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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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Business Law

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TABLE OF CONTENTS

1 The Law of Contract

NOTES

The Chapter Covers :

- Definition of Contract
- Requirements of A Contract
- Essential Elements of A Valid Contract
- Illegal Agreements
- Unlawful Agreements
- Types/Classification of Contract
- Offer
- Classification of Offer
- Offer And Invitation To Offer
- Revocation of Offer/ Proposal
- Rules of A Valid Acceptance
- Elements Vitiating Free Consent
- Discharge of Contract

INTRODUCTION

The law of contract is that branch of law which determines the circumstances in which promises made by the parties to a contract shall be legally binding on them. Its rules define the remedies that are available in a court of law against the person who fails to perform his contract, and the conditions under which the remedies are available. It is the most important branch of business law. It affects all of us in one way or the other.

The law of contract introduces definiteness in business transactions. In simple words, it may be said that the purpose of law of contract is to ensure the realization f reasonable expectation of the parties who enter into a contract.

NOTES

DEFINITION OF CONTRACT

'Contract' is the most usual method of defining the 'give and take' rights and duties in a business transaction. The main contract law in India is codified in the Indian Contract Act which came into effect on September 1, 1872 and extends to whole of India except the state of Jammu and Kashmir. All agreements are not studied under the Indian Contract Act, 1872, as some of those are not contracts. Only those agreements, which are enforceable by law, are contract.

According to Salmond, "An agreement creating and defining obligations between the parties is called a contract."

Section 2(h) of the Act defines the term contract as "an agreement enforceable by law". There are two essentials of this act, agreement and enforceability.

Agreement + enforceability by law = Contract.

Section 2(e) defines agreement as "every promise and every set of promises, forming the consideration for each other".

Section.2 (b), defines promise in these words: "When a 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."

Thus, an agreement is a promise or a set of reciprocal promises. A promise is the acceptance of a proposal. There must be an offer or a proposal which the person accepts and when he accepts he knows that the acceptance will give rise to a binding contract. A contract creates rights and obligations between the parties entering into a contract.

Requirements of a Contract:

1. **Two Parties:** For the formation of a contract, there must be two parties i.e. promisor and promisee. Under section 2(c),

   Promisor – The person who makes a proposal is called promisor.

   Promisee – The person whom the proposal is made is called promisee.

2. **An agreement:** An agreement implies an offer and its acceptance. When an offer is accepted, it becomes an agreement. If an agreement does not create any legal obligation, there cannot be any contract. Thus all agreements are not contracts but all contracts are must be an agreement. For Example, if Mr. A agrees to go to Mr. Y's house for a dinner, there is an agreement, but this is not a contract as it does not carry any legal obligation.

3. **Legal Obligation:** An obligation is the legal duty to do or abstain from doing something. Moral, religious or social obligations do not have any legal value. For the formation of any contract, an agreement should give rise to a legal obligation and the obligation must be enforceable by law.

Distinction Between an agreement and a contract:

Agreement	Contract
1. Every promise and every set of promises, forming consideration for each other is an agreement. Thus, Agreement = Offer + its acceptance.	1. An agreement enforceable by law is a contract. Thus, Contract = Agreement + its enforceability
2. An agreement is a wider concept than that of a contract.	2. A contract is a narrow concept.
3. It is not necessary that every agreement must create legal obligation.	3. Every contract necessarily creates a legal obligation.
4. An agreement cannot be a binding contract.	4. A contract is always binding on the concerned parties.

Essential Elements of a Valid Contract

According to Section 10, "All agreements are contracts, if they are made by the free consent of the parties, competent to contract, for a lawful consideration with a lawful object, and not hereby expressly to be void." The following essential elements must co-exist in order to make a valid contract:

1. Proper Offer and proper acceptance with the intention to create legal relationship,
2. Consideration – lawful consideration with a lawful object,
3. Capacity of parties to contract – competent parties,
4. Free consent,
5. An agreement must not be expressly declared to be void,
6. Writing and Registration if so required by law,
7. Legal relationship,
8. Certainty,
9. Possibility of performance,
10. Enforceable by law.

1. Offer and Acceptance with the intention to create legal relationship:

There must be two or more parties, to create a valid contract. One who makes the offer and the other who accepts the offer. One person cannot make an offer and accept it. There must be at least two persons. Also the offer must be clear and properly communicated to the other party. Similarly proper and unconditional acceptance must be communicated to the offerer. Proper offer and proper acceptance should be there to treat the agreement as a contract which is enforceable by law. The parties entering into a contract must have an intention to create a legal relationship. Generally, there is no intention to create a legal relationship in social and domestic agreements. Like, invitation for lunch does not create a legal relationship. Certain agreements and obligation between father and daughter, mother and

son and husband and wife does not create a legal relationship. An agreement wherein it is clearly mentioned that "This agreement is not intended to create formal or legal agreement and shall not be subject to legal jurisdiction in the law of courts." cannot be treated as a valid contract. The first step towards creating a valid contract is that one person shall signify or make a proposal or offer to the other, with a view to obtaining the acceptance of that another person to whom the offer is made. A proposal when accepted becomes a promise. There must be an agreement based on a lawful offer made by one person to another and lawful acceptance of that offer made by the latter. Section 3 to 9 of the contract act, 1872 lay down the rules for making valid acceptance.

2. Lawful Consideration

The second aspect to look for is the presence of "lawful consideration" which is an essential element of a valid contract. Consideration is, the price agreed to be paid by the promise for the obligation of the promisor. According to Section 2(d), Consideration is defined 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 abstain something, such an act or abstinence or promise is called consideration for the promise."

