1. A promissory must be in writing. Writing includes print and typewriting.
2. It must contain an undertaking or promise to pay. Thus, a mere acknowledgment of indebtedness is not sufficient. Also, a receipt for money, if it does not contain an express promise to pay is not a promissory note. But if the receipt is coupled with a promise to pay, it shall be promissory note.

   Example: "We have received a sum of ₹ 9,000 from Shri R. R. Sharma. This amount will be repaid on demand. We have received this amount in cash." This is a promissory note.

   However, note that the use of the word 'I promise' is not essential to constitute an instrument as a 'promissory note'.
3. The promise to pay must not be conditional. Thus, instruments payable on performance or non-performance of a particular act or on the happening or non-happening of an event are not promissory notes.

   Example: (i) A promises to pay B, ₹ 500 provided C leaves sufficient money in favour of A after C's death. It is not a promissory note. (ii) A promises to pay B ₹ 5000 seven days after his marriage with C. It is not a promissory note.

   However, the promise to pay may be subject to a condition which according to the ordinary experience of mankind is bound to happen, e.g., death. Thus, where A promises to pay B a sum of ₹ 10,000 on the death of C, the promise is a valid promise for it is certain that C shall die.
4. The promissory note must be signed by the maker, otherwise it is of no effect. Even if it is written by the maker himself and his name appears in the body of the instrument, it shall not constitute a valid promissory note, if it is not signed by the maker. 'Signature' means the writing of a person's name in order to authenticate the contract contained in the instrument. Signature by an authorised attorney (agent) shall be valid.
5. The instrument must point out with certainty the maker and the payee of the promissory note, e.g., son of..... resident of....., etc. The identification of payee by description does not invalidate the promissory note. For example, the note drawn payable to the 'General Manager of HDFC Ltd.'

   A promissory note cannot be drawn payable to the maker himself. Such a note is nullity. But if it is endorsed by the maker to some other person, or endorsed in blank, it becomes a valid promissory note.
6. The sum payable must be certain or capable of being made certain. Where rate of interest is specified, the sum shall be deemed to be certain. But, expressions like 'market rate of interest' do not make the amount certain since 'market rate' may vary with the source of borrowing, purpose of borrowing, financial standing of the borrower and so on. However, a promissory note containing an undertaking to pay the amount 2% above the 'bank rate' shall be valid. It's because there is only one 'bank rate' (i.e., the rate at which Reserve Bank of India lends to commercial banks) at a given point of time.

7. It must contain a promise to pay money only. If the instrument contains a promise to pay something in addition to money, it cannot be a promissory note. Thus, the following instrument is not a promissory note: "I promise to pay B ₹ 50,000 and also deliver him a Maruti 800".
8. The number, place, date, etc., of a promissory note are usually found but are not essential in law. The date of note is not material unless the amount is made payable at a certain time after date. But even if it does not bear a date, it is deemed to have been made when it was delivered.
9. It may be payable in instalments (s.5, para 3).
10. It may be payable on demand or after a definite period. Payable 'on demand' means payable immediately or any time till it becomes time-barred. A demand promissory note becomes time barred on expiry of 3 years from the date it bears.
11. It cannot be made payable to bearer no matter whether it is payable on demand or after a certain time. (s.31 of RBI Act)
12. It must be duly stamped under the Indian Stamp Act. It means that the stamps of the requisite amount must have been affixed on the instrument and duly cancelled either before or at the time of its execution. A promissory note which is not so stamped is a nullity.
13. It cannot be payable to bearer on demand (s.31 of R. B. I. Act).
14. It cannot be crossed unlike a cheque.

7.4.3 Specimen of a Promissory Note

₹ 10,000	New Delhi – 110001
	Jan. 10, 2006
On demand [or six months after date] I promise to pay X or order the sum of rupees ten thousand with interest at 12 per cent per annum only for value received.	
To X	Sd/-A
Address.....	Stamp

7.4.4 Parties to a Promissory Note

1. ***Maker:*** It is the person who makes the note promising to pay the amount stated therein.
2. ***Payee:*** It is the person to whom the amount of the note is payable.
3. ***Holder:*** It is either the original payee or any other person in whose favour the note has been endorsed.
4. ***Endorser:*** It is the person who endorses the note in favour of another person.
5. ***Endorsee:*** It is the person in whose favour the note is negotiated by indorsement.

7.4.5 Meaning of a Bill of Exchange

A 'bill of exchange' is defined by s.5 as 'an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of, a certain person, or to the bearer of the instrument'.

7.4.6 Features of a Bill of Exchange

1. It must be in writing.
2. It must contain an order to pay and not a promise or request. Words, like 'Please pay ₹ 10,000 to A on demand and oblige,' do not constitute the instrument a bill of exchange.
3. The order must be unconditional.
4. There must be three parties, viz., drawer, drawee and payee. However, one person may assume the role of two parties, e.g., a person may draw a bill of exchange in his own favour, i.e., he may be drawer as well as a payee. He cannot, however, be a drawer as well as a drawee because that will render that instrument a promissory note.
5. The parties must be certain.
6. It must be signed by the drawer.
7. The sum payable must be certain or capable of being made certain.
8. The order must be to pay money and money alone.
9. It must be duly stamped as per the Indian Stamp Act. Accordingly, all bills of exchange other than 'demand bills' must bear the adhesive stamps of the requisite amount and the same must have been affixed either before or at the time of execution and also cancelled.
10. The number, date and place of the bill are not essential. Oral evidence may be obtained as to date and place of execution.

7.4.7 Specimen of a Bill of Exchange

₹ 10, 000

New Delhi – 110 016

Jan. 13, 2006

Six months after date pay to A or order/bearer the sum of ten thousand rupees only for value received.

To X

Address .....

.....

Sd/-Y

Stamp

Here Y is the drawer, A is the payee and X is the drawee. X will express his willingness to pay 'accepting' the bill by writing words somewhat as below across the face of the bill:

ACCEPTED

Sd/

X Jan. 16, 2006.

The specimen given above is of a usance bill, payable after a specified period of time. A bill of exchange may be drawn payable 'at sight', i.e., on demand or payable 'after certain time after sight' also.

7.4.8 Stamp Duty, Attestation and Registration of a Promissory Note and a Bill of Exchange

A promissory note as well as a bill of exchange is liable to stamp duty. However, an endorsement of a negotiable instrument is exempt from any stamp duty. Neither, a promissory note nor a bill of exchange is to be attested or registered.

7.4.9 Distinction between a Promissory Note and a Bill of Exchange

	Promissory Note	Bill of Exchange
1.	There are only two parties – the maker (debtor) and the payee (creditor).	There are three parties – the drawer, the drawee and the payee although drawer and payee may be the same person.
2.	A note contains an unconditional promise by the maker to pay the payee.	It contains an unconditional order to the drawee to pay according to the drawer's directions.
3.	No prior acceptance is needed.	A bill payable 'after sight' must be accepted by the drawee or his agent before it is presented for payment.
4.	The liability of the maker or drawer is primary and absolute.	The liability of the drawer is secondary and conditional upon non-payment by the drawee.
5.	No notice of dishonour need be given.	Notice of dishonour must be given by the holder to the drawer and the intermediate endorsers to hold them liable thereon.
6	The maker of the note stands in immediate relation with the payee.	The maker or drawer does not stand in immediate relation with the acceptor or drawee.

7.4.10 Kinds of Bills

Bills are of different kinds. Some of these are: (1) Inland Bills (2) Foreign Bills (3) Trade and accommodation bills (4) Time Bills (5) Demand Bills (6) Clean Bills (7) Documentary Bills.

Inland bill: An Inland bill or instrument is defined as 'a promissory note, bill of exchange or cheque drawn or made in India and payable in or drawn upon any person resident in India' (s.11). On analysis of the above definition it follows that an inland bill: (a) must be drawn or made in India and made payable in India, or (b) must be drawn in India upon a person resident in India although it may be payable outside India.

Example:

(i) A of Delhi draws a bill on B of Mumbai payable at Kolkata.

(ii) A of Mumbai draws a bill on B of Delhi payable at Yorkshire (U.K.).

In example (i) the bill is drawn in India and is payable in India and, therefore, is an Inland bill. In example (ii) the bill is drawn in India on a person resident in India, though it is payable outside India, it is again an Inland bill.

Foreign bills: According to s.12, a foreign bill is a negotiable instrument which is not an inland instrument, as defined above. Thus, a foreign bill of exchange is (a) drawn in India upon a person resident outside India and made payable outside India, or (b) drawn outside India and payable in India.

Example:

(i) X of Mumbai draws a bill of exchange on Y of London payable at London.

(ii) A of London draws a bill of exchange on B of Delhi payable at Mumbai.

Bills in sets: Foreign bills are generally drawn in sets of three, each of which is called a '*via*'. It is only one of these three '*vias*' that have to be accepted and paid for. With the acceptance and payment of any of them the others become inoperative. If, however, any person endorses different parts of a bill in favour of different persons he and all the subsequent endorsers of each part are liable on such part as if it were a separate bill (s.132). However, as between holders in due course of different parts of the same set, he who first acquired title to his part is entitled to the other parts and the money represented by the bill (s.133).

Drawee in case of need (s.7): In case of foreign bills particularly, the drawer mentions another person, besides drawee, who may be approached for acceptance or/and payment in case the need arises. For instance, the drawee may either refuse to accept or pay or may not be available at the given address. Such a person whose name is mentioned as an alternative drawee is called a 'drawee in case of need'. In English Law, he is called 'reference in case of need'. He is so called because primarily the payee is expected to approach the drawee and it is only in case there is a problem (e.g., either the payee has refused or is not available and the like) that the 'drawee in case of need' would be contacted.

Trade and accommodation bills: A trade bill is a bill of exchange issued in respect of a genuine trade transaction. Such bills are drawn by the seller on the buyer in respect of payment of the price of the goods sold and purchased. But, however, all bills are not genuine bills, i.e., they do not represent a trade transaction but are drawn as a convenient mode of accommodating a friend. Thus, X may be in need of money and approaches his friend Y who instead of lending money directly, accepts a bill exchange, say for ₹ 5,000, drawn by X on Y. If the credit of Y is good it lends a currency to the bill and it can be discounted with the banker or any other person. On maturity, X remits the amount to Y who in turn pays it in honouring the bill of exchange on presentment. Thus, it provides an accommodation to the party and is, therefore, called an Accommodation Bill. The language and form of an accommodation bill is, however, similar to a genuine trade bill.

Since an accommodation bill is drawn and accepted without any consideration, it creates on obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without endorsement to a holder for consideration, such holder and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto (s.43).

Further, it will be pertinent to note here the provision of s.118(a) that every negotiable instrument unless the contrary is proved, "was made or drawn for consideration and that every such instrument, when it has been accepted, indorsed, negotiated, or transferred was accepted, endorsed, negotiated, or transferred for consideration." As the consideration in a negotiable instrument is presumed, the party denying the same has to prove his case.

Time bills (usance bills): Time bills, also called as usance bills, are bills payable at a fixed period after date or sight of the bills. Thus, a bill of exchange drawn payable at 3 months after the date it is drawn is a time or usance bill. Similarly, a bill drawn payable at 90 days after sight is again a time or usance bill. A time bill may also be made payable at a fixed period after an event which is certain to happen. Hence, a bill payable at 90 days after the death of the drawer will be a valid time bill.

Demand bills: A bill of exchange or a promissory note is payable on demand when it is made payable 'on demand' or 'at sight' or 'on presentation' (s.21). Thus, no time for payment is mentioned therein (s.19).

Clean and documentary bills: It is a common practice in home as well as foreign trade to deliver to the banker along with the bills of exchange, the documents to title to the goods (for example, Lorry Receipt, Railway Receipt or Bill of Lading). Where the banker is instructed to deliver to the drawee of the bill the documents of title against acceptance of the bill, the bill is called as Documents against Acceptance of Bill (D/A Bill), and where the documents are to be released only against payment, it is called as Documents against Payment of Bill (D/P Bill.) Where no documents of title to goods are enclosed to the bill, it is called a clean bill.

7.4.11 Acceptance of Bills

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. Section 7 says that an acceptance is the signature of the drawee of a bill who has signed his assent upon bill and delivered it or given notice of such signing to the holder or to some person on his behalf. After acceptance, the drawee is known an acceptor. Writing the word 'accepted' is immaterial to the establishment of the drawer's responsibility. But, an oral acceptance or writing of the words accepted without the drawee's signature is not an acceptance. An acceptance to be valid must be (a) in writing, (b) signed by the drawee or his agent, (c) on the bill of exchange and (d) completed by delivery to the holder or by notice of acceptance to him or some person on his behalf.

Kinds of acceptance: An acceptance of a bill may be general or qualified.

1. ***General acceptance:*** A general acceptance is an acceptance without any condition or qualification. Where the drawee accepts the order of the drawer in absolute, i.e., without adding any condition regarding payment, the acceptance is a general acceptance.

2. ***Acceptance for honour:*** When a bill of exchange has been noted or protested for non-acceptance for the better security and any person accepts it supra protest for honour of the drawer or of any one of the endorsers, such person is called an acceptor for honour (s.7). The question of acceptance for honour does not arise in the case of promissory notes or cheques.

3. ***Presentment for acceptance (s.61):*** It is only bills of exchange that require presentment for acceptance and that too not all but certain kinds of bills only. Bills payable on demand or on a fixed date need not be presented for acceptance. But the following bills must be presented for acceptance otherwise the parties to the bill will not be liable on it. (i) a bill payable after sight. Such a bill has to be presented for acceptance to fix maturity of the bill, (ii) a bill that contains an express stipulation that it should be presented for acceptance before it is presented for payment.

   In case where presentation for acceptance is not necessary but optional, it is always desirable to get a bill accepted as soon as possible, in order to obtain (a) the additional security of the acceptor's name on the bill, or (b) an immediate right of resource against the drawer and other parties if the bill is refused acceptance and thereby dishonoured.

4. ***Presentment to whom:*** Presentment for acceptance must be made--- (i) to the drawer or his duly authorised agent; (ii) to all the drawees where there are more than one unless they are partners and one has express or implied authority to accept on behalf of all; (iii) to the legal representative, if the drawee is dead; (iv) to the official receiver or assignee, in case the drawee has been declared insolvent.

5. ***Time and place for presentment (Ss. 61 and 62):*** Bills must be presented for acceptance before maturity. Where a period for presentment is specified, it must be presented within that period. Where no period is specified and the presentment is obligatory, it must be made within a reasonable time. Further, the presentment must be made on a business day and within business hours. Regarding place of presentment, a bill should be presented at the place of business and where drawee has no place of business, at his residence. Where the bill is presented at the residence, it must be at the reasonable hour.

6. ***Presentment for acceptance when excused:*** Where presentment for acceptance is obligatory and the holder fails to do so, the drawer and all other parties thereon

cease to be liable to him. He is not entitled to a decree, nor can he base his claim on the original consideration. However, presentment is excused under the following circumstances: (i) where the drawee cannot, after reasonable search, be found (s.61), (ii) where the drawee becomes insolvent or is dead, the bill must be presented to the official receiver or official assignee of the insolvent or to the legal representative of the deceased. (iii) where the acceptance is qualified and not absolute (s.91). (iv) where the drawee is a fictitious person or one incapable of contracting, e.g., minor or lunatic (s.91). (v) where, though presentment is irregular, the acceptance is refused on some other ground.

7.4.12 Parties to a Bill of Exchange

(i) The drawer – the person to whom the amount of the bill is payable. (ii) The drawee – the person on whom the bill is drawn. Thus, drawee is the person responsible for acceptance and payment of the bill. In certain cases however a stranger may accept the bill on behalf of the drawee. (iii) The payee –the person to whom amount of the bill is payable. It may be the drawer himself or any other person. (iv) The holder – is the original payee but where the bill has been endorsed, the endorsee. In case of a bearer bill, the bearer or possessor is the holder. (v) The endorser – is the person who endorses a bill. (vi) The endorsee – is the person to whom the bill is negotiated by endorsement. (vii) Drawee in case of need. (viii) Acceptor for honour.

7.5 CHEQUES

7.5.1 Meaning of a Cheque

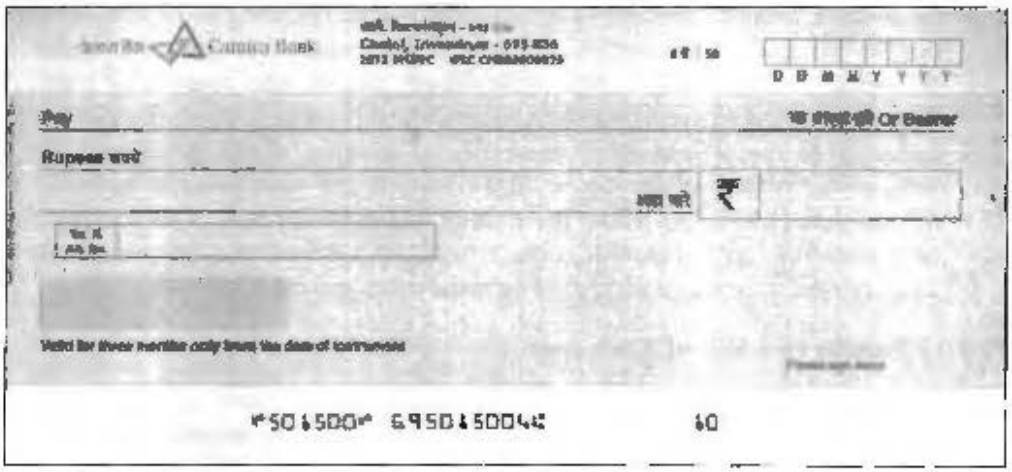
A cheque is the usual method of withdrawing money from a current account with a banker. Savings bank accounts are also permitted to be operated by cheques provided certain minimum balance is maintained. A cheque, in essence, is an order by the customer of the bank directing his banker to pay on demand, the specified amount, to or to the order of the person named therein or to the bearer. Section 6 defines a cheque. The Amendment Act 2002 has substituted new section for s.6. It provides that a 'cheque' is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

'A cheque in the electronic form' means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system.

'A truncated cheque' means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

7.5.2 Specimen of a Cheque

Every bank has its own printed cheque forms which are supplied to the account holders at the time of opening the account as well as subsequently whenever needed. These forms are printed on special security paper which is sensitive to chemicals and makes any chemical alterations noticeable. Although, legally, a customer may withdraw his money even by writing his directions to the banker on a plain paper but in practice bankers honour only those orders which are issued on the printed forms of cheques.



7.5.3 Requisites of a Cheque

The requisites of a cheques are:

1. ***Written instrument:*** A cheque must be an instrument in writing. Regarding the writing materials to be used, law does not lay down any restrictions and therefore cheque may be written either with (a) pen (b) typewriter or may be (c) printed.

2. ***Unconditional order:*** A cheque must contain an unconditional order. It is, however, not necessary that the word order or its equivalent must be used to make the document a cheque. Generally, the order to bank is expressed by the word "pay". If the word "please" precedes "pay" the document will not be regarded as invalid merely on this account..

3. ***On a specified banker only:*** A cheque must be drawn on a specified banker. To avoid any mistake, the name and address of the banker should be specified.

4. ***A certain sum of money:*** The order must be only for the payment of money and that too must be specified. Thus, orders asking the banker to deliver securities or certain other things cannot be regarded as cheques. Similarly, an order asking the banker to pay a specified amount with interest, the rate of interest not specified, is not a cheque as the sum payable is not certain.

5. ***Payee to be certain:*** A cheque to be valid must be payable to a certain person. 'Person' should not be understood in a limited sense including only human beings. The term in fact includes 'legal persons' also. Thus, instruments drawn in favour of a body corporate, local authorities, clubs, institutions, etc., are valid instruments being payable to legal persons.

6. ***Payable on demand:*** A cheque to be valid must be payable on demand and not otherwise. Use of the words 'on demand' or their equivalent is not necessary. When the drawer asks the banker to pay and does not specify the time for its payment, the instrument is payable on demand (s.19).