An agreement must be supported by a consideration of something in return. That is, the agreement must be supported by some type of service or goods in return of money or goods. However, it is not necessary the price should be always in terms of money. It could be a service or other things. In short, Consideration means quid pro quo i.e. something in return. It must result in benefit to one party and detriment to the other party or a detriment to both. It can be cash, kind, an act or abstinence. It can be past, present or future. However, consideration should be real and lawful. An agreement to form a valid contract should be supported by consideration. Consideration is the cause of the promise. It is the most essential element of the contract. As a general rule, agreement without consideration is void.

For Example, A agrees to sell his house to B for Rs 50,000. Here A's promise to sell his house is for B's consideration to pay Rs 50,000. Similarly B's promise to pay Rs 50,000 is for A's consideration to sell his house to B.

The consideration or object of an agreements is unlawful if —

(1) it is forbidden by law,

(2) it is of such a nature that, if permitted it would defeat the provisions of any laws,

(3) it is fraudulent,

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

(5) the court regards it as immoral or opposed to public policy.

In each of these cases, the consideration or object of an agreement is said to be unlawful. The objective of the agreement must be lawful. Any act prohibited by law will not be valid and such agreements cannot be treated as a valid contract. Therefore the consideration as well as the object of the agreement should be lawful.

3. Capacity of parties to contract – Competent parties:

Parties entering into an agreement must be competent and capable of entering into a contract. If "A" agrees to sell a Government property to B and B agrees to buy that property, it could not treated as a valid agreement as A is not authorized or owner of the property. If any of the party is not competent or capable of entering into the agreement, that agreement cannot be treated as a valid contract. **Section** 11 of The Indian Contract Act specifies that every person is competent to contract provided:

1. He should not be a minor i.e. an individual who has not attained the age of majority i.e. 18 years.
2. He should be of sound mind while making a contract. A person with unsound mind cannot make a contract.
3. He is not a person who has been personally disqualified by law.

In other words, (a) a minor, (b) a person of sound mind, and (c) a person disqualified from contracting by any law to which he is subject, e.g. foreign sovereigns, accredited representatives of foreign state, insolvents, etc are not competent to contract.

Minors – According to Section 3 of the Indian Minoriry Act,1875, a person who has not completed his 18^{th} year of age is considered to be minor in the eyes of law. An agreement with the minor is absolutely void –ab- intio. However, in the following two cases, a minor attains majority after 21 years of age:

1) Where a guardian of minor's person or property has been appointed under the Guardian and Wards Act, 1890, or
2) Where the superintendence of minor's property is assumed by a Court of Wards.

4. Free Consent:

According to section 14, consent is said to be free when it is not caused by (i) coercion, (ii) undue influence (iii) fraud, (iv) misrepresentation, or (v) mistake. If the contract made by any of the above four reason, at the option of the aggrieved party it could be treated as a void contract. In such cases, the contract becomes voidable at the option of the party whose consent is not free. An agreement can be treated as a valid contract when the consent of the parties are free and not under any undue influence, fear or pressure etc. The consent of the parties must be genuine and free consent. Parties to a contract must give their consent. The term 'consent' means the parties must agree upon the same thing in the same sense i.e. there should be consensus-ad-idem. Hence, two or more persons are said to consent when they agree upon the same thing in the same sense.

For Example, 'A' threatened to shoot 'B' if he (B) does not lend him Rs. 5000 and B agreed to it. Here the agreement is entered into under coercion and hence voidable at the option of B.

5. Agreement not expressly declared void:

The agreement must not be one, which the law declares to be either illegal or void. A void agreement is one, which is without any legal effects. Section 24 to 30

NOTES

specifies certain types of agreement which have been expressly declared void. For example, an agreement in restraint of marriage has been expressly declared void under Section 26. If John promises to pay 10, 000 to Mary if she does not marry throughout her life and Mary promises not to marry at all. But this agreement cannot be treated as a valid contract owing to the fact that, under section 26 restraint of marriage expressly declared void. Some of the agreements which have been expressly declared void are agreement in restraint of legal proceedings, agreement in restraint of trade, agreement in restraint of marriage and agreement by way of wager. A void agreement is not enforceable by law [Sec 2(g)]. It does not give rise to any rights and obligations. Various agreements are expressly declared void under the Act.

6. Writing and registration:

The contract act does not insist that the agreement must be in writing, it could be oral. No particular form of writing is required to constitute a contract. Intentions of the parties to enter into a particular contract must be manifest in it, in order to constitute a valid contract. But, in some cases the law strictly insists that the agreement must be in writing like agreement to sell immovable property must be in writing and should be registered under the Transfer of Property Act, 1882. Documents specified under section 17 of the Indian Registration Act, 1908, are required to be registered. These agreement are valid only when they fulfill the formalities like writing, registration. If these legal formalities are not completed, it cannot be treated as a valid contract.

7. Legal relationship:

Agreements which create legal relations or are capable of creating legal relations are contracts, for example, an invitation to a dinner does not create any legal relation and therefore is not a contract.

8. Certainty:

The terms of a contract should be clear. In other words, the contract must not be vague. Wording of the agreement must be clear and not uncertain or vague. For Example, Ravi agrees to sell 500 tons of oil to Manoj, but what kind of oil is not mentioned clearly. So on the ground of uncertainry, this agreement stands void. If the meaning of the agreement can be made certain by the circumstances, it could be treated as a valid contract. For example, if Ravi and Manoj are sole trader of coconut oil, the meaning of the agreement can be made certain by the circumstance and in that case, the agreement can be treated as a valid contract.