7. ***Amount of the cheque:*** Amount of the cheque must be clearly mentioned. The amount should be written both in words as well as figures so as to avoid mistakes. Moreover, the amount should be so written as to leave no blank space before or after the words and figures specifying the amount. In case a customer does so, though innocently and his banker pays the forged amount because the forgery is not noticeable in spite of reasonable care, the banker would be justified in debiting his account with the amount actually paid.

8. ***Dating of cheques:*** The drawer of a cheque is expected to date it before it leaves his hands. A cheque without a date is considered incomplete and is returned

unpaid by the banks. The drawer can date a cheque with the date earlier or later than the date on which it is drawn. A cheque bearing an earlier date is antedated and the one bearing the later date is called post-dated. A post-dated cheque cannot be honoured, except at the personal risk of the bank's manager, till the date mentioned. A post-dated cheque is as much negotiable as a cheque for which payment is due, i.e., the transferee of a post-dated cheque, like that of the cheque on which payment is due, acquires a better title than its transferor, if he is a holder in due course. A cheque that bears a date earlier than six months is a stale cheque and cannot be claimed for.

7.5.4 A Bill of Exchange and a Cheque Distinguished

Though, a cheque is defined as a bill of exchange, it differs from the latter in the following respects:

	Cheque	Bill of Exchange
1.	It must be drawn only on a banker.	It can be drawn on any person including a banker.
2.	The amount is always payable on demand.	The amount may be payable on demand or after a specified time.
3.	The cheque is not entitled to days of grace.	A usance (time) bill is entitled to three days of grace.
4.	Acceptance is not needed.	A bill payable after sight must be accepted.
5.	A cheque can be crossed.	Crossing of a bill of exchange is not possible.
6.	Notice of dishonour is not necessary. The parties thereon remain liable, even if no notice of dishonour is given.	Notice of dishonour is necessary to hold the parties liable thereon. A party who does not receive a notice of dishonour can generally escape its liability thereon.
7.	A cheque is not to be noted or protested in case of dishonour.	A bill is noted or protested to establish dishonour.
8.	The protection given to the paying banker in respect of crossed cheques is peculiar to this instrument.	No such protection is available in the case of bills.

7.5.5 Out-of-date, or Stale and Over-due Cheques

The paying banker is bound to pay only such cheques as are presented to him for payment within a reasonable time of issue. Usually, the cheque presented after six months of the date mentioned thereon are considered stale and hence are returned by the banker for their confirmation of the drawers. This period of six months is sometimes varied by a special agreement with a particular customer. For example, a company issuing dividend warrants reduces this period to three months. In any case, the company may revalidate the same on the request of the holder who fails to present it within the stipulated period of three months.

Section 84 provides that if the holder fails to present the cheques for payment within a reasonable time of its issue and in the meanwhile the bank fails causing damage to the drawer, the latter is then discharged as against the holder to the extent of the actual damage suffered by him. The Limitation Act provides that a cheque becomes time-barred after three years from its date of issue.

7.6 HOLDER AND HOLDER IN DUE COURSE

7.6.1 Meaning

According to s.8, a holder of a negotiable instrument is "a person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. 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. Thus, a person who has obtained the possession of an instrument by theft or under a forged endorsement is not a holder as he is not entitled to recover the amount of the instrument.

A 'holder in due course', on the other hand, is "a person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order, before the amount mentioned in it becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title (s.9). Thus, where a person receives a negotiable instrument without consideration, he may be a holder but will not be called a holder in due course. Besides, the title of holder of a negotiable instrument is always subject to the title of its transferor whereas a holder in due course acquires a better title than that of its transferor. So where a lost negotiable instrument is transferred to a person who takes it, say, without consideration and thus becomes the holder, he will not be entitled to enforce his claim against its real owner. But, if he is a holder in due course as per s.9, he will be able to establish his claim even against the real owner of that instrument. Also, in order to be a holder in due course the holder must have obtained the instrument before maturity. It he obtains it after the instrument is due, then the right of a holder is that of his transferor (s.59). From the definition of holder in due course as given in s.9 it can be inferred that a holder must satisfy the following criteria so as to be known as a holder in due course:

(i) he must have taken the instrument for value;

(ii) he must have obtained the instrument before maturity;

(iii) the instrument is not incomplete or irregular and does not have any defect on the face of it;

(iv) he must have taken the instrument in good faith and without notice of any defect in the title of the person from who he derived his title.

7.6.2 Privileges of a Holder in Due Course

A holder in due course is given certain additional privileges under the Act, which are not available to a holder.

1. ***Privilege against inchoate stamped instruments:*** According to s.20, a person, who signed and delivered to another a stamped but otherwise inchoate (incomplete) instrument, is stopped from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him provided the amount filled is covered by the stamp affixed.

2. As per s.3, every prior party to a negotiable instrument, i.e., the maker or drawer, the acceptor and all the intermediate endorsers continue to remain liable to the holder in due course until the instrument is duly satisfied.

3. ***Fictitious drawer or payee:*** Where a bill of exchange is drawn by a fictitious person and is payable to his order, the acceptor cannot be relieved from his liability to the holder in due course. The holder in due course shall, however, have to prove that the instrument was endorsed by the same hand as drawer's signature (s.42).

4. When a negotiable instrument is made, drawn accepted or transferred without consideration and the negotiable instrument gets into the hands of a holder in due course, then the plea of absence of consideration cannot be raised against him or against any subsequent holder deriving title from him (s.43).

5. Where an instrument is negotiated to a holder in due course, the parties to the instrument cannot escape liability on the ground that the delivery of the instrument was conditional or for a special purpose only (s.46).

6. ***Right of an endorsee from a holder in due course:*** Not only that the title of the holder in due course is not subject to the defect in previous holder's title but once

that instrument passes through the hands of a holder in due course, it is purged of all defects. Any person acquiring it takes it free of all defects, unless he was himself a party to the fraud (s.53).

7. ***Estoppel against denial of validity:*** Section 120 provides that no maker of a promissory note and no drawer of a bill of exchange or cheque shall, in a suit thereon by a holder in due course, be permitted to deny the validity of the instrument as originally made or drawn.

8. ***Estoppel against denial of payee's capacity:*** No maker of a note and no acceptor of a bill payable to order is in a suit thereon by a holder in due course, permitted to deny the payee's capacity at the date of the note or bill to endorse it (s.121).

9. ***Presumption:*** Section 118 provides that every holder is deemed *prima facie* to be a holder in due course. The burden of proving his title does not lie on him.

10. ***Prior defects (s.58):*** The party liable to pay an instrument cannot, as against a holder in due course, contend that he had lost the instrument or that it was obtained from him by means of an offence or fraud, or for an unlawful consideration.

    Example: A cheque is given to an employee of a company to enable him to withdraw money for payment of workers' bonus. He instead transfers the cheque to a bank for consideration. The bank will be entitled to get the payment on the cheque.

11. 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 (s.122).

7.7 NEGOTIATION OF A NEGOTIABLE INSTRUMENT

7.7.1 Meaning of Negotiation

The transfer of an instrument by one party to another so as to constitute the transferee a holder thereof is called 'negotiation'. A bearer instrument is transferable by mere delivery (s.14). An instrument payable to order can be transferred by endorsement and delivery (s.46).

7.7.2 Negotiation and Assignment

The negotiation of an instrument should be distinguished from assignment. Let's first see what is assignment and what are the common points in negotiation and assignment. When a person transfers his right to receive the payment of a debt that is called "assignment of the debt". Where, for example, the holder of a life insurance policy takes a loan from a bank, he transfers the right to receive the payment under the policy to the bank that is an assignment. Where the holder of a note, bill or cheque transfers the same to another, he in essence, gives his right to receive the payment of the instrument to the transferee. Thus, both the assignment and negotiation involve the transfer of the right to receive the payment of debt. However, the rights, which the transferee of an instrument by negotiation acquires, are substantially superior to those of an assignee. When an instrument is negotiated, its transferee gets good title irrespective of the defective title, if any, of the transferor. On the other hand, when transfer is made by assignment, the assignee has only those rights, which the assignor possessed.

A negotiable instrument may be transferred by negotiation or assignment. When a negotiable instrument is transferred by negotiation, its transferee, if a holder in due course, gets a better title than its transferor. On the other hand, when the transfer is

made by way of assignment, the assignee has only those rights which the assignor possesses. Thus, although law does not prohibit transfer of negotiable instruments by means other than negotiation, transfer by negotiation has certain advantages.

Negotiation by mere delivery: Section 47 provides that a bill or cheque payable to bearer is negotiated by mere delivery of the instrument.

Payable to bearer: An instrument is payable to bearer (1) where it is made so payable, or (2) where it is originally made payable to order but the only or the last endorsement is in blank. A cheque which is originally drawn payable to bearer remains bearer even though it is subsequently endorsed in full. The rule is once a bearer cheque always a bearer cheque, or (3) where the payee is a fictitious person.

In case of negotiation by mere delivery, the transferor incurs no obligation to any party other than the immediate transferee. The transferee becomes the holder of the instrument within the meaning of s.8. The importance of delivery of the instrument cannot be over emphasised; as without it the transferee does not become a holder thereof. Thus, a thief or finder of an instrument cannot be termed as holder. However, if the thief or the finder negotiates the same to another person, then that other person does become the holder of the instrument.

"Subject to the provisions of s.58 a promissory note, bill of exchange or cheque payable to bearer is negotiable by delivery thereof."

Exception: A promissory note, bill of exchange or cheque delivered on condition that it is not to take effect except in a certain event is not negotiable (except in the hands of a holder for value without notice of the conditions) unless such event happens.

Example:

(i) A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.

(ii) A, the holder of a negotiable instrument payable to bearer, which is in the hands of A's bankers, who is at the time the banker of B, directs the bankers to transfer the instrument to B's credit in B's account with the bank. The banker does so and accordingly now possesses the instrument as B's agent. The instrument has been negotiated and B has become the holder of it.

Negotiation by Endorsement and Delivery: Instruments payable to a specified person or to the order of a specified person can be negotiated only by endorsement and delivery. If an instrument payable to order is transferred without endorsement, it is merely assigned and not negotiated and the holder thereof shall not be entitled to the rights of a holder in due course.

7.7.3 Endorsement

An endorsement is the mode of negotiating a negotiable instrument. A negotiable instrument payable otherwise than to bearer can be negotiated only by endorsement and delivery. An endorsement according to s.15, is "when the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same and is called the endorser". The person to whom the instrument is endorsed is called the endorsee. Usually the endorsement is on the back of the instrument; though it may be even on the face of it. Where no space is left on the instrument, the endorsement may be made on a slip of paper attached to it. This attached slip of paper is called 'Allonge'.

Kinds of Endorsements

Endorsement may take any of the following seven forms:

1. ***Endorsement in blank:*** Where the endorser just puts his signature without specifying the endorsee, the endorsement is said to be in blank (s. 160). The effect of such an endorsement is to render the instrument payable to bearer even though originally payable to order (s.54). No further endorsement is needed for its negotiation.

   Example: A cheque is payable to 'X or order', and 'X' merely signs on the back of it. This will constitute endorsement in blank. Where an endorsement in blank is subsequently followed by an endorsement in full, the endorser in full will be liable to his immediate endorsee and parties deriving title from him, but not to others (s.55).

2. ***Endorsement in full:*** Where along with endorser's signature, the name of the endorsee is specified, the endorsement is called endorsement in full (s.16). Thus, where the instrument states, 'Pay Y or order', and is signed by 'X', the payee, it constitutes 'endorsement in full'. An endorsement in blank may be converted into 'endorsement in full' by the holder by merely adding above the endorser's signature, a direction to pay to any other person. By doing so, the endorser does not incur any responsibility of an endorser. (s.49).

   Example: A cheque is endorsed in blank by 'X'. Y, the holder of the cheque, may convert this 'blank endorsement' into 'endorsement in full' by say, adding the words 'Pay Z or order', above 'X's signature. Y, in this case cannot be held liable on the cheque, if it is dishonoured.

3. ***Restrictive endorsement:*** An endorsement is restrictive which prohibits the further negotiation of a negotiable instrument. Section 50 states: "The endorsement may, by express words, restrict or exclude the right to negotiate or may constitute the endorser an agent to endorse the instrument or to receive its contents for the endorser or for some other specified person."

   Example: If a cheque is endorsed 'Pay X only', or 'Pay D for the account of X', it cannot be negotiated further.

4. ***Conditional endorsement:*** A conditional endorsement is one which makes the transfer of the property in a negotiable instrument from the endorser to the endorsee dependent upon the fulfillment of a stated condition. Thus, according to s.52, where an endorser makes his liability on the instrument conditional on the happening of a particular event, it is called conditional endorsement, though such event may never happen. Similarly, the right of the endorser may be made conditional on the happening of a particular event.

   Example: Where the endorsement states "Pay 'X' if he reaches Delhi". In such a case, X can claim payment on the instrument only if he reaches Delhi.

5. ***Endorsement 'sans recourse':*** An endorser of a negotiable instrument may, by express words in the endorsement, exclude his own liability thereon (s.52). Such endorsement is called Endorsement sans recourse; or 'without resource to me'.

   Example: Where X endorses a cheque as 'Pay Y or order San Recourse', or 'Pay Y or order without Recourse to me', X will not be liable on the instrument if it is dishonoured.

6. ***Facultative endorsement:*** Where such words are added to an endorsement whereby the endorser waives his right to receive notice of dishonour, the endorsement is termed as 'facultative endorsement'.

7. ***Partial endorsement (s.56):*** Where the negotiable instrument is endorsed for part of the amount, it is called partial endorsement. Such endorsement is not valid.

7.7.4 Negotiation Back

When a bill of exchange comes back to the acceptor by the process of negotiation, and he becomes its holder, it is called negotiation back.

7.7.5 Effect of Endorsement

An unconditional endorsement of a negotiable instrument followed by its unconditional delivery has the effect of transferring the property therein to the endorsee. The endorsee acquires a right to negotiate the instrument to anyone he likes and to sue all parties whose names appear on it.

The effect of an endorsement in blank and delivery of an instrument originally made, drawn payable to order is to convert it into one payable to bearer and transferable by mere delivery.

The effect of restrictive endorsement is (a) to prohibit or exclude further negotiation, or (b) to constitute the endorsee an agent of endorser to endorse the instrument, or (c) to constitute the endorsee as agent to receive its contents for some other specified persons.

In case joint payees are endorsees, all of them must endorse the instrument otherwise the endorsement is rendered as invalid, even if it is made in favour of the other payee.

7.7.6 Forged Endorsement (s.85)

In case an instrument is endorsed in full, it cannot be endorsed or negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable. Thus, if such an instrument is negotiated by way of a forged endorsement, the endorsee will acquire no title even though he be a purchaser for value and in good faith, because the endorsement is nullity. But where the instrument has been endorsed in blank, it can be negotiated by mere delivery and the holder derives his title independent of the forged endorsement and can claim the amount from any of the parties to the instrument.

Example: A bill is endorsed, "pay to X or order". X endorses it in blank and it comes into the hands of Y, who simply delivers it to A. A forges Y's endorsement and transfers it to B. B, as the holder, does not derive his title through the forged endorsement to Y, but through the genuine endorsement of X and can claim payment from any of the parties to the instrument in spite of the intervening forged endorsement.

7.8 PRESENTMENT

Presentment of a negotiable instrument is made for two purposes: (i) for acceptance and (ii) for payment.

Before discussing the presentment for payment, it is necessary to refer to the maturity of the instrument.

7.8.1 Maturity (Ss.21-25)

Cheques are always payable on demand but other instruments like bills, notes, etc., may be made payable on a specified date or after the specified period of time. The date on which payment of an instrument falls due is called maturity (s.22). Therefore most of the provisions relating to presentment for payment are linked with the

maturity of the instrument. Section 21 provides that a note or bill 'at sight' or 'on presentment' is payable on demand. It is due for payment as soon as it is issued. Therefore the question of maturity arises only in the case of a note or bill payable 'After sight' or 'After date' or at a certain period after the happening of an event which is certain to happen.

Section 22 provides that the maturity of a note or bill is the date on which it falls due. Further, it adds that in calculating the maturity of a note or bill which is not payable on demand, at sight or on presentment, three days – called the days of grace – must be added to the date on which the instrument is expressed to be payable. Thus a note or bill payable after a specified period after date or after sight matures or falls due on the last day of the grace period and must be presented for payment on that day and if dishonoured, suit can be filed on the next day after maturity.

7.8.2 Presentment for Payment

A negotiable instrument must be presented for payment to the maker, acceptor or drawee thereof, as the case may be, by the holder or his agent. In case of default, the parties to the instrument other than the maker, acceptor or drawee are not liable to such holder (s.64). The presentment for payment must be made during the usual hours of business, and at a banker's premises, during banking hours (s.65).

7.9 DISHONOUR

7.9.1 Dishonour of a Bill

A bill of exchange may be dishonoured either by non-acceptance or by non-payment. A negotiable instrument is said be dishonoured by non-payment when the maker, acceptor or drawee, as the case may be, makes default in payment upon being duly required to pay the same (s.92). The effect of dishonour of a negotiable instrument whether by non-acceptance or non-payment is to render the drawer and all the endorsers liable to the holder. However, their liability can be invoked only if the holder gives them notice of such dishonour. The drawer is liable only if the instrument is dishonoured by non-payment.

When a negotiable instrument is dishonoured by non-acceptance or non-payment, the holder must give notice of dishonour to the drawer and all other parties whom he seeks to make liable.

7.9.2 Noting

Noting is a convenient method of authenticating the fact of dishonour. Where an instrument is dishonoured, the holder, besides giving the notice as referred to above, should get the bill or promissory note 'noted' by the notary public. The notary public presents the instrument, notes down in his register the date of its dishonour and the reason, if any, given by the acceptor. If the instrument has been expressly dishonoured, the reason why the holder treats it as dishonoured, and the notary's charges should be mentioned. 'Noting' must be made within a reasonable time after dishonour. The holder may cause such dishonour to be noted by the notary public upon the instrument or upon a paper attached thereto or partly upon each (s.99). Every notary is required to have and use a seal, and an act can only be deemed a notarial act if it is done by a notary under his signature and official seal. However, noting is not compulsory in the case of an inland bill or note, but foreign bills must be protested, if so required by the law of the place where drawn.

7.9.3 Protesting (s.100)

The protest is the formal notarial certificate attesting the dishonour of the bill and based upon the noting. After the noting has been made, the formal protest may be drawn up by the notary at his leisure. When the protest is drawn up it relates back to the date of noting.

Sometimes, a bill is protested for better security. This may happen when the acceptor of a bill has become insolvent, or has suspended payment or his credit has been publicly impeached before the maturity of the bill. It should, however, be noted that the acceptor is not bound to give such security, nor can the holder sue the endorsers or drawers before maturity in spite of protest.

7.10 CROSSING OF CHEQUES

7.10.1 Meaning of Crossing

Crossing is a unique feature associated with a cheque affecting to a certain extent the obligation of the paying banker and also its negotiable character. It is a peculiar method of modifying the instrument to the banker for payment of the cheque. Crossing on cheque is a direction to the paying banker by the drawer that payment should not be made across the counter. The payment on a crossed cheque can be collected only through a banker. Section 123 defines crossing as, "Where a cheque bears across its face an addition of the words 'and company' or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words, 'not negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally." The crossing of a cheque is effected by drawing two parallel transverse lines with or without the words 'and company' or any abbreviation thereof. Cheques having the cross mark such as 'X' is not generally regarded as a crossed cheque. A cheque that is not crossed is called an open cheque.

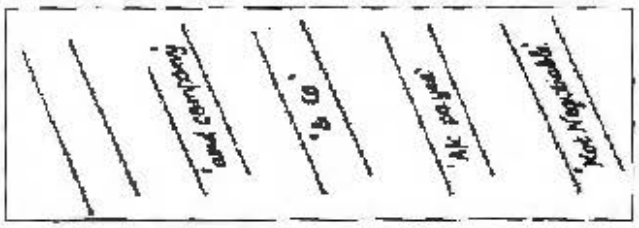
7.10.2 Significance of Crossing

As payment cannot be claimed across the counter on a crossed cheque, crossing of cheques serves as a measure of safety against theft or loss of cheques in transit. By crossing a cheque, a person, who is not entitled to receive its payment, is prevented from getting the cheque encashed at the counter of the paying banker.