9. Possibility of performance:

Contracts based on impossibility of performance are not valid. The contracts must be capable of being performed. As per section 56, if the act is impossible of performance, physically or legally, the agreement cannot be enforced by law. There must be possibility of performance of the agreement. Impossible agreements like one claim to run at a speed of 1000km/hour or Jump to a height of 100feet etc. would not create a valid agreement. All such acts which are impossible of performance would not create a valid contract and cannot be treated as a valid contract. In essence, there must be possibility of performance to create a valid contract.

10. Enforceable by Law:

Check Your Progress

1. Define Contract?
2. What is Free Consent?
3. Explain Offer?

A contract in order to be valid must be enforceable by law. If an agreement is enforceable by law it is contract otherwise it is an agreement. The aggrieved party should be able to obtain relief through law in the event of breach of contract.

Most important essential elements of a valid contract are mentioned above. These elements should be present in a contract to make it a valid contract. If any one of them is missing we cannot treat that agreement as a valid contract.

Void Agreement in Contract Act:

The agreements which are not enforceable by law are said to be void [section2 (g)] such agreements do not give rise to any legal consequences. All agreements which are opposed to public policy are void. Following agreements have been expressly declared to be void by the Contract Act:

1. Agreements by incompetent parties [section 11].
2. Agreements made under mutual mistake [section 20].
3. Agreement, the consideration of which is unlawful [section 23].
4. Agreements entered into without any consideration [section 25].
5. Every agreement in restraint of the marriage of any person, [Section26].
6. Every agreement, made in restrained of trade, business, and occupation [section 27].
7. Every agreement in restraint of legal proceedings [section28].
8. Agreements the meaning of which is not certain [section 29].
9. Wagering Agreements [section 30].
10. Agreements contingent on impossible events [section 36].
11. Agreements to do an act impossible in itself [section 56].

Illegal Agreements:

An illegal agreement is one which is against the law enforceable in India. All illegal agreements are void but all void agreements are not necessarily illegal. For Example: an agreement entered into with a minor is void but not illegal.

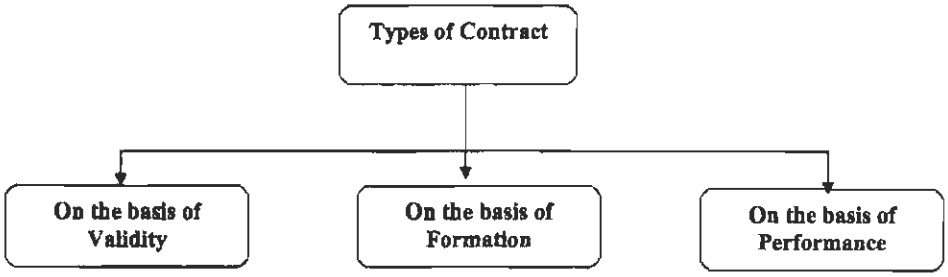
Unlawful Agreements:

An unlawful agreement is not enforceable by law. Every illegal agreement is unlawful but every unlawful agreement may not be necessarily illegal.

Difference between Void and Illegal Agreements:

Basis of Difference	Void Agreement	Illegal Agreement
1. Meaning	Void agreement is an agreement which cannot be enforced by law. by law or against the public policy	An illegal agreement is an agreement which is against or criminal in nature.
2. Scope	All void agreements are not illegal.	All illegal agreements are void.
3. Time of becoming Void	Void agreements may be void since beginning.	An illegal agreement is Void-ab-initio.
4. Punishment	There is no punishments to the parties.	Illegal agreements are punishable as provided by law

Types/Classification of Contract:



1. On the basis of Validity:

1. **Valid contract:** An agreement which has all the essential elements of a valid contract is called a valid contract. A valid contract can be enforced by law.
2. **Void contract:** According to Section 2(j) "a void contract is a contract which ceases to be enforceable by law". It is a contract without any legal effect and cannot be enforced in a Court of Law.
3. **Voidable contract:** According to Section 2(i) "An agreement which is enforceable by law at the option of one or more the parties thereto, but not at the option of the other or others, is a voidable contract." If the essential element of free consent is missing in a contract, the law confers right on the aggrieved party either to reject the contract or to accept it.
4. **Illegal contract:** The word 'illegal' means contrary to law and the term contract refers to an agreement which is enforceable by law. It is a contract which the law forbids to be made. For Example, Contract to commit crime. These contracts are immoral or opposed to public policy.
5. **Unenforceable contract:** Certain contracts cannot be enforced in a court of law because of some technical defects like absence in writing, barred by limitation, registration etc. Such contracts are called unenforceable contract. These contracts are neither void nor voidable.

2. On the basis of Formation:

1. **Express contract:** The terms of the contract are expressed in words (written or spoken) at the time of formation, the contract is said to be express contract. Section 9 of the act says that when the proposal or acceptance of any promise is made in words, the promise is said to be express.
2. **Implied contract:** An implied contract is one which is inferred from the acts or conduct of the parties or from the circumstances of the cases. Where a proposal or acceptance is made otherwise than in words, promise is said to be implied. For Example, A delivers goods by mistake at B's warehouse instead of at C's place. Here there is an obligation on the part of B to return the goods to A, though they never intended to enter into the contract.
3. **Tacit contract:** A contract is said to be tacit when it has to be inferred from the conduct of the parties. Examples obtaining cash through automatic teller machine, sale by fall of hammer at an auction sale.