7.10.3 Types of Crossing

Crossing may be either (1) General or (2) Special. The term general crossing implies the addition of two parallel transverse lines.

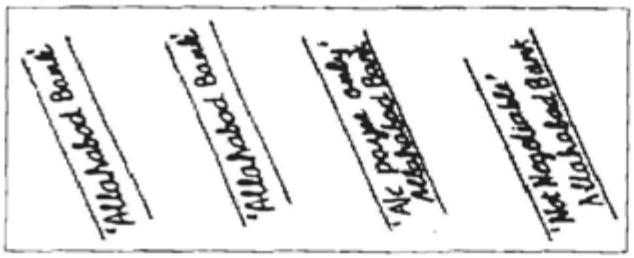
Specimen of general crossing



'Special Crossing' implies the specification of the name of the banker on the face of the cheque. Section 124 in this regard reads: "Where a cheque bears across its face, an addition of the name of banker, either with or without the words 'not negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be paid to that banker". The drawing of two parallel lines is not

necessary in case of a specially crossed cheque. The object of special crossing is to direct the drawee banker to pay the cheque only if it is presented through the particular bank mentioned therein. Thus, it makes the cheques safer.

Specimen of special crossing



7.10.4 Not Negotiable Crossing

We have mentioned above that crossing whether 'general' or 'special' may be accompanied by words 'not negotiable'. The effect of inclusion of such words will not be to render the cheques 'non-transferable'. Such cheques can very well be transferred by endorsement and delivery. But as per s.130, a person who takes such a cheque shall not have and shall not be capable of giving a better title to the cheque than that which the person, from whom he took it in the first instance, had. Thus, by including the words 'not negotiable', the cheque is deprived of its special feature of negotiability. Such a cheque is like any other goods where the title of the transferee is always subject to the title of the transferor. A bank, therefore, should be extra careful in paying such cheques. The payment should be made only after he is satisfied that the person demanding payment is the person entitled to receive it.

7.10.5 Account Payee Crossing (A/c Payee Crossing)

An A/c payee crossing signifies that the drawer intends the payment to be credited only to the payee's account. The addition of 'A/c payee' to a crossing has no legal sanctity and the paying banker may ignore such a direction without being liable for any damages. In practice, however, the collecting banker sees to it that such instruction is carried out.

7.10.6 Not Negotiable (A/c Payee Crossing)

The combination of 'not negotiable' and 'A/c payee,' crossing is the safest form of crossing. It has double advantage. The instrument is rendered not negotiable (making the 'paying banker' responsible to see that payment is made to the person who is entitled to receive it) plus A/c payee crossing directs the collecting banker to collect it for the payee only and warns that if the amount is collected for someone else, he may be held liable for damages.

7.10.7 Who can Cross a Cheque?

As noted above, crossing is an instruction to the banker not to pay across the counter. Thus, it lends security to the cheque and ensures payment to the payee or his order. A cheque may be crossed by any of the following: (i) The drawer of a cheque (ii) The holder of a cheque. When a cheque is issued uncrossed, it may be crossed generally or specially by its holder. If the cheque is already crossed generally, he may convert it into special crossing by adding the name of a particular bank. Further, a holder may add the words 'not negotiable' in case of both the types of crossing. However, a holder cannot convert special crossing into general, as it amounts to material alteration of the cheque. (iii) The banker, in whose favour the cheque has been crossed specially, may again cross it especially in favour of another banker. The latter bank in such a case acts as the agent of the former.

7.11 THE PAYING BANKER

The 'paying banker' is a term used to denote the position and duties of the drawee-banks in paying the cheques of their customers. Thus, 'paying banker' is a banker upon whom a cheque is drawn.

7.11.1 Payment in Due Course

What is a payment in due course is defined in s.10 and has been given above. The following conditions must be satisfied before a payment of a negotiable instrument can be called as a payment in due course:

1. ***Payment must be in accordance with the apparent tenor of the instrument:*** It is necessary that a payment to constitute a payment in due course should be made at or after maturity. A payment before maturity is not a payment in due course. For example, payment of a postdated cheque is not a payment in due course.
2. ***Payment must be made in good faith and without negligence:*** When there exists suspicious circumstances and the paying banker fails to make any enquiry as to them, the payment is not in due course. So payment is not in due course, where a banker makes payment on a cheque materially altered, without exercising due care.
3. ***Payment must be made to the person in possession of the instrument:*** A payment is not a payment in due course if it is made to a person entitled to receive it. A thief is not said to be in possession of the instrument. Thus, in the event of suspicious circumstances, payment should not be made without drawer's confirmation.
4. Payment must be made under circumstances which do not afford a reasonable ground for believing that a person is not entitled to receive payment of the amount mentioned therein. So, where a peon of a company presents a cheque for a big amount on behalf of the company, which is contrary to the past experience, the banker should conduct proper enquiry before making payment on such a cheque.
5. ***Payment must be made in money only:*** Payment must be made in money only unless the payee agrees to accept payment in some other form (e.g., bill of exchange or promissory note). Money includes bank notes or currency notes but excludes cheque, bills of exchange, promissory notes and goods.

Thus, under s.10, payment in due course means payment in accordance with the apparent tenor of the instrument made in good faith and without negligence.

7.11.2 Dishonour of a Cheque on Ground of Insufficiency of Funds

Sections 138 to 142 incorporated by the Amendment Act in 1988 provide for criminal penalties in the event of dishonour of cheques for insufficiency of funds. The drawer, under s.138, may be punished with imprisonment up to 2 years or with a fine up to twice the amount of the cheque or with both. However, in order to attract the aforesaid penalties following conditions must be satisfied:

1. The cheque has been dishonoured due to insufficiency of funds only – either the amount of money standing to the credit of the account is insufficient or that the amount of cheque exceeds the amount arranged to be paid from that account by an agreement with the bank.
2. The payment for which the cheque was issued should have been in discharge of a legally enforceable debt or liability in whole or part of it. It implies that a cheque given as gift will not attract such punishment.

3. The cheque should have been presented to the paying banker within 6 months from the date on which it is drawn or within the period of validity, whichever is earlier.

4. The payee or the holder in due course of the cheque should have given notice in writing to the drawer demanding payment, within 30 days of the receipt of information of dishonour of the cheque from the bank. The court shall take cognizance of the offence under s.138 only if the complaint is made by the payee or by the holder in due course of the cheque.

5. The drawer is liable only if he fails to make the payment within 15 days of such notice period. In other words, the drawer can make payment within 15 days of the receipt of the notice.

6. The payee or holder in due course of the cheque dishonoured should have made a complaint within one month of cause of action arising out of s.138 (i.e., expiry of 30 days' time given to the drawer to make payment s.142).

It may be noted that the holder of a cheque shall be presumed to have received the cheque for discharge, in whole or in part, of any debt or other liability (s.139). The drawer of the dishonoured cheque cannot defend himself on the ground that he had no reason to believe when he issued the cheque, that the cheque may be dishonoured on presentation on account of insufficiency of funds (s.140).

Further, the cheque will be deemed to have been dishonoured for insufficiency of funds in the following situations:

(i) where there is a notice of stop-payment to the bank, unless the notice can be justified.

(ii) where the account has been closed by the drawer.

(iii) where the payee is directed by the drawer not to present the cheque to the bank for payment.

However, no court shall take cognizance of any offence punishable under s.138 except upon a complaint, in writing, made, by the payee, or, as the case may be, the holder in due course of the cheque. Further, no court inferior to that of a Metropolitan Magistrate or Judicial Magistrate of the First Class shall try any offence punishable under s.138 (s.142).

Offence by companies: If the person committing an offence is a company, every person, who at the time the offence was committed, was in charge of and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of offence and shall be liable to be proceeded against and punished accordingly. Further, a director, manager, secretary or other officer of the company shall be liable to be proceeded against and punished accordingly in case the offence has been committed with his consent or connivance, or is attributable to any neglect on his part in this regard. However, a person will not be liable in case: (i) where such person proves that the offence was committed without his knowledge, or (ii) where he had exercised all due diligence to prevent the commission of such offence. The expression 'Company' here includes anybody corporate and includes a firm and association of individuals; and 'Director' in relation to a firm, means a partner in the firm (s.141).

The provisions of Negotiable Instrument (Amendment and Miscellaneous Provisions) Act, 2002 as regards section 138, 141-143 are summarized below.

1. The jail term for the accused has been enhanced from existing 1 year to 2 years (s.138).

2. The period of sending notice by the payee to the drawer has been extended from earlier 15 days to 30 days from the date of receipt of information by him from the bank regarding the return of the cheque as unpaid/bounced. (s.138).
3. Any person who is nominated as a director of the company by virtue of his holding any office or employment in the Central Government or State Government or financial corporation owned or controlled by the central or state government shall not be liable for prosecution under s.138 (s.141).
4. The court can take cognizance of a complaint after the prescribed period of one month, provided sufficient cause exists for not filing the complaint within one month. (s.142).
5. The court can try the cases summarily notwithstanding anything contained in Cr. P.C. and the provisions of section 262 to 265 of Cr. P.C. shall, as far as may be, apply to such trials (s.143).
6. Every trial shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint (s.143).
7. Notwithstanding anything contained in Cr. P.C. and for the purpose of such trial of bounced cheques, a Magistrate issuing a summons for an accused or a witness may direct a copy of summons to be served at the places where such accused or witness ordinarily resides or carries on business or personally works for gain, by speed post or by such courier services as are approved by a Court of Sessions (s.144).
8. Where an acknowledgment purporting to be signed by the accused or the witness or an endorsement purported to be made by any person authorized by the postal department or the courier services that the accused or the witness refused to take delivery of summons has been received, the court issuing the summons may declare that the summons has been duly served (s.144).
9. Notwithstanding anything contained in Cr. P.C. the evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions, be read in evidence in any enquiry, trial or other proceeding under the Cr. P.C. (s.145).
10. The court may, if it thinks fit, and shall, on the application of the prosecution or the accused, summon and examine any person giving evidence on affidavit as to the facts contained therein (s.145).
11. The court shall, in respect of every proceeding for cheque bounce offences, on production of Bank's slip or memo having thereon the official mark denoting that the cheque has been dishonoured, presume the fact of dishonour of such cheque, unless and until such fact is disproved (s.146).
12. Notwithstanding anything contained in Cr. P.C. every offence of cheque bouncing shall be compoundable (s.147).
13. The provisions of the Information Technology Act, 2000 are made applicable to Negotiable Instruments Act in relation to electronic image of a truncated cheque and a cheque in the electronic form (sections 5, 81, 39, and 131 of the Negotiable Instruments Act, 1881).

7.11.3 Consequences of a Wrongful Dishonour

If a banker, without justification, dishonours his customer's cheque, he makes himself liable to compensate the customer for any loss or damage. The words 'loss or damage' used in s.31, not only mean the pecuniary loss but also loss of credit or injury to reputation of the customer. Thus, if the customer is a trader or a business man, the damages may be substantial. But, a non-trader is not entitled to recover substantial

damages for the wrongful dishonour of his cheque. Thus, a non-trader may be awarded only nominal damages because of the absence of any special loss. In assessing the damages for injury to credit, the Courts give due consideration to various factors, such as financial position and business reputation of the customer and the customs of the trade to which he may belong.

The Amendment Act, 2002 has added an Explanation to s.131. It provides that it shall be the duty of the banker, who receives payment based on an electronic image of a truncated cheque held with him, to verify the prima facie genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary case.

7.11.4 Collection of Bills

Unlike cheques, a banker is not charged with the legal responsibility of collection of his customer's bills. But, in fact, no commercial bank can afford to exist without providing this facility to his customers. In collecting bills a banker has to be extra cautious in examining the title of the depositor as the statutory protection contained in s.131 does not extend to bills. Thus, if the title of the banker's customer turns out to be defective, the true owner can claim the amount of the bill from the banker. The banker, though he can claim the amount from his customer, should accept bills for collection only on behalf of the trusted parties. In case of new customers, the bank should extend this facility to customers with a trusted reference.

7.12 INTERNATIONAL LAW CONCERNING NEGOTIABLE INSTRUMENTS

There are four sections dealing with the international law concerning Negotiable Instruments. These are explained below:

7.12.1 Liability on Foreign Instruments (s.134)

In the absence of a contract to the contrary, the liability of the maker or drawer of a foreign bill, note or cheque is governed in all essential respects by the law of the place where he made the instrument. The respective liability of the acceptor and endorser is governed by the law of the place where the instrument is made payable.

Example: A bill is drawn by A in California, where the rate of interest is 25 per cent and accepted by B, payable in Washington, where the rate of interest is 6 per cent. The bill is indorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6 per cent only; but if A is charged as drawer, he is liable to pay interest at the rate of 25 per cent.

7.12.2 Law in Respect of Dishonour (s.135)

Where an instrument is made payable in a different country from that in which it is made or endorsed, the law of the country where it is made payable determines what constitutes dishonour and what notice of dishonour is sufficient.

Example: A bill drawn and endorsed in India, but accepted payable in France, is dishonoured. The endorsee causes it to be protested for such dishonour and gives notice thereof in accordance with the law of France, though not in accordance with the rules contained in respect of bills which are not foreign. The notice is sufficient.

7.12.3 Foreign Instruments Made in Accordance with Indian Law (s.136)

If a negotiable instrument is made, drawn, accepted or endorsed out of India, but in accordance with the law of India, the circumstance that any agreement evidenced by

such instrument is invalid according to the law of the country wherein it was entered into does not invalidate any subsequent acceptance or endorsement made thereon in India.

7.12.4 Presumption as to Foreign Law (s.137)

The law of any foreign country regarding negotiable instruments shall be presumed to be the same as that of India unless and until the contrary is proved.

7.13 DISCHARGE OF NEGOTIABLE INSTRUMENT

The term 'discharge' in relation to negotiable instruments is used in two senses: (1) discharge of an instrument, and (2) discharge of one or more parties.

7.13.1 Discharge of an Instrument

An instrument is discharged when all the rights under it are extinguished so that the instrument ceases to be negotiable. For example, when the party primarily liable on the instrument, i.e., the maker or the acceptor is discharged, the instrument is also discharged. After an instrument is discharged all the parties are also discharged from their liabilities even holder in due course cannot claim the amount of the instrument from any party to the instrument.

An instrument is discharged in the following ways:

(i) ***By payment in due course [Sec. 10 and Sec. 82(c)]:*** Perhaps this is the most natural and usual mode of discharge of an instrument. All parties to an instrument are discharged by payment made in due course.

Essential Rules Regarding Payment

The following are the essential rules regarding the payment of an instrument:

(a) The payment should be made by the party primarily liable, i.e., the maker of a note or the acceptor of a bill and the drawee of a cheque. If the payment is made by any endorser, the instrument will not be discharged; only that endorser and subsequent parties will be discharged.

(b) The payment of the instrument should be made at or after maturity. If the payment is made before maturity, it will not discharge the instrument unless the instrument is cancelled. If it is not cancelled, it is likely to reach again in the hands of a holder in due course who can enforce payment [Burbridge vs. Manners].

(c) Payment should be made to the holder; otherwise it will not discharge the party liable to pay (Sec. 78). In case the instrument is payable to bearer, the payment may be made to any person in possession of the instrument unless there is a suspicion to show that he/she is not entitled to payment.

In that case, payment even to a thief or finder will discharge the instrument. In case the instrument is payable to order, the payment should be made to the payee named. This condition is very strict. Even if the payment is made to another person of the same name, it will not discharge the party liable to pay it.

Example: A bill was drawn payable to Ram Lal. Another Ram Lal picked up the bill and got the payment. The acceptor is not discharged. The true Ram Lal can still recover the amount from the acceptor.

However, in case of a cheque, special protection has been granted by Sec. 85(1):

'Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course'.

Thus, in the above example, if it were a cheque and not a bill, then the true Ram Lal would have no remedy against the drawee, i.e., the bank.

(ii) ***Discharge by cancellation [Sec. 82(a)]:*** Where the holder of an instrument with the intention of discharging the instrument, cancels the name of the party primarily liable (i.e., the maker of a note or the acceptor of a bill), the instrument is discharged. An instrument is also discharged if the holder cancels the instrument itself with an intention of discharging all the parties to the instrument. He/she may cancel the instrument by scoring it out or tearing it off.

Example: A drew a bill for ₹ 500 on B. A endorsed the bill to C, C to D and D to E. E, the holder of the bill, cancels the name of the drawer A. Now B, C and D are also discharged as their liability is dependent upon the liability of the drawer A.

It should be noted that cancellation should be intentional.

An accidental cancellation will not discharge the instrument. To discharge the instrument, the name of the party primarily liable should be cancelled. If the name of a party who is secondarily liable is cancelled, the instrument will not be discharged; only the subsequent parties will be discharged in that case. The instrument should be destroyed physically so that it may not be used again.

Example: 'A' accepted a bill and gave it to 'B' for getting discounted. B failed to discount the bill and returned the bill to A. Then, A tore the bill in half with the intention of cancelling it and threw the pieces on the road. B was very clever, he picked up the pieces and pasted them together so nicely that it appeared to have been folded for safe custody rather than cancelled. B passed it so that it reached a holder in due course. Held, 'A' was liable on the bill. A did not clearly tear off the bill so as to show his intention unmistakably. [Ingham vs. Primerose].

(iii) ***By acceptor of a bill becoming its holder [Sec. 90]:*** Where the acceptor of a bill of exchange (which has been negotiated) becomes its holder at or after maturity, the bill is discharged. This is based on the principle of 'Negotiation Back' discussed earlier. The party primarily liable becomes the holder of the instrument; it will not be allowed to enforce its claim against other parties because it will lead to circuitry of action. Hence the instrument is discharged.

(iv) ***By release [Sec. 82 (b)]:*** Where the holder of the instrument releases the party primarily liable on the instrument or otherwise discharges him, the instrument is also discharged. The reason is very simple. Discharge of principal debtor discharges the surety. In a negotiable instrument, an endorser and subsequent parties are in the position of sureties.

7.13.2 Discharge of One or More Parties

When one or more parties are discharged, the instrument continues to be liable and the undercharged parties remain liable on the instrument. For example, when the name of the endorser is cancelled, the drawer and acceptor continue to be liable.

It may be pointed out that the term 'discharge of instrument' is wider than the term 'discharge of party (ies).' When an instrument is discharged, all the parties to the instrument are also discharged automatically. However, discharge of one or more parties does not necessarily discharge the instrument.

(i) ***Discharge by cancellation [Sec. 82(a)]:*** This point has already been discussed while discussing discharge of an instrument.

(ii) ***Discharge by release [Sec. 82(b)]:*** Where the holder of the instrument releases any endorser or otherwise discharges him, then that endorser and subsequent parties are discharged from the liabilities.

(iii) ***Discharge by payment [Sec. 82(c)]:*** Where the party primarily liable on the instrument makes the payment, the instruments as well as all the parties to the instrument are discharged. For essential rules regarding payment, please refer to discharge of instrument discussed earlier.

(iv) ***Discharge by allowing more than 48 hours to the drawee to accept the bill [Sec. 83]:*** If the holder allows more than 48 hours to the drawee to consider whether or not he/she will accept the bill, all previous parties not consenting to such allowance, are discharged from their liability to such holder.

(v) ***Discharge by delay in presenting cheques [Sec. 48]:*** A cheque must be presented for payment within a reasonable time. When a cheque is not presented for payment within a reasonable time of its issue and the drawer suffers actual damage through the delay, he/she is to that extent discharged from his liability. However, the holder shall become the creditor of the bank to that extent.

Example: 'A' issued a cheque for ₹ 500 to 'B'. When the cheque should have been presented, there was enough balance in his account. But the cheque is delayed beyond reasonable time and the bank fails in the meantime. A is discharged from his liability. However, B can claim ₹ 500 from the liquidator of the bank, i.e., whatever dividend is paid to the other creditors.

If in the above example, before A could present the cheque in the ordinary course, the bank fails. A will not be discharged because A has not suffered any loss due to the presentment of the cheque which was in time.

(vi) ***Discharge by qualified acceptance:*** As a rule, acceptance must be absolute or unqualified. A holder is entitled to object to a qualified acceptance. However, if he/she does not object to such qualified acceptance, all other parties who do not consent to such qualified acceptance are discharged to such holder and those claiming under him, unless, on notice given by the holder, they agree to such acceptance.

(vii) ***Discharge by material alteration [Sec. 87]:*** Any material alteration of a negotiable instrument renders the same void as against anyone who is party thereto at the time of making such alteration. However, if the party consents to such alteration or it was made to carry out the common intention of the parties, the alteration does not discharge the party concerned.

Alteration by Endorsee

Any alteration made by the endorsee, discharges his endorser from all liability to him. However, it should be noted that an acceptor or endorser of a negotiable instrument is bound by his acceptance or endorsement if the alteration was made before he/she accepted or endorsed the instrument. The reason is simple. In such a case, he/she has in a way consented to such alteration.

An alteration is void only if it is made subsequent to acceptance or endorsement.

(viii) ***Discharge by payment of instrument on which alteration is not apparent:*** When an instrument has been materially altered but does not look like that or where cheque has been crossed but does not appear to have been crossed, e.g., crossing clearly erased, the person paying or the banker is discharged from all liabilities thereon.

(ix) ***Discharge by debtor becoming its holder, i.e., when the acceptor of a bill again becomes its holder [Sec. 90]:*** We have already made reference to negotiation back which discharges all the parties to the bill. A debtor (acceptor) who again becomes the holder of a bill discharges all other parties on the same principle.

(x) ***Discharge by operation of law:*** Liability of party to a negotiable instrument is discharged by operation of law. It may be by:

(a) *Insolvency:* An insolvent is discharged from his liability.

(b) *Merger:* When merger takes place, the liability is discharged, i.e., merging of debt under the instrument into the judgement debt.

(c) *Law of limitation:* Further, the liability may be discharged by the debt becoming time- barred by the law of limitation.

Check Your Progress

Fill in the blanks:

1. The word _____ means transferable from one person to another either by mere delivery or by endorsement and delivery, to enable the transferee to get a title in the instrument.
2. An _____ instrument means an instrument that is incomplete in certain respects.
3. The promissory note must be signed by the _____.
4. _____ bills are also called as usance bills.
5. A _____ is the usual method of withdrawing money from a current account with a banker.
6. An _____ is the mode of negotiating a negotiable instrument.

7.14 LET US SUM UP

- A negotiable instrument means a promissory note, a bill of exchange or a cheque. A promissory note is an instrument in writing (not being a bank or a currency note), containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person or to the bearer of the instrument.
- A bill of exchange is an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order, a certain person, or to the bearer of the instrument.
- Bills are of different kinds. Some of these are: (i) Inland bills; (ii) Foreign bills; (iii) Trade and accommodation bills; (iv) Time bills; (v) Demand bills; (vi) Clean bills; (vii) Documentary bills.
- A cheque is a bills of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand, and it includes the electronic image of a truncated cheque and a cheque in the electronic form. The transfer of an instrument by one party to another so as to constitute the transferee a holder thereof is called 'negotiation of the instrument'.
- Instruments payable to a specified person or to the order of a specified person can be negotiated only by endorsement and delivery. Endorsement of an instrument may take any of the seven forms discussed in the lesson.
- Cheques may be crossed. Crossing is a unique feature associated with cheques affecting to a certain extent the obligation of the paying banker and also its negotiable character. A cheque may be crossed either (i) generally or (ii) specially.
- A cheque may have what is known as 'not negotiable' crossing. A person who takes such a cheque shall not have and shall not be capable of giving a better title to the cheque than that which the person, from whom he took it in the first instance, had.

- The term 'discharge' in relation to negotiable instrument is used in two senses, viz., (a) discharge of one or more parties from liability thereon, and (b) discharge of the instrument.
- Any material alteration of a negotiable instrument renders the same void as against anyone who is party thereto at the time of making such alteration.

7.15 LESSON END ACTIVITY

Discuss the following case with your classmates:

Are the following instruments duly signed by A promissory notes? (i) "I am liable to X to a sum of ₹ 1000 which is to the paid in instalments for rent" (ii) "I acknowledge myself to be indebted to X by ₹ 500 to be paid on demand for value received". (iii) "I promise to pay ₹ 5000 and give a Maruti Car to P." [*Hint:* (i) It is only an admission of liability and does not involve any promise to constitute a promissory note (s.4). (ii) It is a promissory note. (iii) A promissory note must contain a promise to pay a certain sum of money only. Therefore, it is not a promissory note.]

7.16 KEYWORDS

Instrument: It means any written document by which a right is created in favour of some person.

Ambiguous instrument: It is an instrument which may be construed either as a promissory note or as a bill of exchange.

Holder: A holder is a person who is entitled in his own name to the possession of a negotiable instrument and to receive or recover the amount due thereon from the parties thereto.

Negotiation: The transfer of an instrument by one party to another so as to constitute the transferee a holder thereof is called 'negotiation'.

Endorsement: It is the mode of negotiating a negotiable instrument.

Crossing: Crossing on cheque is a direction to the paying banker by the drawer that payment should not be across the counter.

Negotiable Instrument: A negotiable instrument is one, the property and the title in which is acquired by anyone who takes it as *bona fide* and for value notwithstanding any defect in the title of the person from whom he/she took it.

Conditional Endorsement: An endorsement where the endorsee limits or negates his liability by putting some condition in the instrument is called a conditional endorsement.

Secondary Liability: It refers to the responsibility of a person or entity that arises when the party directly liable fails to perform a duty.

7.17 QUESTIONS FOR DISCUSSION

1. Explain the term 'Instrument'.
2. What do you understand by 'negotiable instruments'?
3. Explain the meaning of 'negotiability'.
4. Name the instruments which are recognised as negotiable instruments by the Negotiable Instruments Act, 1881.
5. Give the different forms in which an instrument must be payable so as to constitute a negotiable instrument.

6. Write explanatory notes on the following: (i) Ambiguous instruments, (ii) Inchoate instruments, (iii) Lost or stolen instruments.
7. State briefly the presumptions as to negotiable instruments under the Negotiable Instrument Act.
8. "The capacity of a party to draw, accept, make or endorse a negotiable instrument is co-extensive with his capacity to enter into a contract".
9. What are the essential requirements of a valid promissory note? Give some examples of instruments which: (a) are promissory notes, (b) are not promissory notes. (iii) Enumerate the different parties to a promissory note.
10. What is a bill of exchange? State its essential characteristics. How does a promissory note differ from a bill of exchange?
11. Distinguish between (i) inland and foreign bills; (ii) Time and demand bills; (iii) clean and documentary bills; and (iv) general acceptance and qualified acceptance.
12. When is a bill deemed to have been dishonoured by non-acceptance?
13. Define a Cheque. Distinguish between a cheque and a bill of exchange.
14. What are the various requisites of a cheque?
15. What do you understand by – (i) a stale cheque, (ii) an overdue cheque, (iii) bank draft or demand draft?
16. Define the term 'holder', 'holder for value' and 'holder in due course'. Enumerate the privileges of a 'holder in due course'.
17. Explain the term 'negotiation'. Distinguish it from assignment.
18. Distinguish between a (i) 'bearer' and an 'order' instrument, (ii) conditional endorsement and restrictive endorsement.
19. Write a short note on essentials of a valid endorsement of a negotiable instrument.
20. Write a short note on 'once a bearer always a bearer'.
21. Write short notes on (i) presentment for acceptance and payment, (ii) maturity of an instrument.
22. What is meant by (i) dishonour for non-acceptance, (ii) dishonour for non-payment?
23. Explain the provisions relating to 'Noting' and 'Protesting' of a bill which has been dishonoured by the acceptor.
24. Write a short note on crossed cheques.
25. Explain clearly the meaning of 'general' and 'special' crossing and "crossing after the issue of a cheque".
26. Cheques crossed 'not negotiable' are nevertheless transferable. Explain.
27. Explain the effect of (i) Not-negotiable crossing (ii) "Account payee only" crossing.
28. When is payment on a negotiable instrument said to be payment in due courses?
29. Has a holder of a cheque any remedy against the banker for wrongful dishonour of the cheque?
30. "Issuing of a cheque that bounces is an offence". Comment.

31. What are the provisions of the Negotiable Instruments Act, 1881, regard international law concerning negotiable instruments?
32. Discuss International Law concerning Negotiable Instruments in respect of (i) dishonour and (ii) liability on foreign instruments.
33. What is discharge of an instrument?
34. What is discharge by cancellation?
35. What is discharge by operation of law?

Check Your Progress: Model Answer

1. Negotiable
2. Inchoate
3. Maker
4. Time
5. Cheque
6. Endorsement

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BLOCK IV

UNIT 8

CONSUMER PROTECTION ACT, 1986

CONTENTS

8.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the meaning of a negotiable instrument
- Discuss the nature and requisites of negotiable instruments
- Describe the transfer of negotiable instruments and liability of parties
- Explain the meaning of promissory note, bill of exchange and cheque
- Know what is crossing of cheques
- Describe the liability of the paying banker

- Explain holder in due course and special rules for cheques and drafts
- Discuss the discharge of negotiable instruments

8.1 INTRODUCTION

In this lesson, we will discuss the six basic rights of consumers. You will be able to describe the procedure of consumer grievances redressal and various consumer redressal machineries and forums. The oft-repeated cliché that 'the consumer is king', has been translated into something of a reality in India since the setting up of special consumer courts under the Act, which are dispensing quick disposal of consumer grievances. We will explain about IPR (Intellectual Protection Rights) and consumer protection.

When the world was younger and communities smaller, consumer protection was virtually unnecessary. Unfair trade was almost impossible in the life style of those times. One could not comfortably cheat someone in the morning and break bread with him, the same evening. In India, exploitation of consumers has assumed serious proportions. Buyers have a very weak bargaining power and also cannot assert their right of being heard. As a consequence, manufacturers and traders are tempted to follow diverse practices, which turn out to be unfair to consumers.

8.2 MAIN FEATURES

It was quite necessary to protect the consumers from this predicament. Therefore the Consumer Protection Act, 1986 took shape. It is described as a unique legislation of its kind ever enacted in India to offer protection to the consumers. The main objective of this Act is to provide better protection to the consumers. Unlike other laws, which are punitive or preventive in nature – the provisions of this Act are compensatory in nature. The Act intends to provide simple, speedy and inexpensive redressal to the consumers' grievances.

Other salient features of the Act are:

- It applies to all goods and services unless specifically exempted by the Central Government.
- It covers all sectors whether private, public or co-operative.
- It confers certain rights on consumers.
- It envisages establishment of consumer protection councils at the Central and State levels whose main object shall be to promote and protect the rights of the consumers.

The provisions of this Act are in addition to and not in derogation of the provisions of any other Act.

The Consumer Protection Act, 1986 was substantially amended in 1991, 1993 and 2002.

8.3 IMPORTANT TERMS

Complainant: A complainant means any of the following and having made a complaint:

- A consumer; or
- Any voluntary consumer association registered under the Companies Act, 1956 or under any other law for the time being in force; or

- The Central Government or any State Government; or
- One or more consumers, where there are numerous consumers having the same interest, or
- In case of death of consumer, his legal heir or representative.

Complaint: Complaint means any allegation in writing made by a complainant with a view to obtaining any relief under the Act, that:

- Any unfair trade practice or restrictive trade practice has been adopted by any trader or service provider; and the complainant has suffered loss or damage;
- The goods bought by him or agreed to be bought by him suffer from defect(s) in any respect;
- The services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;
- A trader or the service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price–(a) fixed by or under any law for the time being in force; (b) displayed on the goods or any package containing such goods; (c) displayed on the price list exhibited by him by or under any law for the time being in force; (d) agreed between the parties;
- Goods which will be hazardous to life and safety when used are being offered for sale to the public—(a) in contravention of any standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force; (b) if the trader could have known with due diligence that the goods so offered are unsafe to the public;
- Services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by the service provider which such person could have known with due diligence to be injurious to life and safety.

Consumer: Consumer means any of the following persons:

- Who buys any goods for consumption which has been paid or promised or partly paid and partly promised or under any system of deferred payment i.e., in respect of hire-purchase transactions. The term includes any other user of such goods when such use is made with the approval of the buyer.

  The expression 'consumer', however, does not include a person who obtains such goods for resale or for any commercial purpose.
- Who hires or avails of any services for consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment. The term includes any other beneficiary of such services with the approval of the first mentioned person.

Consumer Dispute [Sec. 2(1) (c)]: It means a dispute where the person against whom a complaint has been made; denies or disputes the allegations contained in the complaint.

Defect [Sec. 2(1) (f)]: A 'defect' is defined to mean any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or under any contract, express or implied, or as is claimed by the trader in any manner whatsoever in relation to any goods.

Deficiency: Parallel to 'defect' in case of goods, deficiency is relevant in case of services.

Accordingly, it is defined to mean any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

District Forum: District Forum means a consumer Dispute Redressal Forum established under Clause (a) of s.9. This section provides that for the purposes of the Act 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. The State Government may, if it deems fit, establish more than one District Forum in a district.

Goods: Goods under this Act shall have the same meaning as assigned to them under the Sale of Goods Act, 1930. Accordingly, 'Goods' means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale [Sec. 2(7) of the Sale of Goods Act, 1930].

Manufacturer: The expression Manufacturer for the purpose of this Act, means any of the following persons: (i) A person who makes or manufactures any goods or part thereof. (ii) A person who does not make or manufacture any goods but assembles parts thereof made or manufactured by others. But, where a manufacturer dispatches any goods or parts thereof to any branch office maintained by him, such branch office shall not be deemed to be manufacturer even though the parts so dispatched to it are assembled at such branch office and are sold or distributed from such branch office. (iii) A person who puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer.

Member: The expresaion member has been inserted for the first time into the Act vides the Amendment Act, 1993. The term includes the President and a member of the National Commission or a State Commission or a District Forum, as the case may be.

National Commission: National Commission means the National Consumer Disputes Redressal Commission established under clause (c) of Section 9. This section provides that there shall be established for the purposes of this Act a National Consumer Disputes Redressal Commission established by the Central Government by notification. The Government vide powers conferred upon it under the said clause established a National Commission in 1987.

Person: The expression person for the purposes of the Act shall include: (i) a firm, whether registered or not; (ii) a Hindu Undivided Family; (iii) a Co-operative Society; (iv) Every other association of persons whether registered under Societies Registration Act or not.

Restrictive Trade Practice: This definition was introduced in the Act vide Amendment Act, 1993. It has now been amended by the Amendment Act, 2002. It provides that a "restrictive trade practice" means a trade practice which tends to bring about manipulation of price or its conditions of delivery or to affect flow of supplies in the market relating to goods or services in such a manner as to impose on the consumers unjustified costs or restrictions and shall include:

(a) delay beyond the period agreed to by a trader in supply of such goods or in providing the services which has led or is likely to lead to rise in the price.

(b) any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as condition precedent to buying, hiring or availing of other goods or services.

Service: 'Service' means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service.

Spurious Goods and Services: It means such goods and services which are claimed to be genuine but they are actually not so.

State Commission: It means a Consumer Disputes Redressal Commission established in a State under clause (b) of s.9., which provides that there shall be established for the purpose of this Act a Consumer Disputes Redressal Commission to be known as the 'State Commission' established by the State Government by notification in the Official Gazette.

Trader: A 'trader' in relation to any goods means a person who sells or distributes any goods for sale and includes the manufacturer thereof. Where such goods are sold or distributed in package form, the expression 'trader' shall include the packer of those goods.

Unfair Trade Practice: The expression 'unfair trade practice' is defined to mean a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any service adopts any unfair method or unfair or deceptive practice including any of the following practices, namely:

1. ***Misleading Advertisement and False Representation:*** The practice of making any statement, whether orally or in writing or by visible representation which,

   (i) falsely represents that the goods are of a particular standard, quality, quantity, grade, composition, style or model;

   (ii) falsely represents that the services are of a particular standard, quality, or grade;

   (iii) falsely represents any rebuilt, second hand, renovated, reconditioned or old goods as new goods;

   (iv) represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have;

   (v) represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;

   (vi) makes a false or misleading representation concerning the need for, or the usefulness of any goods or services;

   (vii) gives to the public any warranty or guarantee of the performance, efficiency or length of life of a product or of any good that is not based on an adequate or proper test thereof.

   However, where a defence is raised to the effect that such warranty or guarantee is based on adequate or proper test, the burden of proof of such defence shall lie on the person raising such defence;

   (viii) makes to the public a representation in a form that purports to be: (a) a warranty or guarantee of a product or of any goods or services; or (b) a promise to replace, maintain or repair an article or any part thereof or to repeat or continue a service until it has achieved a specified result; (c) if such purported warranty or guarantee or promise is materially misleading or if there is no reasonable prospect that such warranty, guarantee or promise will be carried out;

(ix) materially misleads the public concerning the price at which a product or like products or goods or services, have been or are, ordinarily sold or provided;

(x) gives false or misleading facts disparaging the goods, services or trade of another person.

2. ***Bargain Sale:*** The publication of any advertisement, whether in any newspaper or otherwise, for the sale or supply at a bargain price of goods and services that are not intended to be offered for sale or supply at the bargain price, or for period that is and in quantities that are reasonable, having regard to the nature of the market and size of business and the nature of the advertisement.

'Bargain Price' means: (a) a price that is stated in any advertisement to be a bargain price, by reference to an ordinary price or otherwise or (b) a price that a person who reads, hears or sees the advertisement would reasonably understand to be a bargain price having regard to the prices at which the product advertised or like products are ordinarily sold. [Explanation to sub-clause (2)]

3. Offering gifts, prizes, etc., and conducting contests or lottery.

(a) The offering of gifts, prizes or other items with the intention of not providing them as offered or creating impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole;

(b) the conduct of any contest, lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest.

3A. Withholding of information about final results of scheme offering gifts etc. The Amendment Act 2002 provides for another unfair trade practice.

The withholding of the information about final results of the scheme from the participants of any scheme offering gifts, prizes or other items free of charge on its closure is an unfair trade practice.

Explanation: The participants of a scheme shall be deemed to have been informed of the final results of the scheme where such results are within a reasonable time published, prominently in the same newspapers in which the scheme was originally advertised.

4. ***Not conforming to prescribed standards:*** The sale or supply of goods intended to be used, or are of a kind likely to be used, by consumers, knowing or having reason to believe that the goods do not comply with the standards prescribed by competent authority relating to performance, composition, contents, design, construction, finishing or packaging as are necessary to prevent or reduce the risk of injury to the person using the goods.

Thus, sale of helmets without ISI certification will amount to an unfair trade practice under this clause.

5. ***Hoarding or Destruction of goods:*** The hoarding or destruction of goods, or refusal to sell the goods or to make them available for sale or to provide any service, if such hoarding or destruction or refusal raises or tends to raise or is intended to raise, the cost of those or other similar goods or service.

6. ***Manufacture of Spurious Goods:*** The Amendment Act, 2002 has widened the scope of the Act, by including the manufacture of spurious goods or offering such goods for sale or adopting deceptive practices in the provision of services as unfair trade practices.

8.4 CONSUMER RIGHTS

You must note that Mahatma Gandhi, the father of nation, linked great significance to what he explained as the "poor consumer", who as per him should be the main beneficiary of the consumer movement. He said:

"The customer is the most important visitor on our premises. He is not dependent on us. We are dependent on him. He is not an interruption on our work. He is the purpose of it. He is not an outsider on our business. He is part of it. We are not doing him a favour by serving him. He is doing us a favour by giving us an opportunity to do so."

–Mahatma Gandhi

You must be aware that consumer is the actual deciding factor for every economic activity. It is at present universally accepted that the degree of consumer protection is an actual indicator of the level of progress in a nation. The expanding size and complications of production and distribution systems, the great level of sophistication in marketing and selling practices and types of promotion such as advertising, etc., have led to the enhanced requirement for consumer protection.

Example: A jeep was purchased to be used as a taxi. The question was whether the buyer of the jeep was a consumer under the Act. The Rajasthan State Commission held that to use the jeep as a taxi with the object to earn profits was a commercial purpose, and therefore, the buyer/user was not a consumer within the meaning of the Act. [Smt. Pushpa Meena vs. Shah Enterprises (Rajasthan) Ltd. (1991) 1 CPR 229].