4. **Quasi contract:** A quasi contract is created by law. Quasi contracts are strictly not contracts as there is no intention of parties to enter into a contract. It is a legal obligation which is imposed on a party who is required to perform it. A quasi contract is based on the principle that a person shall not be allowed to enrich himself at the expense of another. For Example: Mr. A is a businessman, forgot some articles at Mr. B's residence. Mr. B utilized those articles. Here Mr. B must pay to Mr. A for the articles he utilized.

3. On the basis of Performance:

1. **Executed contract:** An executed contract is one in which both the parties have performed their respective obligation.
2. **Executory contract:** An executory contract is one where one or both the parties to the contract have still to perform their obligations in future. Thus, a contract which is partially performed or wholly unperformed is termed as executory contract.
3. **Unilateral contract:** A unilateral contract is a one-sided contract in which only one party has to perform his obligation.
4. **Bilateral contract:** A bilateral contract is one in which the obligation on both the parties to the contract is outstanding at the time of the formation of the contract.

OFFER

Offer or proposal is defined under section 2(a) of the Indian contract Act, 1872 as "when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal/offer". Thus, for a valid offer, the party making it must express his willingness to do or not to do something. But mere expression of willingness does not constitute an offer. An offer should be made to obtain the assent of the other. For Example, 'A' tells to 'B' that he desires to marry at the end of this month; it does not constitute an offer of marriage by A to B. If in the above example, 'A' further adds, 'Will you marry me', it will constitute an offer. Therefore, to constitute a valid offer expression of willingness must be made to obtain the assent of the other.

Rules of Valid Offer:

The Indian Contract Act, 1872 contains certain legal rules regarding offers which are as under:

1. Terms of an offer must be clear, specific or definite.
2. An offer must create legal relationship.
3. An offer must be communicated to the person to whom it is made.
4. An offer must be made with a view to obtaining the consent of the offeree.

NOTES

5. An offer may be express or implied, general or specific.
6. An offer must be distinguished from an invitation offer.

Classification of Offer

1. **General Offer:** It is an offer made to the public in general hence anyone can accept and do the desired act.
2. **Special Offer:** When offer is made to a definite person, it is known as specific offer and such offer can be accepted only by that specified person.
3. **Cross Offer:** When two parties exchange of identical offers in ignorance at the time of each other's offer, the offers are called Cross offers.
4. **Counter Offer:** When the offeree offers to qualified acceptance of the offer subject to modifications and variations in terms of original offer, he is said to have made a counter offer. Counter offer amounts to rejection of the original offer.
5. **Standing, Open or Continuing Offer:** When an offer is allowed to remain open for acceptance over a period of time is known as a standing, open or continuing offer.

Offer and Invitation to offer

An offer should be distinguished from an invitation to offer. An offer is definite and capable of converting an intention into a contract. Whereas an invitation to an offer is only a circulation of an offer, it is an attempt to induce offers and precedes a definite offer. Acceptance of an invitation to an offer does not result contract and only an offer emerges in the process of negotiation.

Revocation of Offer/ Proposal:

A proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards. An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

A proposal is revoked -

(1) by the communication of notice of revocation by the proposer to the other party;

(2) by the lapse of the time prescribed in such proposal for its acceptance, or, if no time is so prescribed, by the lapse of a reasonable time, without communication of the acceptance;

(3) by the failure of the acceptor to fulfill a condition precedent to acceptance; or

(4) by the death or insanity of the proposer, if the fact of the death or insanity comes to the knowledge of the acceptor before acceptance.

Acceptance

When an offeree agrees to an offer, it is said to be his acceptance. According to Section 2(b), "When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted."

Rules of a Valid Acceptance:

1. Acceptance must be absolute and unqualified.
2. Acceptance must be communicated to the offeror.
3. Acceptance must be in the prescribed mode.
4. Acceptance must be given within a reasonable time before the offer lapses.
5. Acceptance by the way of conduct.
6. Mere silence is no acceptance.

Free Consent: Consent is an essential element of a contract. According to Section 13, "two or more persons are said to be consented when they agree apon the same thing in the same sense (*Consensus-ad-idem*). Consent is said to be free when it not caused by:

a) Coercion, as defined in Section15, or

b) Undue influence, as defined in Section 16, or

c) Fraud, as defined in Section 17, or

d) Misrepresentation, as defined in Section 18, or

e) Mistake.

Elements vitiating free Consent:

1. **Coercion (Section 15):** "Coercion" is the committing, or threatening to commit, any act forbidden by the Indian Penal Code, or 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.

   For Example: A says to B, "I will kill your son, unless you agree to sell your house to me for Rs. 10,000." B says, "All right, I will sell my house to you for Rs.10,000: do not kill my son". Here A has employed coercion; he cannot therefore enforce the contract. But B can enforce the contract if he finds the contract to his benefit. An agreement induced by coercion is voidable and not void.

2. **Undue influence (Section 16):** 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 other and uses that position to obtain an unfair advantage of the other. For Example: A father, by reason of his authority over the son can dominate the will of the son.

NOTES

3. **Fraud (Section 17):** According to the Section 17 of the Indian Contract Act, "Fraud" means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto of his agent, or to induce him to enter into the contract:

   - The suggestion, as a fact, of that which is not true, by one who does not believe it to be true,
   - The active concealment of a fact by one having knowledge or belief of fact,
   - A promise made without any intention of performing it,
   - Any other act fitted to deceive,
   - Any such act or omission as the law specially declared to be fraudulent.