The Consumer Protection Act, 1986 is the most vital legislation passed to offer for efficient safeguards to consumers against several kinds of exploitations as well as unfair dealings. This Act was altered in 2002 in the shape of Consumer Protection (Amendment) Act, 2002 with few vital inclusions.

The definition of consumer right is 'the right to have information about the quality, potency, quantity, purity, price and standard of goods or services', as it may be the instance, however the consumer is to be saved as opposed to any unfair practices of trade. It is very important for the consumers to be aware of these rights.

But there are sturdy and obvious laws in India to defend consumer rights but the real dilemma of consumers of India can be felt as being entirely dismal. Out of the several laws that have been imposed to safeguard the consumer rights in India, the most vital is the Consumer Protection Act, 1986. As per this law, everybody, involving individuals, a firm, a Hindu undivided family as well as a company, have the right to practice their consumer rights for the buying of goods and services made by them. It is vital that, as consumer, one knows the fundamental rights as well as about the courts and procedures that pursue with the breach of one's rights.

For the first time in the history of consumer legislation in India, the Consumer Protection Act, 1986 extended a statutory recognition to the rights of consumers. Section 6 of the Act recognises the following six rights of consumers:

1. ***Right to Safety:*** According to the Consumer Protection Act 1986, the consumer right to safety is referred to as 'right to be protected against marketing of goods and services which are hazardous to life and property'. It is applicable to specific areas like healthcare, pharmaceuticals and food processing; this right is spread across the domain having a serious effect on the health of the consumers or their wellbeing, viz. Automobiles, Housing, Domestic Appliances, and Travel, etc.

   When there is violation of the right then medical malpractice lawsuits occur in the country. It is estimated, every year thousands or millions of citizens of India are killed or seriously injured by immoral practices by doctors, hospitals, pharmacies

and the automobile industry. Still the government of India, known for its callousness, does not succeed in acknowledging this fact or making a feeble effort for maintaining statistics of the mishaps. If a consumer does not have the proper documents required for filing a case then it would be very difficult for the consumer to win or even file a case.

The Government of India needs to have world class product testing facilities to test drugs, food or any other consumable products those can prove to be a menace to life. It does not happen coincidently that Tata Nano is sold in India so cheaply in a country; this is a classic case of requirement of a cheap product that outweighs the need for safety of family and self.

2. ***Right to be Informed:*** The right to information is defined as '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' in the Consumer Protection Act of 1986. In the market place of India, consumers get information by two ways namely advertising and word of mouth however these sources are considered to be unreliable but still this word of mouth is quite common here.

   Because of this, the Indian consumers hardly have precise and complete information for assessing the true value, safety, suitability, reliability of any product. Usually the hidden costs, lack of suitability, quality problems and safety hazards can be found only after the purchase of the product.

   Example: You can get your money back or a repair or replacement if a product is faulty or does not do what it is supposed to.

3. ***Right to Choose:*** The definition of Right to Choose as per the Consumer Protection Act 1986 is 'the right to be assured, wherever possible, to have access to a variety of goods and services at competitive prices'. For regulating the market place, there is just one factor required and that is competition. The existence of cartels, oligopolies and monopolies prove to be counterproductive to consumerism.

   The natural resources, liquor industry, telecommunications, airlines etc., all are being controlled by *mafias* to some or the other extent. Since the Indian consumers come from a socialistic background, the tolerating of monopolistic market is found in their blood. It is seldom seen that people want to switch the power company, in the times when they have a blackout at home. It is interesting to know that even micro markets like fish vendors in some cities are known to collude and discourage the consumers' bargaining power.

   No matter what size or form, or span, but collusion of various companies which sell a similar kind of product is unethical or say less legal. It can be estimated that India has to stride for about 20 more years for empowering its citizens fully in this regard.

4. ***Right to be Heard:*** As stated in the Consumer Protection Act 1986, the Right to be Heard has been defined as– 'the right to be heard and to be assured that consumer's interests will receive due consideration at appropriate forums'. This right helps to empower the consumers of India for putting forward their complaints and concerns fearlessly and raising their voice against products or even companies and ensure that their issues are taken into consideration as well as handled expeditiously. However, till date the Indian Government has not formed even one outlet for hearing the consumers or their issues to be sorted out.

5. ***Right to Seek Redressal:*** The right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers' is referred

to as the right to redressal according to the Consumer Protection Act 1986. The government of India has been bit more successful with regard to this right.

The consumer courts like District Consumer Disputes Redressal Forums at district level, State Consumer Disputes Redressal Commissions and National Consumer Disputes Redressal Commissions have been incorporated with the help of the Consumer Protection Act. These consumer grievance redressal agencies have fiduciary as well as geographical jurisdictions which address consumer cases between businesses and consumers.

6. ***Right to Consumer Education:*** The right of every Indian citizen to have education on matters regarding consumer protection as well as about her/his right is regarded as the last right provided by the Consumer Protection Act 1986. The right makes sure that the consumers in the country have informational programs and materials which are easily accessible and would enable them to make purchasing decisions which are better than before.

Consumer education might refer to formal education through college and school curriculums as well as consumer awareness campaigns being run by non-governmental and governmental agencies both. Consumer NGOs, having little endorsement from the government of India, basically undertake the task of ensuring the consumer right throughout the country.

8.5 PROCEDURE FOR CONSUMER GRIEVANCES REDRESSAL

You will find it interesting to note that Department of Consumer Affairs has been receiving a very large number of complaints from the consumers regarding shortfall in the supplies/expectations of the consumers. The complaints cover a wide range of subjects like supply of defective refrigerators, T.V. Sets, use of poor material by the builders in the construction of flats, non-refund of fixed deposit amounts by companies on maturity and complaint against unfair trade practice against service providers, etc.

The procedure for redressal of consumer grievances is given below:

8.5.1 Who can File a Complaint?

A complaint in relation to any goods or services may be filed by:

- A consumer, or
- Any voluntary consumer association registered under the Companies Act, 1956 (1 of 1956) or under any other law for the time being in force, or
- The Central Government or any State Government, or
- One or more consumers, where there are numerous consumers having the same interest, or
- In case of death of a consumer, his legal heir or representative.

A power of attorney holder cannot file a complaint under the Act.

8.5.2 What Constitutes a Complaint?

A complaint means any allegation in writing made by a complainant that:

- An unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider.

- The goods bought by him or agreed to be bought by him: suffer from one or more defects.
- The services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect.
- A trader or service provider, as the case may be, has charged for the goods or for the service mentioned in the complaint a price in excess of the price fixed by or under any law for the time being in force or displayed on the goods or any package containing such goods or displayed on the price list exhibited by him by or under any law for the time being in force or agreed between the parties.
- Goods which will be hazardous to life and safety when used or being offered for sale to the public.
- Services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by the service provider which such person could have known with due diligence to be injurious to life and safety.

8.5.3 How to File a Complaint?

Following are the steps to file a complaint:

1. A complaint can be filed on a plain paper. It should contain:
   - ❖ The name description and address of the complaints and the opposite party
   - ❖ The Facts relating to complaint and when and where it arose
   - ❖ Documents in support of allegations in the complaint
   - ❖ The relief which the complainants is seeking
   - ❖ The complaint should be signed by the complainants or his authorised agent.
2. No lawyer required for filing the complaint,
3. Nominal court fee.

8.5.4 Where to File a Complaint?

It depends upon the cost of the goods or services or the compensation asked. The complaint can be filed at any of the three agencies:

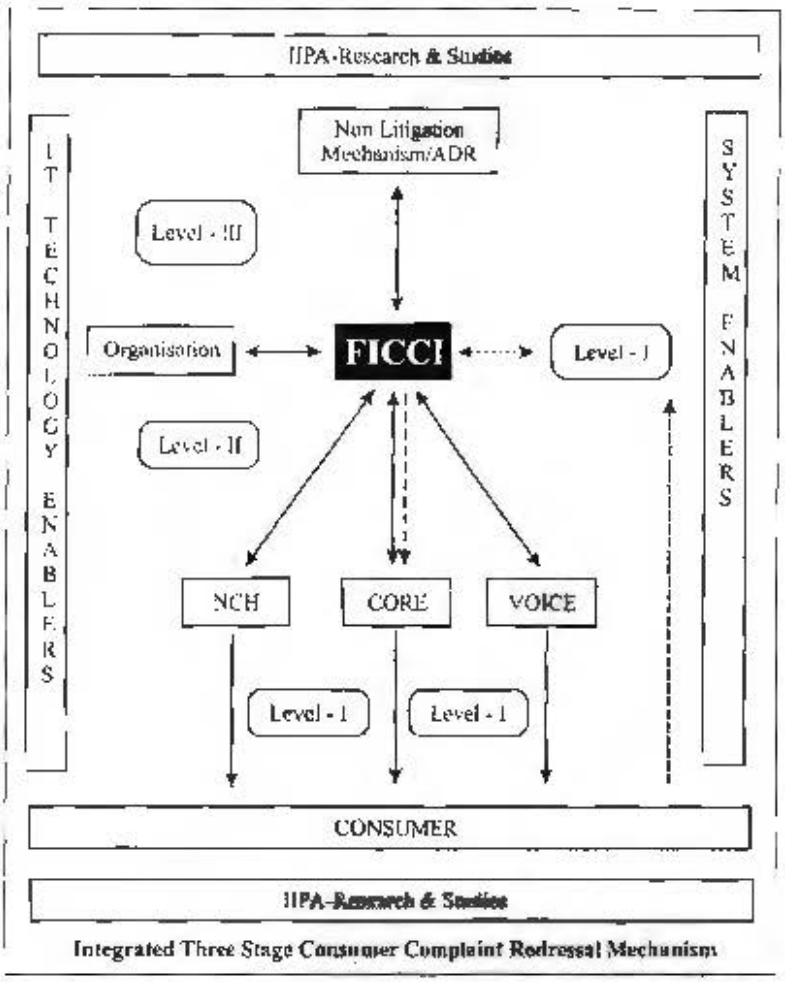
District Forum: If it is less than Rs 20 lakh

State Commission: If more than Rs 20 lakh but less than Rs1 crore

National Commission: If more than Rs 1 crore

8.5.5 Integrated Three Stage Consumer Complaint Redressal Mechanism

This mechanism includes Consumer Online Research and Empowerment (CORE) Centre, National Consumer Helpline (NCH) and Consumer Voice at Level 1 and FICCI Alliance for Consumer Care at Level 2. While, at Level 3 is the Non-litigation Mechanism or Alternative Dispute Resolution (ADR).



Source: http://business.gov.in/consumer_rights/consumer_complaints.php

Figure 8.1: Integrated Three Stage Consumer Complaint Redressal Mechanism

Consumer Online Research and Empowerment (CORE) Centre: A CORE Centre has been set up in collaboration with Consumer Coordination Council (CCC) through signing of a MOU (Memorandum of Association). It is intended to provide the most scientific and effective system of collection and dissemination of consumer related information to generate consumer awareness and empowerment of all sections of the society. It is the only authorised agency of the Department of Consumer Affairs to handle 'Online Consumer Complaints' for redressal through mediation. By accessing the online Complaint Redressal System in the CORE, the consumers can register themselves and lodge their grievance online.

If the grievance/complaint is still not redressed, complainant is advised that it is up to him to decide, whether he/she would like to take the matter to the Consumer Court. For this, necessary support by way of indication of the procedure and the contact address of the nearest member organisation of CCC, who can provide assistance in this regard, is also provided to the complainant.

National Consumer Helpline (NCH): A National Consumer Helpline project was launched by the Department of Consumer Affairs in coordination with Delhi University, Department of Commerce, at an approved cost of Rs 3.12 crore. Under the helpline, consumers from all over the country can dial toll-free number 1800-1-4000 and seek telephonic for problems that they face as consumers. The helpline intends to deal with problems related to telecom, courier, banking, insurance, financial services, etc.

Consumer Voice – Voluntary Organisation in Interest of Consumer Education: It is a voluntary action group, consisting of academicians, professionals and volunteers, channelising their energies towards creating informed consumers. It raises awareness in consumers not only about malpractices perpetuated in the marketplace, but also about her/his rights. Mission of Voice is to promote right choices in a volatile and dynamic market place by providing consumer education for all through integrating experiential good practices and scientific knowledge for the safety and health of consumers and the environment. It provides legal support to its subscribers for seeking grievance redressal under the Consumer Protection Act, 1986.

FICCI Alliance for Consumer Care (FACC): FICCI, with the support of the Department of Consumer Affairs has taken the initiative of setting up a dedicated Centre called "FICCI Alliance for Consumer Care". FACC provides an interface between business and the consumer and facilitates prompt redressal of consumer grievances. It also facilitates a dialogue between the business and consumers for promotion of responsible business practices and consumer satisfaction. It has been set up with a goal of devising a mechanism and providing a platform that facilitates prompt redressal of consumer complaints through voluntary self-regulation and consumer education.

FACC Dispute Resolution: A neutral body, which will have panel of professionally trained mediators, will be responsible for dealing with complaint redressal. The Centre will only facilitate communication between the company and the complainant to help both sides resolve the complaint. In many cases, mediation and conciliation may be available to help resolve the dispute.

FACC's value to the business community is based on its neutrality. The system is not to act as an advocate for business or consumers, but to act as a mutually trusted intermediary, to resolve disputes, to facilitate communication and to provide information on ethical business practices.

When FACC Board receives a complaint, it refers it to the business concerned for dealing with it and most companies would be happy at the opportunity given to resolve the problem, since their patronage by the customer is preserved.

Non-litigation Mechanism or Alternative Dispute Resolution (ADR): Alternative dispute resolution (ADR) consists of a variety of approaches to dispute resolution, many of which include the use of a neutral individual such as a mediator who can assist disputing parties in resolving their disagreements. ADR increases the parties' opportunities to resolve disputes prior to or during the use of formal administrative procedures and litigation (which can be very costly and time-consuming).

ADR is generally classified into at least three subtypes: negotiation, mediation, and arbitration. The salient features of each type are as follows:

- In negotiation, participation is voluntary and there is no third party who facilitates the resolution process or imposes a resolution.
- In mediation, there is a third party, a mediator, who facilitates the resolution process (and may even suggest a resolution, typically known as a "mediator's proposal"), but does not impose a resolution on the parties.
- In arbitration, participation is typically voluntary, and there is a third party who, as a private judge, imposes a resolution. Arbitrations often occur because parties to contracts agree that any future dispute concerning the agreement will be resolved by arbitration. In recent years, the enforceability of arbitration clauses, particularly in the context of consumer agreements (e.g., credit card agreements), has drawn scrutiny from courts. Although parties may appeal arbitration outcomes to courts, such appeals face an exacting standard of review.

Computerization and Computer Networking of Consumer Forums in the Country (CONFONET): This scheme has been launched through National Informatics Centre (NIC) as a turnkey project to be implemented from 2004-05. The objective of the scheme is to provide IT solutions in order to achieve e-governance, transparency, efficiency of consumer fora and facilitate disposal of cases in a time bound manner. It will help in systematising processing of various types of cases, data and generation of reports and also facilitate better administrative control for subsequent maintenance. It will enable consumers to file their complaints online and to see the status of their cases on the website. Under it, all consumer related websites (those of National Commission, State Commissions, District Fora, Department of Consumer Affairs, CORE Centre, National Consumer Helpline, etc.) will be linked so that consumers can access any consumer related information from any of these websites.

8.6 TYPES OF CONSUMER REDRESSAL MACHINERIES AND FORUMS

You need to know that the Consumer Protection Act, 1986 has set up three-tier quasi-judicial redressal machinery for expeditious and inexpensive settlement of consumer disputes. It is an alternative to the ordinary process of instituting actions before a civil court. The three redressal agencies are described below:

8.6.1 District Forum

Under Section 8 of the Act, the State Government shall establish a District Forum in each district of the state. However, more than one District Forum may be established in a district if it is deemed fit.

Composition of District Forum

According to Section 10 (1), each District Forum shall consist of the following:

1. ***President:*** He shall be a person who is, or has been or is qualified to be a District Judge.
2. ***Members:*** There shall be two other members, one of whom shall be a woman. A member must have the following qualifications:
   (i) Be not less than 35 years of age,
   (ii) Possess a bachelor's degree from a recognised university,
   (iii) Must be a person of ability, integrity and standing and have adequate knowledge and experience of at least 10 years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs, or administration.

Jurisdiction of the District Forums [Sec. 11]

The District Forum shall have jurisdiction to entertain complaints where the value of services and compensation claimed does not exceed rupees five lakh. Following are the jurisdictions of the district forums:

1. ***Pecuniary Jurisdiction [Sec. 11 (1)]:*** The District Forum can entertain complaints where the value of goods or services and the compensation if any, claimed does not exceed rupees twenty lakh. The jurisdiction is based on the value of claim made but not on the value of relief granted, or the value of subject matter. The forum may also pass orders against traders indulging in unfair trade practices, sale of defective goods or rendering of deficient services provided their turnover of goods or value of services does not exceed rupees five lakh.

2. ***Territorial Jurisdiction [Sec. 11(2)]:*** A complaint shall be instituted in a District Forum within the local limits of whose jurisdiction:

   (i) The opposite party, at the time of institution of the complaint, actually resides or carries on business, or has a branch office or personally works for gain, or

   (ii) Any of the opposite parties, where there are more than one at the time of institution of complaint, actually resides, or carries on business, or has a branch office, or personally works for gain provided that the other party acquiesces in such institution or the permission of the Forum is obtained in respect of such parties, or

   (iii) The cause of action has arisen wholly or in part.

Where two or more forums have jurisdiction, a complaint can be instituted in either of them. However, jurisdiction cannot be vested by agreement if otherwise the court has no jurisdiction.

If the dispute between the parties is pending before the civil court, the Consumer Forum has no jurisdiction to entertain the same [Oswal Fine Art vs. HMT 1991 CPJ 330(NC)].

Objections against territorial jurisdiction should be taken up at the earliest opportunity or the same will be deemed to have been waived [Kurukshetra University vs. Vinay Prakash Verma II (1993) CPJ 647].

8.6.2 State Commission

Under the Act, a State Consumer Disputes Redressal Commission shall be set up by the State Government for the respective State. At present there are 35 State Commissions functioning in different States. It shall consist of:

1. ***President:*** He shall be a person who is or has been a Judge of the High Court. His appointment shall not be made except after consultation with the Chief Justice of the High Court.

2. ***Members:*** There shall be not less than two or not more than such number of members as may be prescribed, one of whom shall be a woman. The member shall have following qualifications:

   (i) Not less than thirty-five years of age;

   (ii) Possession of bachelor degree from a recognised university, and

   (iii) Being person of ability, integrity and standing with adequate knowledge and experience of at least 10 years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration. However, not more than fifty per cent of the members shall be from amongst persons having a judicial background, i.e., having knowledge and experience of at least 10 years as a presiding officer of a district court or any tribunal at equivalent level.

Jurisdiction of the State Commission [Sec. 17]

State commission shall have jurisdiction to the following:

1. ***Monetary Jurisdiction (Original):*** It can entertain complaints where the value of goods or services and compensation, if any claimed, exceeds Rs 20 lakh but does not exceed one crore rupees.

2. ***Appellate Jurisdiction:*** It can entertain appeals against the order of any District Forum within the State. But no appeal shall be entertained by a person who has

been required to pay any amount by an order of District Forum, unless he has deposited 50 per cent of the amount or Rs 25000, whichever is less.

3. ***Supervisory or Revisional Jurisdiction:*** It can call for the records and pass appropriate order in any consumer dispute which is pending before or has been decided by any district forum within the state if it appears to it that such District Forum has exercised any power not vested in it by law, or has failed to exercise a power rightfully vested in it by law, or has acted illegally or with material irregularity.

The territorial jurisdiction of the State Commission can be invoked on the same grounds as that of the District Forum under Section 11(2).

Transfer of Cases (Sec. 17 A): On the application of the complainant, or of its own motion, the State Commission may, at any stage of the proceeding, transfer any complaint pending before the District Forum to another District Forum within the State if the interests of justice so require.

Circuit Benches (Sec. 17B): The State Commission shall ordinarily function in the State Capital. But it may be required to perform its functions at any other place as the State Government may, in consultation with State Commission, notify in the Official Gazette.

Tenure: Term of office of a member shall be five years, or 65 years of age, whichever is earlier. A member shall be eligible for reappointment for another term of five years or up to 67 years of age, whichever is earlier.

8.6.3 National Commission

Remember, the Act empowers the Central Government to establish a National Consumer Disputes Redressal Commission. It is headed by:

(i) ***President:*** He shall be a person who is or has been a Judge of the Supreme Court. His appointment shall be made by the Central Government in consultation with the Chief Justice of India.

(ii) ***Members:*** There shall be not less than four and not more than such number of members as may by prescribed, possessing the qualifications as are prescribed for a member of the State Commission.

Appointment: The Central Government shall make the appointment on the recommendation of a Selection Committee consisting of a Judge of the Supreme Court nominated by the Chief Justice of India who shall act as Chairman; the Secretary in the Department of Legal Affairs, and Secretary in the Department dealing with consumer affairs, as members.

The President and every member shall give an undertaking that he does not have and will not have any such financial or other interest as is likely to affect prejudicially his functions as such member.

Jurisdiction of the National Commission

Subject to the other provisions of this Act, the National Commission shall have jurisdiction to:

1. ***Monetary Jurisdiction:*** It can entertain complaints where the value of goods or services and compensation, if any, claimed exceeds rupees one crore.

2. ***Appellate Jurisdiction:*** It can entertain appeals against the orders of any State Commission. Under second proviso to Section 19, no appeal by a person, who is required to pay any amount in terms of an order of State Commission, shall be

entertained by the National Commission unless the appellant has deposited fifty per cent of the amount or rupees thirty five thousand, whichever is less.

3. ***Supervisory or Revisional Jurisdiction:*** It can call for records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any State Commission where it appears to the National Commission that such State Commission has exercised a jurisdiction not vested in it by law, or has failed to exercise jurisdiction so vested, or has acted in exercise of its jurisdiction illegally or with material irregularity.

The jurisdiction, powers and authority of the National Commission may be exercised by Benches thereof. A Bench may be constituted by the President with one or more members as the President may deem fit.

8.6.4 Consumer Grievance Redressal Cell (CGRC) and Consumer Coordination Council (CCC)

The department had set up a Consumer Grievance Redressal Cell (CGRC) in February 2002, for providing services for redressal of complaints of the consumers belonging to the following categories:

- Sale of defective goods or deficient services and charging of higher prices, etc.
- General grievances including those received from the Cabinet Secretary and the PMO related to consumer matters.
- Attending to the consumer complaints appearing in the columns of the newspapers to the extent possible.

Also, complaints regarding delay in disposal of pending cases with the various Districts/States/National Commission were received and processed and necessary follow up action were taken up as pro-active measures in order to redress their grievances to their satisfaction. The Redressal Cell had received many complaints. These complaints were forwarded to the Consumer Coordination Council (CCC) for redressal regarding replacement of goods, re-installation of telephone/electricity, rectification of wrong bills, possession of allotted flats, payment of amounts due to the investors on maturity, etc.

8.7 IPR AND CONSUMER PROTECTION

In this section we will learn about IPR and consumer protection. A robust intellectual property right (IPR) regime is a serious prerequisite for stimulating and enhancing economic growth in the country. It enables larger investment into the research and development as well as provides means to enhance the quality of life of people in the country. IPR protects the creative and innovative capacity of competitors and owners of IP rights that supply goods and services along with the interests of the consumers of those goods and services, directly or indirectly. The existence of such rights is essential for overall development of society.

You need to know that the zones of intellectual property that are most pertinent for protection of consumers are Trade Marks, Patents, Copyrights, Geographical Indications and protection against unfair competition. A trade mark is a sign which is used in the course of trade and differentiates goods or services of one enterprise from those of other enterprises. While a geographical indication is an indication used to recognise goods having distinctive characteristics originating from a certain geographical territory. These IP rights help the consumers in procuring quality products and protect them from use of inferior products which may cause health and safety hazards. Therefore, the proper operation of IP rights and their enforcement is

very essential for consumers. Further, it is the core of IP system that people of the country must be protected from unfair competition, that is, from any act of fraudulent practice in trade and business.

Check Your Progress

Fill in the blanks:

1. _____ means any allegation in writing made by a complainant with a view to obtaining any relief under the Act.
2. National Commission means the National Consumer Disputes Redressal Commission established under clause (c) of _____.
3. A _____ Centre has been set up in collaboration with Consumer Coordination Council (CCC) through signing of a MOU (Memorandum of Association).
4. _____ provides an interface between business and the consumer and facilitates prompt redressal of consumer grievances.
5. The department had set up a Consumer Grievance Redressal Cell (CGRC) in _____.
6. A _____ is a sign which is used in the course of trade and differentiates goods or services of one enterprise from those of other enterprises.

8.8 LET US SUM UP

- In India, exploitation of consumers has assumed serious proportions.
- In view of the ever-increasing population and the need for many goods and services of which there is no matching supply, a situation of near 'total sellers' market has come to stay.
- Buyers have a very weak bargaining power and also cannot assert their right of being heard. As a consequence, manufacturers and traders are tempted to follow diverse practices, which turn out to be unfair to consumers.
- Consumer are provided with some basic rights such as: right to safety, right to be informed, right to choose, right to be heard, right to seek redressal and right to consumer education.
- A CORE Centre has been set up in collaboration with Consumer Coordination Council (CCC) through signing of a MoU.
- It is intended to provide the most scientific and effective system of collection and dissemination of consumer related information to generate consumer awareness and empowerment of all sections of the society.
- Alternative dispute resolution (ADR) consists of a variety of approaches to dispute resolution, many of which include the use of a neutral individual such as a mediator who can assist disputing parties in resolving their disagreements.
- The areas of intellectual property that are most relevant for consumer protection are Trade Marks, Geographical Indications and Protection against unfair competition. Thus, the proper operation of IP rights and their enforcement is very important for consumers.

8.9 LESSON END ACTIVITY

Choose an organisation of your preference and study how the patent or copyright obtained by the organisation is helpful for its customers and write an article on the same.

8.10 KEYWORDS

Consumer: He is a person who consumes or acquires goods or services for direct use or ownership rather than for resale or use in production and manufacturing.

Consumer Dispute: It means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

Complaint: It means an unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider.

Defect: It means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force under any contract, express or implied or as is claimed by the trader in any manner whatsoever in relation to any goods.

Spurious Goods and Services: It means such goods and services which are claimed to be genuine but they are actually not so.

8.11 QUESTIONS FOR DISCUSSION

1. Define consumer.
2. What is right to safety?
3. Define right to be informed.
4. Discuss right to choose.
5. What is right to be heard?
6. What is right to seek redressal?
7. Define consumer education.
8. Define right to consumer education.
9. What do you mean by consumer grievance redressal?
10. Prepare the diagram of integrated three stage consumer complaint redressal mechanism.
11. What is District forum?
12. What is the composition of District forum?
13. Who heads the National Commission?
14. Give the full form of IPR.
15. What is trademark?
16. Define appellate jurisdiction.
17. What is territorial jurisdiction?
18. Discuss pecuniary jurisdiction.
19. Where will you file a complaint?

20. "Consumer is king." Comment.
21. Who can file a complaint under procedure for consumer grievance redressal? What constitutes a complaint?
22. Give an overview of present status of consumer rights in India.
23. What is FACC dispute resolution?
24. Explain the jurisdiction of the district forums.
25. Describe state commission.
26. Briefly explain the jurisdiction of the state commission.
27. Describe the jurisdiction of the national commission.
28. Briefly discuss IPR and consumer protection.
29. Explain the procedure for consumer grievances redressal step by step.

Check Your Progress: Model Answer

1. Complaint
2. Section 9
3. CORE
4. FACC
5. February 2002
6. Trade mark

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FOREIGN EXCHANGE MANAGEMENT ACT, 2000 (FEMA)

CONTENTS

9.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Understand the formulation of Foreign Exchange Management Act (FEMA) and its objectives
- Explain main provision /rules / regulation of FEMA, 2000
- Discuss the regulation and management of foreign exchange
- Describe contravention and penalties, adjudication and appeal and directorate of enforcement

9.1 INTRODUCTION

The Indian government has formulated the Foreign Exchange Management Act (FEMA), which relates to the foreign direct investment in the country. Foreign Exchange Management Act (FEMA) has assisted the country by encouraging external payment and trade. Foreign Exchange Management Act (FEMA) was formulated in order to be compatible with the policies of pro-liberalization of the Indian government.

9.2 FORMULATION OF FOREIGN EXCHANGE MANAGEMENT ACT (FEMA)

The Foreign Exchange Management Act (FEMA) was an act passed in the Winter Session of the Parliament in 1999, which replaced Foreign Exchange Regulation Act. This act seeks to make offences related to foreign exchange civil offences. It extends to the whole of India.

The Foreign Exchange Regulation Act (FERA) of 1973 in India was replaced on June 2000 by the Foreign Exchange Management Act (FERA), which was passed in 1999. The FERA was passed in 1973 at a time when there was acute shortage of foreign exchange in the country.

It had a controversial 27 years stint during which many bosses of the Indian corporate world found themselves at the mercy of the Enforcement Directorate. Moreover, any offence under FERA was a criminal offence liable to imprisonment. But FEMA makes offences relating to foreign civil offences.

FEMA had become the need of the hour to support the pro-liberalisation policies of the Government of India. The objective of the Act is to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments for promoting the orderly development and maintenance of foreign exchange market in India.

FEMA extends to the whole of India. It applies to all branches, offices and agencies outside India owned or controlled by a person, who is a resident of India and also to any contravention there under committed outside India by two people whom this Act applies.

9.2.1 Extent of Foreign Exchange Management Act (FEMA)

Foreign Exchange Management Act (FEMA) is applicable to the entire country. Agencies, offices and branches, outside India, which are owned by Indian residents, also fall under the jurisdiction of this act. Foreign Exchange Management Act (FEMA) also extends to any dispute that are committed in offices, agencies and branches outside India owned by individuals covered by this act.

9.2.2 Objectives of FEMA

Main objective of apply FEMA is to reduce the restriction on foreign exchange. Now, any offense in foreign exchange will be civil offense not criminal offense.

This law's main objective is to increase the flow of foreign exchange in India. Now, under this law, you can bring foreign currency in India without any legal barrier.

The following are some of the important features of Foreign Exchange Management Act:

(i) It is consistent with full current account convertibility and contains provisions for progressive liberalisation of capital account transactions.

(ii) It is more transparent in its application as it lays down the areas requiring specific permissions of the Reserve Bank/Government of India on acquisition/holding of foreign exchange.

(iii) It classified the foreign exchange transactions in two categories such as capital account and current account transactions.

(iv) It provides power to the Reserve Bank for specifying, in, consultation with the central government, the classes of capital account transactions and limits to which exchange is admissible for such transactions.

(v) It gives full freedom to a person resident in India, who was earlier resident outside India, to hold/own/transfer any foreign security/immovable property situated outside India and acquired when s/he was resident.

(vi) This act is a civil law and the contraventions of the Act provide for arrest only in exceptional cases.

(vii) FEMA does not apply to Indian citizen's resident outside India.

9.2.3 Implementation of Foreign Exchange Management Act (FEMA)

Extensive efforts have been undertaken to ensure the effective implementation of FEMA in India. Proper implementation and efficient supervision are the significant preconditions for the success of the Foreign Exchange Management Act (FEMA).

9.3 DEFINITION UNDER THE ACT

Authorised Person: It means an authorised dealer, money changer, offshore banking unit or any other person for the time being authorised under the Act to deal in foreign exchange or foreign securities.

Capital Account Transaction: It means a transaction which alters the assets or liabilities, including contingent liabilities, outside India or assets or liabilities in India of persons resident outside India, and includes transactions referred to in Section 6 (3).

Currency: This expression includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers' cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instrument as may be notified by the Reserve Bank. Vide Notification No. FEMA 15/2000/RB dated May 3, 2000, RBI has notified 'debit cards', 'ATM' cards or any other instrument by whatever name called that can be used to create a financial liability, as 'currency'.

Currency Notes: It means and includes cash in the form of coins and bank notes.

Currency Account Transaction: It means a transaction, other than a capital account transaction and without prejudice to the generality of the foregoing, such transaction includes—(i) payments due in connection with foreign trade, other current business, services and short-term banking and credit facilities in the ordinary course of business; (ii) payments due as interest on loans and as net income from investments; (iii) remittances for living expenses of parents, spouse and children residing abroad; and (iv) Expenses in connection with foreign travel, education and medical care of parents, spouse and children.

Export: 'Export' with its grammatical variations and cognate expressions, means: (i) the taking out of India to a place outside India any goods, (ii) provision of services from India to any persons outside India.

Foreign Currency: It means any currency other than Indian currency.

Foreign Exchange: It means foreign currency and includes: (i) deposits, credits and balances payable in any foreign currency; (ii) drafts, travellers' cheques, letters of

credit or bills of exchange expressed or drawn in Indian currency but payable in any foreign currency; (iii) drafts, travellers' cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency.

Foreign Security: The expression means any security, in the form of shares, stocks, bonds, debentures, or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividend is payable in Indian currency.

Import: Import with its grammatical variations and cognate expressions, means bringing into India any goods or services.

Indian Currency: It means currency which is expressed or drawn in Indian rupees but does not include special bank notes and special one rupee notes issued under Sec. 28A of the Reserve Bank of India Act, 1934.

Person Resident Outside India: It means a person who is not resident in India.

Transfer: The expression 'transfer' includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer or right, title, possession or lien.

Definitions of certain other terms used under FEMA Regulations are:

Non-resident Indian (NRI): It means a person resident outside India who is a citizen of India or is a person of Indian origin.

Overseas Corporate Body (OCB): The expression means a company, partnership firm, society and other corporate body owned directly or indirectly to the extent of at least 60 per cent by non-resident Indians. Further, the expression includes overseas trusts in which not less than 60 per cent beneficial interest is held by non-resident Indians directly or indirectly but irrevocably.

Person of Indian Origin (PIO): It means a citizen of any country other then Bangladesh or Pakistan, if:

(a) He at any time held Indian passport; or

(b) He or either of his parents or any of his grandparents was a citizen of India by virtue of the Constitution of India or the Citizenship Act of 1955; or

(c) The person is a spouse of an Indian citizen or a person referred to in (a) and (b).

Convertible Currency/Hard Currency: Certain currencies are freely convertible i.e. one can exchange these currencies with any other currency without any restriction. Major among these are: Dollars (USA), Pound Sterling (UK), Euro (European Common Currency), Deutsche Mark—DM (Germany), Yen (Japan), Franc (France), Lira (Italy) etc. This is often called 'hard currency'.

9.4 PROVISION /RULES / REGULATION OF FEMA, 2000

The main provision /rules / regulation of FEMA, 2000 are:

1. ***Provision regarding dealing in foreign exchange:*** According to section 3 of FEMA 2000,"only authorized person under the govt. terms can deal in foreign exchange in India. "
2. ***Provision regarding holding of foreign exchange:*** According to section 4 of FEMA 2000, "All persons which are provided authority only can hold or purchase foreign exchange in India or outside India."
3. ***Provision regarding current account transactions:*** According to section 5 of FEMA 2000, "There is no restriction regarding sale or deal foreign exchange, if it is a current account transaction."

The following transactions are deemed current account transactions under FEMA:

(a) Expenses in connection with foreign travel, education and medical care of parents, spouse and children (Anybody now can send the foreign currency in India for above expenses under current account)

(b) Payment due as interest on loan

(c) Payment due under short term loan for business.

4. ***Provision regarding capital account transactions:*** Under section six," RBI will fix the limit of foreign exchange transactions relating to capital account after discussion with Indian govt."

RBI can restrict following:

(a) Transfer of foreign security by Indian resident.

(b) Transfer of foreign security by Indian resident which is now outside India.

(c) Transfer of immovable property.

5. ***Provision regarding export of goods and services:*** According to section 7 of FEMA 2000 , " It is the duty of exporter to declare the true and correct detail of goods which , he have to sell the market outside India and must send complete report to RBI .

(a) RBI can make particular requirement for any exporter.

(b) RBI can also make rules and regulations for realization of amount earned from foreign country.

6. ***Provision regarding authorised persons:*** RBI can authorize anybody who can deal in money exchange or off shore transaction and foreign exchange.

(a) He has to follow the rules and guidelines of RBI.

(b) RBI can revoke the authorisation granted to any person at any time in public interest.

If authorized person will be done contravention the rules of RBI, he will be liable to pay up to ₹ 10000 penalty and ₹ 2000 for every day during which such contravention continue.

7. ***Provision regarding contravention and penalties:***

Section 13 to 15

If anybody or person contravenes the rules and regulation of FEMA 2000 or RBI direction, he will be liable to a penalty three times of sum involved in contravention.

If contravention will continue, then he will pay upto ₹ 5000 per day during the time of contravention.

8. ***Provision regarding adjucation and appeal:*** According to section 18, "Central govt. can appoint adjudicating authority who can give the punishment of civil imprisonment of maximum six months if case is less than one crore. If demanded value is more than one crore then punishment of imprisonment may be of three years. The person can appeal to special director against the decisions of adjudicating officer. He can also appeal in appellate tribunal and also in high court with the sixty days of communication of order.

9.5 REGULATION AND MANAGEMENT OF FOREIGN EXCHANGE

Sections 3-9 deal with regulation and management of foreign exchange.

- ***Dealings in Foreign Exchange etc. (Sec. 3):*** It prohibits any person other than an authorised person from (a) dealing in or transferring any foreign exchange or foreign security to any person or (b) making any payment to or for the credit of any person resident outside India in any manner; or (c) receive otherwise than through an authorised person any payment by order or on behalf of any person resident outside India in any manner. (d) entering into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.
- ***Holding of Foreign Exchange etc.:*** Section 4 provides that except as otherwise provided in the Act; no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.
- ***Current Account Transactions:*** Section 5 explains dealings in current account transactions. This section provides that any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction. Also it empowers the central government to impose reasonable restrictions for current account transaction in the public interest in consultation with the Reserve Bank of India by making appropriate rules.
- ***Regulation of Capital Account Transactions:*** Section 6 provides that any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction. However, the Reserve Bank may, in consultation with the Central Government, specify the permissible capital account transactions and the limits up to which foreign exchange will be allowed for such transactions.
- ***Export of Goods and Services:*** Section 7 deals with export of goods and services. Every exporter is required to furnish to Reserve Bank or any other authority as prescribed, a declaration containing true and correct particulars regarding the amount representing the full export value or if the full export value of the goods is not ascertainable at the time of export, the value which the exporter having regard to prevailing market conditions expects to receive on sale of the goods in a market outside India. Every exporter is also required to furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realisation of the export proceeds.

9.6 CONTRAVENTION AND PENALTIES

9.6.1 Penalties

Section 13 provides that if any person contravenes any provision of the Act, rules, regulation etc. or contravenes any condition subject to which the authorization is granted by RBI, he shall be liable for penalty upon adjudication, which may extend upto thrice the sum involved in such contravention where such amount is quantifiable or upto two lakh rupees where the amount is not quantifiable. If the contravention continues, the penalty of Rs. 500 per day after the first day during the period in which the contravention continues shall be imposed.

Again, Section 13 provides that any adjudicating authority may, in addition to the penalty, direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government. It may further direct that the foreign exchange holdings, if any, of the

persons committing the contravention or any part thereof, shall be retained outside India in accordance with the directions made in this behalf.

9.6.2 Enforcement of the Orders of Adjudicating Authority

Section 14 provides that if a person fails to make full payment of the penalty imposed within a period of 90 days from the date on which the notice of payment of such penalty is served on him, he shall be liable to civil imprisonment. However, the defaulter shall not be arrested or detained in civil prison, unless he has been issued and served a notice by Adjudicating Authority calling upon him to show cause why he should not be committed to civil prison.