4. **Misrepresentation (Section 18):** According to the Section 18 of the Indian Contract Act, when a person asserts something which is not true, though he believes to be true, his assertion amounts to misrepresentation. Misrepresentation may be either innocent or without reasonable ground. In other words, misrepresentation is the misstatement of facts by one, which misleads the other who, consequently, avoids the contract.

5. **Mistake (Section 20):** When both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void. For Example, A agrees to sell a cow to B. It is subsequently revealed that cow was dead at the time of bargaining and no one was aware of this fact, the agreement is void. Both the parties must be under mistake.

Distinction between Coercion and Undue influence:

Coercion	Undue influence
1. Coercion is defined under section 15.	1. Undue influence is defined under section 16.
2. It involves the physical force or threat.	2. It involves moral or mental pressure.
3. It involves committing or threatening to commit an act forbidden by Indian.	3. No such illegal act is committed or a threat is given. Penal Code.
4. It is not necessary that there must be some sort of relationship between the parties.	4. Some sort of relationship between the parties is absolutely necessary.
5. The contract is voidable at the option of the party whose consent has been obtained by the coercion.	5. Where the consent is induced by undue-influence, the contract is either voidable or the court may set it aside.

Distinction between Fraud and Misrepresentation:

Fraud	Misrepresentation
1. Fraud is defined under section 17.	1. Misrepresentation is defined under section18.
2. Fraud means misrepresentation of facts with in intention to deceive.	2. Misrepresentation means misstatement is made without an intention to deceive.
3. The person making misstatement does nor believe it to be true.	3. The person making misstatement believe it to be true.

Discharge of Contract:

A contract is said to be discharged, terminated or dissolved when the rights and obligations created by a contract come to an end. In other words, discharge of contract means termination of the relationship between the parties to a contract. A contract may be discharged any of the following ways:

1. By performance,
2. By mutual agreement,
3. By lapse of time,
4. By operation of law,
5. By breach of contract,
6. By impossibility of the contract,
7. By material alteration without the consent of the concerned party.

1. Discharge by performance:

When parties to a contract fulfill their obligations arising under the contract within the specified time and in the manner prescribed, the contract is said to have been performed and discharged. Discharge by performance may be (1) actual performance or (2) attempted performance. Actual performance is said to have taken place, when each of the parties has done what he had agreed to do under the agreement. On the other hand, when the promisor offers to perform his obligation, but the promisee refuses to accept the performance, it amounts to attempted performance.

2. Discharge by mutual agreement:

Since a contract is created by an agreement, it can be discharged also by an agreement. The parties may at any time before or during the performance of the contract discharge by agreement. Such agreements may be express as well as implied. It can be done in any of the following ways:

a) By novation [sec 62]

b) By rescission [sec 62]

c) By alteration [Sec62]

d) By remission [sec 63]

e) By waiver

f) By merger

g) By owing to the occurrence of an event.

a) **Discharge of contract by novation:** Novation of contract means a substitution of a new contract in place of old existing contract. It may be

Check Your Progress

4. Define Quantum Merit?
5. Define Discharge of Contract by Operation of Law?

NOTES

between the same parties or different parties. The novation should take place before the expiry of the time or the performance of the original contract.

b) **Discharge of Contract by rescission:** The term 'rescission' means cancellation of the contract. It takes place when the parties of the contract mutually agree to cancel all or some of the terms of the existing contract. Rescission may be total or partial and express or implied. The rescission of contract may take place in one of the following ways:

- When the party whose consent is obtained either by fraud or coercion.
- When any one party of the contract fails to perform his obligation, other party may rescind the contract.
- By the mutual consent of the parties.

c) **Discharge of Contract by alteration:** When the parties of the contract agree to change one or more terms of the contract, it is called alteration of the contract.

There are some difference between the novation and alteration of the contract. In alteration, there may be a change in one or more terms of the contract but the parties remain same. On the other hand, in novation, there may be change of parties also.

d) **Discharge of Contract by remission:** The term 'remission' refers to the acceptance a lesser performance than due. According to Section 63, "Every promise may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend to the time for such performance, or may accept instead of it any satisfaction which he thinks fit."

e) **Discharge of Contract by Waiver:** The term 'waiver' implies that the deliberate abandonment of a right by a party to a contact. Sometimes, the parties of a contract decide that they shall not be bound any longer by the contract.

f) **Discharge of Contract by merger:** In merger, an inferior right accruing to one of the parties of the contract merges to a superior right accruing to the same party. For Example: A holds a house under a lease. Then, he buys the same; he becomes the owner of the house. Hence his rights as a lease merge into his rights as an owner.

g) **Discharge of Contract by owing to the occurrence of an event:** If both the parties agreed that on the happening of a particular event, all rights and liabilities should cease and if that event occurs, the contract is discharged.

3. **Discharge of Contract by lapse of time:**

A contract should be performed within a specified period or within a reasonable time. If the period of time is lapsed the contract is terminated or dis-

charged and the right to bring an action to enforce the contract is barred under the limitation act.

4. **Discharge of Contract by operation of law:**

NOTES

The term "discharge of contract by operation of law" means that the law discharges the contract under certain circumstances like death, insolvency, merger, complete loss of evidence, etc.

5. **Discharge of Contract by Breach of Contract:**

If one party does not fulfil his contractual promise, or has given information to the other party that he will not perform his duty as mentioned in the contract, he is said to breach the contract. Breach of contract may be actual breach of contract or the anticipatory breach of contract.