The Adjudicating Authority may issue a warrant for the arrest of a defaulter if it is satisfied by affidavit or otherwise that the defaulter is likely to abscond or leave the local limits of the jurisdiction of the Adjudicating Authority with the intention of delaying the execution. The arrest warrant may be issued by the Adjudicating Authority if the defaulter fails to make an appearance in pursuance of the notice issued by him. The arrest warrant issued by an Adjudicating Authority may be executed by any other Adjudicating Authority within whose jurisdiction the defaulter may for the time being be found.

9.6.3 Power to Compound Contraventions

Section 15 empowers the Directorate of Enforcement or Officers of the Directorate of Enforcement and Officers of the Reserve Bank as may be authorised by the Central Government in this behalf to compound the offences. Any contravention under Sec. 13 may be compounded on an application made by the person committing such contravention within 180 days from the date of receipt of application. Further, any contravention so compounded, relieves the accused person from further proceedings for that contravention.

9.7 ADJUDICATION AND APPEAL

9.7.1 Appointment of Adjudicating Authority

Section 16 empowers the Central Government to appoint by notification in the Official Gazette as many Adjudicating Authorities as it may think fit for holding enquiries, for the purposes of Section 13. The Central Government is, however, under obligation to specify the jurisdiction of the Adjudicating Authority. The Adjudicating Authority cannot hold any enquiry, unless a complaint is made in writing by an officer authorised by a general or special order of the central government.

The person alleged to have committed the contravention will be given a reasonable opportunity of being heard before imposing any penalty under Section 13. The person against whom a complaint is made is entitled to present his case before the Adjudicating Authority himself or take the assistance of a legal practitioner or Chartered Accountant.

The Adjudicating Authority has been entrusted with powers of a civil court and all proceedings before it shall be deemed to be judicial proceedings within the meaning of Section 193 and Section 229 of the Indian Penal Code.

9.7.2 Appeal to Special Director (Appeals)

Section 17 empowers the Central Government to appoint one or more special Directors to hear the appeals against the orders of the Adjudicating Authorities. The Central Government while issuing notification to this effect shall also specify the matter and places over which the Special Director (Appeals) have jurisdiction.

An appeal to the Special Director (Appeals) may be made against the orders of the Assistant Directors or Deputy Director of Enforcement if they are acting as Adjudicating Authority. The appeal shall be filed within 45 days from the date on which the copy of the order made by the Adjudicating Authority is received by the aggrieved party.

The appeal shall be filed in the prescribed form and the manner accompanied by the prescribed fees. The Special Director (Appeals) may however extend time limit for filing an appeal if he is satisfied that there was sufficient reason for not filing the appeal in time. On receipt of an appeal, the Special Director (Appeals) after hearing the parties may pass such orders as he thinks fit confirming, modifying or setting aside the order appealed against. Copies of the orders of the Special Director (Appeals) shall be sent to the parties concerned and to the concerned Adjudicating Authority. The Special Director (Appeals) shall have the powers of a civil court and the proceeding before him shall be deemed to be judicial proceedings.

9.7.3 Establishment of Appellate Tribunal

Section 18 empowers the Central Government to establish Appellate Tribunal by a notification in the Official Gazette to hear appeals against the orders of Adjudicating Authorities and special Director (Appeals).

Powers of Appellate Tribunal and Special Director (Appeals)

Section 28 provides for powers of the Appellate Tribunal and Special Director (Appeals). These are summarised as under:

1. The Appellate Tribunal and special Director (Appeals) while disposing of an appeal, shall not be bound by the Code of Civil Procedure but will be guided by the principles of natural justice and other provisions of the Act.
2. The Appellate Tribunal and the Special Director (Appeals) shall have, for the purpose of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit, in respect of the following matters:
   (a) Dummoning and enforcing the attendance of any person and examining him on oath;
   (b) Requiring the discovery and production of documents;
   (c) Receiving evidence on affidavits;
   (d) Subject to the provisions of Sections 123 and 124 of the Indian Evidence Act, 1872 requisitioning any public record or document or copy of such record or document from any office;
   (e) Issuing commissions for the examination of witnesses or documents;
   (f) Reviewing its decisions;
   (g) Dismissing a representation of default or deciding it *ex parte;*
   (h) Setting aside any order of dismissal of any representation for default or any order passed by it *ex parte;*
   (i) Any other matter which may be prescribed by the Central Government.
3. An Order made by the Appellate Tribunal or the Special Director (Appeals) under this Act shall be executable by the Appellate Tribunal or the Special Director (Appeals) as a decree of civil court and, for this purpose, the Appellate Tribunal and the Special Director (Appeals) shall have all powers of a civil court.

4. Notwithstanding anything contained in (3), the Appellate Tribunal or the Special Director (Appeals) may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the orders as if it were a decree made by that court.

5. All proceedings before the Appellate Tribunal and the Special Director (Appeals) shall be deemed to be judicial proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code and the Appellate Tribunal shall be deemed to be a civil court for the purpose of Sections 345 and 346 of the Code of Criminal Procedure, 1973.

Distribution of Business among Benches

Section 29 provides that where Benches are constituted, the Chairperson may, from time to time, by notification, make provisions as to the distribution of the business of the Appellate Tribunal amongst the Benches and also provide for the matters which may be dealt with by each Bench.

Power of Chairperson to Transfer Cases

Section 30 provides that on the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairperson may transfer any case pending before one Bench, for disposal, to any other Bench.

Decision to be by Majority

Section 31 provides that if the members of a Bench consisting of two members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Chairperson who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other members of the Appellate Tribunal and such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.

Members, etc. to be Public Servants

Section 33 provides that the Chairperson, Members and other officers and employees of the Appellate Tribunal, the Special Director (Appeals) and the Adjudicating Authority shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code.

Civil Court not to have Jurisdiction

Section 34 provides that no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Authority or the Appellate Tribunal or the Special Director (Appeals) is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under the Act.

Appeal to High Court

Section 35 provides that any person aggrieved by any decision or order to the Appellate Tribunal may file an appeal to the High Court. Such appeal must be filed within 60 days from the date of communication of the decision or order of the Appellate Tribunal. However, a relaxation for a period of 60 days for making an appeal may be granted by the High Court, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period. The appeal to the High Court can be made on any question of law arising out of such order.

9.8 DIRECTORATE OF ENFORCEMENT

Sections 36 to 38 make provisions as regards Directorate of Enforcement. Section 36 provides that the Central Government shall establish a Directorate of Enforcement with a director and such other officers or class of officers as it thinks fit, which shall be called officers of Enforcement, for the purposes of this Act. Subject to such conditions and limitations as the Central Government may impose, an officer of Enforcement may exercise the powers and discharge the duties conferred or imposed on him under this Act.

Under Section 37, the Director of Enforcement and other officers not below the rank of an Assistant Director shall take up for investigation on the contravention of any provisions of Section 13. In addition, the Central Government may by notification authorize any officer or class of officers in the Central Government, State Government, Reserve Bank of India, not below the rank of under-secretary to Government of India to investigate any such contravention. The officer so appointed shall exercise the like powers which are conferred on the income-tax authorities under the Income-tax Act, 1961, subject to such conditions and limitation as the Central Government may impose. Similarly,

Section 38 provides for empowering other officers with the same powers as are mentioned in Section 37.

Check Your Progress

Fill in the blanks:

1. The FERA was passed in _____ at a time when there was acute shortage of foreign exchange in the country.
2. _____ _____ currency means any currency other than Indian currency.
3. _____ will fix the limit of foreign exchange transactions relating to capital account after discussion with Indian government.
4. ___ ___ explains dealings in current account transactions.
5. Section 14 provides that if a person fails to make full payment of the penalty imposed within a period of _____ days.
6. Sections 36 to 38 make provisions as regards _____.

9.9 LET US SUM UP

- The Foreign Exchange Regulation Act (FERA) of 1973 in India was replaced on June 2000 by the Foreign Exchange Management Act (FERA), which was passed in 1999.
- The objective of the Act is to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments for promoting the orderly development and maintenance of foreign exchange market in India.
- The Adjudicating Authority has been entrusted with powers of a civil court and all proceedings before it shall be deemed to be judicial proceedings within the meaning of Section 193 and Section 229 of the Indian Penal Code.
- An appeal to the Special Director (Appeals) may be made against the orders of the Assistant Directors or Deputy Director of Enforcement if they are acting as Adjudicating Authority.

- Section 36 provides that the Central Government shall establish a Directorate of Enforcement with a director and such other officers or class of officers as it thinks fit, who shall be called officers of Enforcement, for the purposes of this Act.

9.10 LESSON END ACTIVITY

Can anyone file a suit against officer of the government exercising powers under EFMA? If yes, give reasons to support your answer.

9.11 KEYWORDS

Foreign Exchange Management Act: Foreign exchange management act is to facilitate external trade and payments and to promote the orderly development and maintained of foreign exchange in India.

Currency: This expression includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers' cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instrument as may be notified by the Reserve Bank.

Export: Outflow of goods and inflow of foreign currency.

Import: Import with its grammatical variations and cognate expressions, means bringing into India any goods or services.

9.12 QUESTIONS FOR DISCUSSION

1. Explain the objectives of FEMA, 2000.
2. What is Foreign Exchange?
3. Discuss the main provision /rules / regulation of FEMA, 2000.
4. Describe the sections 3-9 which deal with regulation and management of foreign exchange.
5. Write short note on Enforcement of the Orders of Adjudicating Authority.
6. Discuss appointment of adjudicating authority.
7. Discuss establishment of Appellate Tribunal.
8. Write short note on Directorate of Enforcement.

Check Your Progress: Model Answer

1. 1973
2. Foreign
3. RBI
4. Section 5
5. 90
6. Directorate of Enforcement

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UNIT 10

MONOPOLISTIC AND RESPECTIVE TRADE PRACTICES ACT, 1969

CONTENTS

10.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Explain the objectives and provisions of monopolies and restrictive trade practice act
- Define SEBI
- Describe customer and central excise act

10.1 INTRODUCTION

Two or more individuals, associations of individuals, firms, trusts, trustees or bodies corporate (excluding financial institutions), or any combination thereof, which exercise, or is established to be in a position to exercise, control, directly or indirectly, over anybody, corporate, firm or trust IP, protected through law, like any other form of property can be a matter of trade, that is, it can be owned, bequeathed, sold or bought. The major features that distinguish it from other forms are their intangibility and non-exhaustion by consumption.

10.2 THE MONOPOLIES AND RESTRICTIVE TRADE PRACTICES ACT, 1969

An Act provides that the operation of the economic system does not result in the concentration of economic power to the common detriment, for the control of monopolies, for the prohibition of monopolistic and restrictive trade practices and for matters connected therewith or incidental thereto.

Under the purview of MRTP Act, a large number of different types of agreements were identified. Each of such agreements was required to be duly registered with the Registrar of Restrictive Trade Practices along with the names of the parties involved in the agreement.

The MRTP Act, 1969 has its genesis in the Directive Principles of State Policy embodied in the Constitution of India. Clauses (b) and (c) of Article 39 of the Constitution lay down that the State shall direct its policy towards ensuring:

(i) the ownership and control of material resources of the community are so distributed as to best serve the common good; and

(ii) the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

All these registered undertakings were subject to following types of control over their various industrial activities:

(a) while proposing to expand the activities of the undertakings substantially by issuing fresh capital or by installing new machineries, notice to the Central Government is required to be given for getting approval (Section 21);

(b) while proposing to establish a new undertaking, prior permission of the Central Government is required to be obtained (Section 22); and

(c) while proposing to acquire, merge or amalgamate with another undertaking, the sanction of the Central Government must be taken before the execution of such proposal (Section 23).

The entire responsibility to look after the occurrence of concentration of economic power to the common detriment was on the Government. If it so desires, it could refer the matter to the MRTP Commission for making an enquiry. But MRTP Commission has been given an advisory role as the ultimate orders, on any proposal have to be passed by the present Government.

The MRTP Act was formulated with the following objectives:

(a) To have a careful watch that the operation of the economic system does not create any concentration of economic power to the detriment of the common people of the country;

(b) To control monopolies prevailing in the country; and

(c) To have a check on monopolistic, restrictive and unfair trade practices in the country.

Thus, in order to achieve these objectives, the MRTP Act tries to control the activities of the big business houses and dominant undertakings of the country.

10.2.1 Short Title, Extent and Commencement

- This Act may be called the Monopolies and Restrictive Trade Practices Act, 1969.
- It extends to the whole of India except the State of Jammu & Kashmir.
- It shall come into force on such date as the Central Government may, by notification, appoint (1a).

10.2.2 Definitions

In this Act, unless the context otherwise requires:

- "Agreement" includes any arrangement or understanding, whether or not it is intended that such agreement shall be enforceable (apart from any provision of this Act) by legal proceedings;
- "Commission" means the Monopolies and Restrictive Trade Practices Commission established under section 5;
- "Director General" means the Director General of Investigation and Registration appointed under section 8, and includes any additional, Joint, Deputy or Assistant Director General of Investigation and Registration appointed under that section;
- "Dominant undertaking" means:
  - An undertaking which, by itself or along with inter-connected undertakings produces, supplies, distributes or otherwise controls not less than one-fourth of the total goods that are produced, supplied or distributed in India or any substantial part thereof.
  - An undertaking which provides or otherwise controls not less than one-fourth of any services that are rendered in India or any substantial part thereof.

Explanation I: Where any goods are the subject of different forms of production, supply, distribution or control, every reference in this Act to such goods shall be construed as reference to any of those forms of production, supply, distribution or control, whether taken separately or together or in such groups as may be prescribed.

Explanation II: The question as to whether any undertaking, either by itself or along with inter-connected undertakings, produces, supplies, distributes or controls one-fourth of any goods or provides or controls one-fourth of any services may be determined according to any of the following criteria, namely, value, cost, price, quantity or capacity of the goods or services.

Explanation III: In determining, with reference to features specified in sub-clause (iii) sub clause (iv), as the case may be, the question as to whether an undertaking is or is not a dominant undertaking, regard shall be had to:

- The average annual production of the goods, or the average annual value of the services provided, by the undertaking during the relevant period;
- The figures published by such authority as the Central Government may, by notification, specify, with regard to the total production of such goods made, or the total value of such services provided in India or any substantial part thereof during the relevant period.

Explanation IV: In determining the question as to whether an undertaking is or is not a dominant undertaking in relation to any goods supplied, distributed or controlled in India, regard shall be had to the average annual quantity of such goods supplied, distributed or controlled in India by the undertaking during the relevant period.

Explanation V: For the purposes of this clause, "relevant period" means the period of three calendar years immediately preceding that calendar year which immediately precedes the calendar year in which the question arises as to whether an undertaking is or is not a dominant undertaking.

Explanation VI: Where goods produced in India by an undertaking have been exported to a country outside India, then the goods so exported shall not be taken into account in computing for the purposes of this clause:

- The total goods that are produced in India by that undertaking;
- The total goods that are produced, supplied or distributed in India or any substantial part thereof.

10.2.3 Act not to Apply in Certain Cases

Unless the Central Government, by notification otherwise directs, this Act shall not apply to:

- Any undertaking owned or controlled by a Government company,
- Any undertaking owned or controlled by the Government,
- Any undertaking owned or controlled by a corporation (not being a company) established by or under any Central, Provincial or State Act,
- Any trade union or other association of workmen or employees formed for their own reasonable protection as such workmen or employees,
- Any undertaking engaged in an industry, the management of which has been taken over by any person or body of persons in pursuance of any authorisation made by the Central Government under any law for the time being in force,
- Any undertaking owned by a co-operative society formed and registered under any Central, Provincial or State Act relating to co-operative societies,
- Any financial institution.

Explanation: In determining, for the purposes of clause (c), whether or not any undertaking is owned or controlled by a corporation, the shares held by financial institutions shall not be taken into account.

10.2.4 Monopolistic Trade Practice to be Deemed to be Prejudicial to the Public Interest Except in Certain Cases

For the purposes of this Act, every monopolistic trade practice shall be deemed to be prejudicial to the public interest, except where:

- Such trade practice is expressly authorised by any enactment for the time being in force, or
- The Central Government, being satisfied that any such trade practice is necessary:
  - ❖ To meet the requirements of the defence of India or any part thereof, or for the security of the State; or
  - ❖ To ensure the maintenance of supply of goods and services essential to the community; or
  - ❖ To give effect to the terms of any agreement to which the Central Government is a party.

10.2.5 Provisions Relating to Monopolistic, Restrictive and Unfair Trade Practices

- Section 10 of the MRTP Act, 1969 empowers the MRTP Commission to enquire into monopolistic or restrictive trade practices upon a reference from the Central Government or upon its own knowledge or on information. The MRTP Act, 1969 also provides for appointment of a Director General of Investigation and Registration for making investigations for the purpose of enquiries by the MRTP Commission and for maintenance of register of agreements relating to restrictive trade practices.
- The MRTP Commission receives complaints both from registered consumer and trade associations and also from individuals either directly or through various Government Departments. Complaints regarding Restrictive Trade Practices or Unfair Trade Practices from an association are required to be referred to the Director General of Investigation and Registration for conducting preliminary investigation in terms of Sections 11 and 36C of the MRTP Act, 1969 and Regulation 119 of the MRTP Commission Regulations, 1974. The Commission can also order a preliminary investigation by the Director General of Investigation and Registration when a reference on a restrictive trade practice is received from the Central/State Government, or when Commission's own knowledge warrants a preliminary investigation. Enquiries are instituted by the Commission under relevant Sections of the MRTP Act, 1969 after the Director General of Investigation and Registration has completed the preliminary investigation and as a result of the findings, submits an application to the Commission for an enquiry.

10.3 SECURITIES EXCHANGE BOARD OF INDIA ACT

An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto.

SEBI is the Regulator for the Securities Market in India. The Securities and Exchange Board of India was established on April 12, 1992 in accordance with the provisions of the Securities and Exchange Board of India Act, 1992.

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as, ".....to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto."

10.3.1 SEBI Functions and Responsibilities

Chapter IV of the SEBI Act, 1992 deals with the powers and functions of the board. SEBI has to be responsive to the needs of three groups, which constitute the market:

- The issuers of securities
- The investors
- The market intermediaries

SEBI has three functions rolled into one body quasi-legislative, quasi-judicial and quasi-executive. It drafts regulations in its legislative capacity, it conducts investigation and enforcement action in its executive function and it passes rulings and orders in its judicial capacity. Though this makes it very powerful, there is an appeal process to create accountability. There is a Securities Appellate Tribunal which is a three member tribunal. A second appeal lies directly to the Supreme Court.

10.3.2 Guidelines

SEBI has enjoyed success as a regulator by pushing systemic reforms aggressively and successively.

Example: The quick movement towards making the markets electronic and paperless rolling settlement on T+2 basis. (trade date plus two days)

SEBI has been active in setting up the regulations as required under law.

Section 11 of the act lays down that it shall be the duty of the board to protect the interests of the investors in securities and to promote the development of and to regulate the securities markets by such measures as it thinks fit. These measures would include:

- Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities market in any manner.
- Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the board may, by notification, specify in the behalf.
- Registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds.
- Promoting and regulating self-regulatory organizations.
- Prohibiting fraudulent and unfair trade practices relating to securities markets.
- Promoting investors education and training of intermediaries of securities markets.
- Prohibiting insider trading in securities.
- Regulating substantial acquisition of shares and takeover of companies.
- Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organizations in the securities market.
- Performing such functions and exercising such powers under the provisions of the securities contracts Act, 1956, as may be delegated to it by the central government.
- Levying fees or other charges for carrying out the purposes of this section.
- Conduction research for the above purposes.
- Calling from or furnishing to any such agencies, as may be specified by the board, such information as may be considered necessary by it for the efficient discharge of its functions.
- Performing such other functions as may be prescribed.

For carrying out the duties assigned to it under the act, SEBI has been vested with the same powers as are available to a Civil Court under the code of civil procedure, 1908, for trying a suit in respect of the following matters:

The discovery and production of books of account and other documents at the place and time indicated by SEBI. Summoning and enforcing the attendance of persons and examining them on the place and time indicated by SEBI. Inspection of any books, registers and other documents of any person listed in section 12 of the act, namely stock brokers, sub brokers, share transfer agents, bankers to an issue, trustee of trust

deed, registrar to an issue, merchant bankers, underwriters, portfolio managers, registrar to an issue, investment advisors and other such intermediaries associated with securities markets.

10.3.3 Types of Exchanges

The exchanges in India can be divided into national, regional and local exchanges. A detailed explanation of each is as follows:

National Exchange

The National Stock Exchange of India Limited (NSE), is a Mumbai-based stock exchange. It is the second largest stock exchange in India in terms of daily turnover and number of trades, for both equities and derivative trading. Though a number of other exchanges exist, NSE and the Bombay Stock Exchange are the two most significant stock exchanges in India and are responsible for the vast majority of share transactions. The NSE's key index is the S&P CNX Nifty, known as the Nifty, an index of fifty major stocks weighted by market capitalisation.

NSE is mutually-owned by a set of leading financial institutions, banks, insurance companies and other financial intermediaries in India but its ownership and management operate as separate entities.

NSE is the third largest Stock Exchange in the world in terms of the number of trades in equities. It is the second fastest growing stock exchange in the world with a recorded growth of 16.6%.

NSE has remained in the forefront of modernization of India's capital and financial markets, and its pioneering efforts include:

- Being the first national, anonymous, electronic Limit Order Book (LOB) exchange to trade securities in India. Since the success of the NSE, existent market and new market structures have followed the "NSE" model.
- Setting up the first clearing corporation "National Securities Clearing Corporation Ltd." in India. NSCCL was a landmark in providing innovation on all spot equity market (and later derivatives market) in India.
- Co-promoting and setting up of National Securities Depository Limited, first depository in India.
- Setting up of S&P CNX Nifty.
- NSE pioneered commencement of Internet Trading in February 2000, which led to the wide popularization of the NSE in the broker community.
- Being the first exchange that started traded derivatives, particularly on an equity index, in India in 1996. After four years of policy and regulatory debate and formulation, the NSE was permitted to start trading equity derivatives
- Being the first and the only exchange to trade GOLD ETFs (exchange traded funds) in India.
- NSE has also launched the NSE-CNBC-TV18 media centre in association with CNBC-TV18.

Currently, NSE has the following major segments of the capital market:

- Equity
- Futures and Options
- Retail Debt Market

- Wholesale Debt Market
- Currency futures

It is the one of the most important stock exchanges in the world.

Regional Exchange

There are 23 stock exchanges in India. Among them two are national level stock exchanges namely Bombay Stock Exchange (BSE) and National Stock Exchange of India (NSE). The rest 21 are Regional Stock Exchanges (RSE).

List of Regional Stock Exchanges in India:

- Ahmedabad Stock Exchange
- Bangalore Stock Exchange
- Bhubaneshwar Stock Exchange
- Calcutta Stock Exchange
- Cochin Stock Exchange
- Coimbatore Stock Exchange
- Delhi Stock Exchange
- Guwahati Stock Exchange
- Hyderabad Stock Exchange
- Jaipur Stock Exchange
- Ludhiana Stock Exchange
- Madhya Pradesh Stock Exchange
- Madras Stock Exchange
- Magadh Stock Exchange
- Mangalore Stock Exchange
- Meerut Stock Exchange
- OTC Exchange of India
- Pune Stock Exchange
- Saurashtra Kutch Stock Exchange
- Uttar Pradesh Stock Exchange
- Vadodara Stock Exchange

The Regional Stock Exchanges started clustering from the year 1894, when the first RSE, the Ahmedabad Stock Exchange (ASE) was established. In the year 1908, the second in the series, Calcutta Stock Exchange (CSE) came into existence.

During the early sixties, there were only few recognized RSEs in India namely Calcutta, Madras, Ahmedabad, Delhi, Hyderabad and Indore. The number remained unchanged for the next two decades. 1980s was the turning point and many RSEs were incorporated. The latest is Coimbatore Stock Exchange and Meerut Stock Exchange.

A new share trading platform called the BSE Indonext, inaugurated recently, might at best provide a lifeline to regional stock exchanges. These have been fast losing business to the two principal stock exchanges, the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE). A more optimistic inference seems premature if recent stock exchange history is anything to go by. Until the mid-1990s

the regional stock exchanges were significant players in Indian capital market. Company law as well as capital market rules and regulations gave them a sizable captive business from companies located in their areas. A company going public had to have its shares listed in the regional stock exchange nearest to its place of incorporation and only optionally with the BSE. In case of oversubscription, it was the regional exchange that approved the allotment pattern. Companies having a large market capitalisation as well as a wide branch network chose to have their shares listed in many regional stock exchanges as well as in the BSE. A major reason for the survival of regional stock exchanges was seen in the slow pace of technological progress. Well into the 1990s, Indian stock exchanges in general were laggards in adopting communication technology that was transforming bourses in the U.S. and Europe. Regional exchanges could still conduct trade in isolation from one another and from the BSE. This had several undesirable consequences: illiquidity of stocks, possibilities of manipulation, and arbitrage were some of them.

A vastly expanded reach was one of the major benefits the new technology conferred on the stock exchanges. Significantly improved trading and settlement practices resulted. These advantages were dramatically demonstrated by the advent of the NSE; it came into being in November 1994 with a specific mandate to develop a better model than the existing exchanges. Adopting the state of the art in technology and stock exchange management skills — the NSE is the only exchange run wholly by professionals — the new exchange soon acquired pre-eminence. Investors in many centres, outside the metros and even in semi urban areas, could trade on the all-India exchange. Very soon the BSE followed suit with its own "BOLT" system. The marginalisation of the regional stock exchanges became complete. Many large corporates, not perceiving any benefit in sticking to a regional exchange, opted out. This process was facilitated by the changed rules. Simultaneously, as part of stock market reform in India, exchanges were required to professionalise their management and change their organisational structure from a "mutual" basis – essentially a club type format with stock brokers as the only members – to a "demutual" basis, a corporate form. That move has gathered momentum with the Government amending the relevant legislation.

Will the regional exchanges adapt to the requirements of technology and organisational restructuring and remain viable entities? Until recently many experts felt the regional exchanges would go the way of many smaller exchanges in the developed world. However, the advent of Indonext opens up many possibilities for survival by coming together and trading through a new platform specially designed for the stocks of small and medium companies. As a rule such stocks do not have liquidity. The hope is that the new platform will pool the resources of its 18 members and overcome the deficiencies of trading in illiquid stocks and small exchanges. There have been some tall claims of Indonext paving the way for a strong all-India exchange that would eventually be up in competition with the BSE and the NSE. A more realistic view is that the new platform will give regional exchanges a lease of life.

10.4 CUSTOMER AND CENTRAL EXCISE ACT

This is an Act to consolidate and amend the law relating to Central duties of excise.

Whereas it is expedient to consolidate and amend the law relating to Central Duties of Excise on goods manufactured or produced in (certain parts) of India.

10.4.1 Short Title, Extent and Commencement

- This Act may be called the Central Excise Act, 1944
- It extends to the whole of India.

- It shall come into force on (such date) as the Central Government may, by notification in the Official Gazette, appoint in this behalf.

10.4.2 Definitions

In this Act, unless there is anything repugnant in the subject or context:

- "Adjudicating authority" means any authority competent to pass any order or decision under this Act, but does not include the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963 (54 of 1963), [Commissioner of Central Excise (Appeals) or Appellate Tribunal]
  - "Appellate Tribunal" means the Customs, Excise and Gold (Control) Appellate Tribunal constituted under section 129 of the Customs Act, 1962 (52 of 1962)
  - "Broker" or "commission agent" means a person who in the ordinary course of business makes contracts for the sale or purchase of excisable goods for others.
- "Central Excise Officer" means the Chief Commissioner of Central Excise, Commissioner of Central Excise, Commissioner of Central Excise (Appeals), Additional Commissioner of Central Excise, Joint Commissioner of Central Excise, Deputy Commissioner of Central Excise, Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise or any other officer of the Central Excise Department or any person (including an officer of the State Government) invested by the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963 (54 of 1963) with any of the powers of a Central Excise Officer under this Act.
- "Curing" includes wilting, drying, fermenting and any process for rendering an unmanufactured product fit for marketing or manufacturing.
- "Excisable goods" means goods specified in the Schedule to the Central Excise Tariff Act, 1985 as being subject to a duty of excise and include salt.
- "Factory" means any premises, including the precincts thereof, wherein or in any part of which excisable goods other than salt are manufactured, or wherein or in any part of which any manufacturing process connected with the production of these goods is being carried on or is ordinarily carried on:
  - "Fund" means the Consumer Welfare Fund established under section 12C.
- "Manufacture" includes any process:
  - Incidental or ancillary to the completion of a manufactured product.
  - Which is specified in relation to any goods in the section or Chapter notes of the Schedule 1 to the Central Excise Tariff Act, 1985 as amounting to manufacture and the word "manufacturer" shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account.
- "Prescribed" means prescribed by rules made under this Act.
- "Sale" and "purchase", with their grammatical variations and cognate expressions, mean any transfer of the possession of goods by one person to another in the ordinary course of trade or business for cash or deferred payment or other valuable consideration.

- "Wholesale dealer" means a person who buys or sells excisable goods wholesale for the purpose of trade or manufacture, and includes a broker or commission agent who, in addition to making contracts for the sale or purchase of excisable goods for others, stocks such goods belonging to others as an agent for the purpose of sale.

10.5 CENTRAL AND STATE SALES TAX ACT

By the Constitutional (Sixth Amendment) Act 1956, certain amendments were made in the Constitution, whereby-- (a) taxes on sales or purchase of goods in the course of interstate trade or commerce were brought expressly within the purview of the legislative jurisdiction of Parliament, (b) restrictions could be imposed on the powers of State legislatures with respect to the levy of taxes on the sale or purchase of goods within the state where the goods are of special importance in inter-state trade commerce. To provide for the legislation authorized by the Constitution as amended by the said Amendment Act of 1956 the Central Sales Tax Bill was introduced in the Parliament.

10.5.1 Statement of Objects and Reasons

In the interest of the national economy of India, certain amendments were undertaken in the Constitution by the Constitutional (Sixth Amendment) Act'1956, whereby:

- Taxes on sales or purchases of goods in the course of interstate trade or commerce were brought expressly within the purview of the legislative jurisdiction of Parliament.
- Restrictions could be imposed on the powers of State legislatures with respect to the levy of taxes on the sale or purchase of goods within the state where the goods are of special importance in interstate trade or commerce.

The amendments at the same time authorized Parliament to formulate principles for determining when a sale or purchase takes place in the course of interstate trade or commerce or in the course of export or import or outside a state in order that the legislative spheres of parliament and the State legislatures become clearly demarcated. In the case of goods of special importance in interstate trade or commerce, a law of Parliament is to lay down the restrictions and conditions subject to which any State law may regulate the tax on sales or purchases of such goods in the state.

This Bill seeks to provide for the legislation authorised by the Constitution as amended above with a view to enabling the State Governments to raise additional revenues by levying tax on interstate transactions which are at present immune from tax under their respective sales tax laws. After taking into account the recommendations of the Taxation Enquiry Commission and in consultation with the States the Government of India were of the view that the following principles should govern the scheme of the detailed legislation on the three inter-related subjects:

- The Central Government should authorise the State Government to impose on behalf of the Central Government tax on the sale or purchase of goods in the course of interstate trade or commerce. The Central legislation should also delegate to the states the Central Government's power to levy and collect the tax and for this purpose prescribe the same system of registration, assessment, etc., as prevails in the States concerned under their own sales tax system.
- An important aspect of the Central legislation will be concerned with the definition of the locale of sales for the purpose of defining in detail the relative jurisdiction, firstly of the Union and the States, and secondly, of the State inter se. It is therefore, necessary that the law should define clearly, with specific reference

to sales tax the circumstances in which a sale or purchase becomes taxable by a particular state and no other. It should also define for the purpose of the Constitutional restrictions on the State's power to impose a tax under Item 54 of the State list, when a sale or purchase of goods may be said to take place:

- In the course of export out of India,
- In the course of import into India and
- In the course of inter-state trade or commerce.

- The Central legislation should provide for the declaration of certain commodities which are in the nature of raw materials and of special importance in inter-state trade or commerce and lay down the restrictions and conditions as to the rate, system of levy and other incidents of tax subject to which the States may impose tax on the sale or purchase thereof.

Necessary provisions have, therefore, been made in the different Chapters of this Bill incorporating the principles stated above.

10.5.2 List of Amendment Acts

- The Central Sales Tax (Amendment) Act, 1957 (16 of 1957)
- The Central Sales Tax (Amendment) Act, 1958 (5 of 1958)
- The Central Sales Tax (Second Amendment) Act, 1958 (31 of 1958)
- The Repealing and Amending Act, 1960 (58 of 1960)
- The Finance Act, 1961 (14 of 1961)
- The Central Sales Tax (Amendment) Act, 1963 (8 of 1963)
- The Finance Act, 1966 (13 of 1966)
- The Finance Act, 1968 (19 of 1968)
- The Central Sales Tax (Amendment) Act, 1969 (28 of 1969)
- The Central Sales Tax (Amendment) Act, 1972 (61 of 1972)
- The Finance Act, 1975 (25 of 1975)
- The Central Sales Tax (Amendment) Act, 1976 (103 of 1976)
- The Repealing and Amending Act, 1978 (58 of 1960)
- The Finance Act, 1988 (26 of 1988)
- The Finance Act, 1989 (13 of 1989)
- The Finance (No.2) Act, 1996 (33 of 1996)
- The Finance Act, 2000 (10 of 2000)
- The Finance Act, 2001 (14 of 2001)
- The Central Sales Tax (Amendment) Act, 2001 (41 of 2001)
- The Finance Act, 2002 (20 of 2002)
- The Finance Act, 2002 (32 of 2003)
- The Finance (No.2) Act, 2004 (23 of 2004)
- The Finance Act, 2005 (35 of 2005)
- The Central Sales Tax (Amendment) Act, 2006 (3 of 2006)

10.5.3 Short Title, Extent and Commencement

- This Act may be called the Central Sales Tax Act, 1956.
- It extends to the whole of India.
- It shall come into force on such date as the Central Government may, by notification if the Official Gazette, appoint, and different dates may be appointed for different provisions of this Act.

10.5.4 Definitions

In this Act, unless the context otherwise requires:

- "Appropriate State" means:
  - In relation to a dealer who has one or more places of business situated in the same State, that State;
  - In relation to a dealer who has 4 places of business situate in different States, every such State with respect to the place or places of business situate within its territory.
- "Business" includes:
  - Any trade, commerce or manufacture, or any adventure or concern in the nature of trade, commerce or manufacture, whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make gain or profit and whether or not any gain or profit accrues from such trade, commerce, manufacture, adventure or concern; and
  - Any transaction in connection with, or incidental or ancillary to, such trade, commerce, manufacture, adventure or concern.
- "Dealer" means any person who carries on (whether regularly or otherwise) the business of buying, selling, supplying or distributing goods, directly or indirectly, for cash, or for deferred payment, or for commission, remuneration or other valuable consideration, and includes:
  - A local authority, a body corporate, a company, any co-operative society or other society, club, firm, Hindu undivided family or other association of persons which carries on such business;
  - A factor, broker, commission agent, *del credere* agent, or any other mercantile agent, by whatever name called, and whether of the same description as herein before mentioned or not, who carries on the business of buying, selling, supplying or distributing goods belonging to any principal whether disclosed or not; and
  - An auctioneer who carries on the business of selling or auctioning goods belonging to any principal, whether disclosed or not and whether the offer of the intending purchaser is accepted by him or by the principal or a nominee of the principal.

Explanation-1: Every person who acts as an agent, in any State, of a dealer residing outside that State and buys, sells, supplies or distributes, goods in the State or acts on behalf of such dealer as:

- A mercantile agent as defined in the Sale of Goods Act, 1930, (3 of 1930) or
- An agent for handling of goods or documents of title relating to goods, or
- An agent for the collection or the payment of the sale price of goods or as a guarantor for such a collection or payment.

And every local branch or office in a State of a firm registered outside that State or a company or other body corporate, the principal office or headquarters whereof is outside that State, shall be deemed to be a dealer for the purposes of this Act.

Explanation-2: A Government which, whether or not in the course of business, buys, sells, supplies or distributes goods, directly or otherwise for cash or for deferred payment or for commission, remuneration or other valuable consideration, shall except in relation to any sale, supply or distribution of surplus, unserviceable or old stores or materials or waste products or obsolete or discarded machinery or parts or accessories thereof, be deemed to be a dealer for the purposes of this Act;

- "Declared goods" means goods declared under section 14 to be of special importance in inter-State trade or commerce;
- "Goods" includes all materials, articles, commodities and all other kinds of movable property, but does not include newspapers, actionable claims, stocks, shares and securities;
- "Place of business" includes:
  - In any case where a dealer carries on business through an agent (by whatever name called), the place of business of such agent;
  - A warehouse, godown, or other place where a dealer stores his goods; and
  - A place where a dealer keeps his books of account;
- "Prescribed" means prescribed by rules made under this Act;
- "Registered dealer" means a dealer who is registered under sec.7;
- "Sale" with its grammatical variations and cognate expressions, means any transfer of property in goods by one person to another for cash or for deferred payment or for any other valuable consideration, and includes:
  - A transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
  - A transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
  - A delivery of goods on hire-purchase or any system of payment by installments;
  - A transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
  - The supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;
  - A supply, by way of or as a part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration,
- "Sale price" means the amount payable to a dealer as consideration for the sale of any goods, less any sum allowed as cash discount according to the practice normally prevailing in the trade, but inclusive of any sum charged for anything done by the dealer in respect of the goods at the time of or before the delivery thereof other than the cost of freight or delivery or the cost of installation in cases where such cost is separately charged.
- "Turnover" used in relation to any dealer liable to tax under this Act means the aggregate of the sale prices received and receivable by him in respect of sales of

any goods in the course of inter-State trade or commerce made during any prescribed period and determined in accordance with the provisions of this Act and the rules made there under.

- "Year", in relation to a dealer, means the year applicable in relation to him under the general sales tax law of the appropriate State, and where there is no such year applicable, the financial year.

Check Your Progress

Fill in the blanks:

1. _____ means the Consumer Welfare Fund established under section 12C.
2. _____ means any person who carries on (whether regularly or otherwise) the business of buying, selling, supplying or distributing goods, directly or indirectly.
3. "Declared goods" means goods declared under _____ to be of special importance in inter-State trade or commerce.
4. The MRTP Act, 1969 has its genesis in the Directive Principles of State Policy embodied in the _____ of India.
5. "Director General" means the Director General of Investigation and Registration appointed under _____.
6. The Securities and Exchange Board of India was established on _____.

10.6 LET US SUM UP

- Every rule made by the Central Government under this Act shall be laid, as soon as may be after it is made, before each House of Parliament while it is in session for a total period of thirty days which may be comprised in one session or in two or more successive sessions and if before the expiry of the session immediately following the session or the successive sessions aforesaid] both houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.
- Intellectual Property (IP) reflects the idea that its subject matter is the product of the mind or the intellect. These could be in the form of Patents; Trademarks; Geographical Indications; Industrial Designs; Layout-Designs (Topographies) of Integrated Circuits; Plant Variety Protection and Copyright.

10.7 LESSON END ACTIVITY

Do you agree with the statement that the companies under MRTP Act are normally required to obtain the approval of the Government? If yes, give your viewpoints.

10.8 KEYWORDS

Intellectual Property: It is a number of distinct types of legal monopolies over creations of the mind, both artistic and commercial, and the corresponding fields of law.

Copyright: It is a form of intellectual property which gives the creator of original work exclusive rights for a certain time period in relation to that work, including its publication, distribution and adaptation; after which time the work is said to enter the public domain.

Patent Agents: Section 125 provides for a register of patent agents to be maintained by the controller. The register shall contain the names and addresses of all persons qualified to have their names entered under Section 126.

10.9 QUESTIONS FOR DISCUSSION

1. Describe restrictive trade practice act.
2. What do you mean by state sale tax act?
3. Define appropriate state.
4. What do you mean by central excise officer?
5. What are the provisions of MRTP Act?
6. Highlight some of the SEBI Functions and Responsibilities.
7. Discuss various types of exchanges in India.

Check Your Progress: Model Answer

1. Fund
2. Dealer
3. Section 14
4. Constitution
5. Section 8
6. April 12, 1992

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