- **Actual Breach:** When a party fails or neglect or refuse to perform his obligation at the time when the performance of the contract is due or during the performance, it is known as actual breach of contract. In actual breach, the aggrieved party can treat the contract as discharged and can sue for damages.
- **Anticipatory Breech:** When the promisor refuses to perform his promise and signifies his unwillingness before the due date of its performance, it is called anticipatory breech of contract.

6. **Discharge of Contract by Impossibility of the contract:**

Section 56 of the act recognizes very important principle regarding initial impossibility "An agreement to do an impossible act in itself is void." For Example, if A agrees with B to bring star for Rs.1 lac is void-ab-intio.

Impossibility of performance of a contract may be one of the following types:

a) **Initial Impossibility:** When impossibility of performance arises at the time of formation of the agreement, it is called initial impossibility.

b) **Supervening Impossibility:** Supervening impossibility arises subsequent to the formation of the contract. A contract is discharged by supervening impossibility in the following cases:

   i. Destruction of subject matter,

   ii. Death,

   iii. Non-existence of a particular state of things,

   iv. Non-occurrence of particular state of things,

   v. Change of law,

   vi. Out-break of war.

7. **Discharge of Contract by material alteration:**

When promisee intentionally makes any material alteration in a written contract without the consent of the promisor, the promisor is allowed to discharge

NOTES

the contract. Thus, if any alteration is made, the contract is discharged and cannot be enforced.

Remedies for Breach of Contract:

The remedies available for the aggrieved party, in case of breach of contract by the other party are:-

- **Suit for rescission of the contract:** Rescission is the revocation of a contract. When a contract is broken by one party, the other party may treat the contract as rescinded. In such a case, the aggrieved party is absolved of all its obligations under the contract and is entitled to compensation for any damages that he might have suffered.
- **Suit for damages:** Damage is the monetary compensation allowed by the court to the aggrieved party for the loss or injury suffered by him as the result of breach by the other party. Principles of Damages:
    a) Damages can be claimed only when the aggrieved party has suffered some loss by breach of contract.
    b) Damages can be claimed only from the party who is liable for breach of contract.
    c) Damages can be claimed only for the losses which have arisen naturally in the course of breach of contract.
    d) No damages can be claimed for for a remote or indirect losses.
- **Suit for injunction:** An injunction is an order of the court requiring a person to refrain from doing some act which has been the subject matter of contract. The power to grant injunction is discretionary and it may be granted temporarily or for an indefinite period.
- **Suit upon 'Quantum Meruit':** The term "quantum meruit" means, 'as much as is merited' or 'as much as earned' or 'according to the quantity of work done'. When a person has begun the work and before he could complete it, the other party terminates the contact or does something which make it impossible for the other party to complete the contract, he can claim for the work done under the contract. In other words, a suit of quantum meruit is a claim for the value of the work done under a contract that has become void on account of breach by the other party.

Examples

(1) 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 not there. Or A is there but refuses to entertain B. B has no remedy against A. In case A is present in the restaurant but B fails to turn-up, then A has no remedy against B.

(2) A gives a promise to his son to give him a pocket allowance of Rupees one hundred every month. In case A fails or refuses to give his son the promised amount, his son has no remedy against A.

In the above examples promises are not enforceable at law as there was no intention to create legal obligations. Such agreements are social agreements which do not give rise to legal consequences. This shows that an agreement is a broader term than a contract. And, therefore, a contract is an agreement but an agreement is not necessarily a contract.

What obligations are contractual in nature? We have seen above that the law of contracts is not the whole law of agreements. Similarly, all legal obligations are not contractual in nature. A legal obligation having its source in an agreement only will give rise to a contract.

Example

A agrees to sell his motor bicycle to B for Rs. 5,000. The agreement gives rise to a legal obligation on the part of A to deliver the motor bicycle to B and on the part of B to pay Rs. 5,000 to A. The agreement is a contract. If A does not deliver the motor bicycle, 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 motor bicycle and B refuses to make the payment of price, A can go to the court of law and file a suit against B for non-performance of promise.

Similarly, agreements to do an unlawful, immoral or illegal act, for example, smuggling or murdering a person, cannot be enforceable at law. Besides, certain agreements have been specifically declared void or unenforceable under the Indian Contract Act. For instance, an agreement to bet (Wagering agreement) (S. 30), an agreement in restraint of trade (S. 27), an agreement to do an impossible act (S. 56)

CASE STUDY:

The law of Contract

The rules in Rajeev vs. Rahul:

The law is concerned with the objective appearance of the agreement, as well as the actual fact, of agreement.

If Rajeev makes an offer to Rahul and Rahul says that he accepts the offer, but secretly he doesn't intend to accept the offer, there is in fact not an agreement. However, to an outside person there would appear to be an agreement. In other words objectively there appears to be an agreement between Rajeev and Rahul. In such a case the court would say that there was an agreement between Rajeev and Rahul.

NOTES

SUMMARY

- The law of contract is that branch of law which determines the circumstances in which promises made by the parties to a contract shall be legally binding on them.
- The purpose of law of contract is to ensure the realization f reasonable expectation of the parties who enter into a contract.
- agreements, which are enforceable by law, are contract.
- an agreement is a promise or a set of reciprocal promises. A promise is the acceptance of a proposal.
- Requirements of a Contract: There must be two parties i.e. promisor and promise, An agreement, Legal Obligation.
- Essential Elements of a Valid Contract: Proper Offer and proper acceptance with the intention to create legal relationship, Consideration – lawful consideration with a lawful object, Capacity of parties to contract – competent parties, Free consent, An agreement must not be expressly declared to be void, Writing and Registration if so required by law, Legal relationship, Certainty, Possibility of performance, Enforceable by law.
- Consideration means quid pro quo i.e. something in return.
- A person who has not completed his 18th year of age is considered to be minor in the eyes of law.
- Consent is said to be free when it is not caused by (i) coercion, (ii) undue influence (iii) fraud, (iv) misrepresentation, or (v) mistake.
- The term 'consent' means the parties must agree upon the same thing in the same sense i.e. there should be consensus-ad-idem.
- A void agreement is one, which is without any legal effects.
- The agreements which are not enforceable by law are said to be void [section2 (g)] such agreements do not give rise to any legal consequences.
- An illegal agreement is one which is against the law enforceable in India. All illegal agreements are void but all void agreements are not necessarily illegal.
- An unlawful agreement is not enforceable by law. Every illegal agreement is unlawful but every unlawful agreement may not be necessarily illegal.
- An agreement which has all the essential elements of a valid contract is called a valid contract.
- A void contract is a contract which ceases to be enforceable by law"
- According to Section 2(i) "An agreement which is enforceable by law at the option of one or more the parties thereto, but not at the option of the other or others, is a voidable contract."

- A contract is said to be tacit when it has to be inferred from the conduct of the parties.
- A quasi contract is created by law. Quasi contracts are strictly not contracts as there is no intention of parties to enter into a contract. It is a legal obligation which is imposed on a party who is required to perform it.
- Offer or proposal is defined under section 2(a) of the Indian contract Act, 1872 as "when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal/offer".
- When an offeree agrees to an offer, it is said to be his acceptance. According to Section 2(b), "When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted."
- A contract is said to be discharged, terminated or dissolved when the rights and obligations created by a contract come to an end.
- A contract may be discharged any of the following ways:
  1. By performance,
  2. By mutual agreement,
  3. By lapse of time,
  4. By operation of law,
  5. By breach of contract,
  6. By impossibility of the contract,
  7. By material alteration without the consent of the concerned party.
- Remedies for Breach of Contract: Suit for rescission of the contract, Suit for damages, Suit for injunction, Suit upon 'Quantum Meruit', Suit for specific performance.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. "An agreement creating and defining obligations between the parties is called a contract."

   Agreement + enforceability by law = Contract.
2. consent is said to be free when it is not caused by (i) coercion, (ii) undue influence (iii) fraud, (iv) misrepresentation, or (v) mistake.
3. "When one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal/offer".
4. The term "quantum meruit" means, 'as much as is merited' or 'as much as earned' or 'according to the quantity of work done'.
5. "Discharge of contract by operation of law" means that the law discharges the contract under certain circumstances like death, insolvency, merger, complete loss of evidence, etc.

NOTES

TEST YOURSELF

1) Define Contract. What are the requirements of a Contract?
2) What are the essential elements of a Valid Contract?
3) What are the Void Agreements in Contract Act? What is the difference between void and illegal agreements?
4) Explain various types of Contract.
5) Discuss elements vitiating free Consent.
6) How contract is discharged?
7) What are the remedies for the breach of contract?

FURTHER READING

- *Mercantile Law: Sharma, Sareen, Gupta and Chawla*

NOTES

2 The sale of goods act 1930

The Chapter Covers :

- Introduction
- Contract of Sale
- Distinction Between 'Sale' And 'Agreement To Sell'
- Documents of Title To Goods
- Conditions And Warranties
- When Condition To Be Treated As Warranty [Section 13]
- Express And Implied Conditions And Warranties
- Doctrine of Caveat Emptor:
- Transfer of Property:
- Transfer of Title By Non-owners [Sections 27-30]
- Duties of The Seller And Buyer
- Rights of The Buyer:
- Sale By Auction (Section 64):

INTRODUCTION

The law relating to the sale of goods is codified in the Sale of Goods Act, 1930. It defines sale and agreement to sell as a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. According to the provisions of this act, a contract of sale is made by an offer to buy or sell the goods for a price and the acceptance of such offer. The provisions made in this Act are for existing or future goods, perishable goods, ascertainment of price, conditions and warranties, effects of the contract, delivery to career, duties of seller and buyer, buyer's right of examining the goods, liability of buyer for neglecting or refusing the delivery of goods, rights of unpaid seller, suits for breach of the contract, sale, etc.

Sale of Goods Act is one of very old mercantile law. Sale of Goods is one of the special types of Contract. Initially, this was part of Indian Contract Act itself in chapter VII (sections 76 to 123). Later these sections in Contract Act were deleted, and

NOTES

separate Sale of Goods Act was passed in 1930. The Sale of Goods Act is complimentary to Contract Act. Basic provisions of Contract Act apply to contract of Sale of Goods also. Basic requirements of contract i.e. offer and acceptance, legally enforceable agreement, mutual consent, parties competent to contract; free consent, lawful object, consideration etc. apply to contract of Sale of Goods also. A contract of sale may be made in writing or by word of mouth, or partly in writing and partly by word of mouth or may be implied from the conduct of the parties [Section 5(2)]. Thus, credit sale is also a 'sale'. A verbal contract or contract by conduct of parties is valid, e.g. putting goods in basket in super market or taking food in a hotel.

The Sale of Goods Act deals with the 'sale' but not with 'mortgage' or 'pledge', which comes within the purview of Transfer of Property Act and the Indian Contract Act, respectively. Secondly the Act deals with 'goods' but not with all movable property, for example, actionable claims and money. Provisions relating to sale of immovable property and the transfer of actionable claims are contained in the Transfer of Property Act, 1882.

CONTRACT OF SALE

Contract of Sale of Goods is a contract between buyer and seller intending to exchange property in goods for a price. Section 4(1) of the Sale of Goods Act, 1930 defines the term 'Contract of sale' as- a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.

The definition as above reveals important elements of transfer of ownership for a price. Here, there are two parties to a contract who are willing to exchange their goods or services to gain a mutual benefit called price. A contract of sale may be absolute or conditional [Section 4(2)].The term 'contract of sale' is a generic term and includes both a sale and an agreement to sell.

ESSENTIAL ELEMENTS OF CONTRACT OF SALE

The following elements must co-exist so as to constitute a contract of sale of goods under the Sale of Goods Act, 1930:

1. **Two parties to contract** - Two parties are required for contract i.e. a seller and a buyer. "Seller" means a person who sells or agrees to sell goods [section 2(13)]. "Buyer" means a person who buys or agrees to buy goods [section 2(1)]. The two terms, 'buyer' and 'seller' are complementary and represent the two parties to a contract of sale of goods. Both the term are, however, used in a sense wider than their common meaning. Not only the person who buys but also the one who agrees to buy is a buyer. Similarly, a 'seller' means not only a person who sells but also a person who agrees to sell. If joint owners distribute property among themselves as per mutual agreement, it is not 'sale' as there are no two parties.
2. **Goods** – There must be some goods. The goods which firm the subject matter of the contract of sale must be movable. Every kind of moveable property except actionable claims and money is regarded as 'goods'. Transfer of immovable property is not regulated by the sale of goods act.

NOTES

3. **Price** - "Price" means the money consideration for a sale of goods [section 2(10)]. Consideration is required for any contract. However, in case of contract of sale of goods, the consideration should be 'price' i.e. money consideration.

   Ascertainment of price {Section 9]:

   i). The price in a contract of sale may be fixed by the contract,

   ii). Agreed to be fixed in a manner provided by the contract,

   iii). Determined by the course of dealings between the parties [section 9(1)].

   When the price is not determined in accordance with the foregoing provisions, the buyer shall pay the seller a reasonable price.

4. **Transfer of property** –'Property' here means 'ownership'. Transfer of property in goods is another essential element of a contract of sale of goods. The term "property" as used in the Sale of Goods Act, means the 'general property' in goods, as distinguished from 'special property' [section 2(11)]. 'General Property' means 'full ownership'. Thus, transfer of 'general property' is required to constitute a sale. If goods are given for hire, lease, hire purchase or pledge, 'general property' is not transferred and hence it is not a 'sale'.

   Note that 'property' and 'possession' are not synonymous. Transfer of possession does not mean transfer of property. e.g. - if goods are handed over to transporter or godown keeper, possession is transferred but 'property' remains with owner. Similarly, if goods remain in possession of seller after sale transaction is over, the 'possession' is with seller, but 'property' is with buyer.

5. **Essential elements of a valid contract:** The essential elements for a valid contract must be present in the contract of sale. Thus, the parties to the must be competent to contract, the consent of the parties must be free, the object of the contract must not be unlawful and so on.

From the above discussion, the following essentials of a contract of sale may by note:

1. There must be at least two parties.
2. The subject matter of the contract must necessarily be 'goods'.
3. The consideration is Price.
4. Transfer or Agreement to transfer the ownership of goods.
5. A Contract of sale may be absolute or conditional.
6. All other essentials of a valid contract must be present.

Contract of Sale includes agreement to sale –

Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell [section 4(3)]. An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred [section 4(4)]. The provision that contract of sale includes agreement to sale is only for the purposes of rights and

NOTES

liabilities under Sale of Goods Act and not to determine liability of sales tax, which arises only when actual sale takes place.

DISTINCTION BETWEEN 'SALE' AND 'AGREEMENT TO SELL'

Sale: It is a contract where the ownership in the goods is transferred by seller to the buyer immediately at the conclusion contract. Thus, strictly speaking, sale takes place when there is a transfer of property in goods from the seller to the buyer. A sale is an executed contract. It must be noted here that the payment of price is immaterial to the transfer of property in goods.

For Example - A sells his Motor Bicycle to B for Rs. 20,000. It is a sale since the ownership of the motorcycle has been transferred from A to B.

Agreement to sell: It means a contract of sale under which the transfer of property in goods is to take place at a future date or subject to some condition thereafter to be fulfilled.

For Example- (i) A agreed to buy from B a certain quantity of nitrate of soda. The ship carrying the nitrate of soda was yet to arrive. This is 'an agreement to sale'. In this case, the ownership of nitrate of soda is to be transferred to A on the arrival of the ship containing the specified goods (i.e. nitrate of soda)

(ii) On 1st March 2010, A agreed to sell his car to B for Rs. 80,000. It was agreed between themselves that the ownership of the car will transfer to B on 31st March 2010 when the car is registered in B's name. It is an agreement to sell and it will become sale on 31st March when the car is registered in the name of 'B'.

Sale	Agreement to sell
1. A sale is an executed contract, i.e contract fot which consideration has been paid.	1. An Agreement to sell is an executoiy contract, i.e. contract for which consideration is to be paid at a future date.
2. The property in the goods passes to the buyer along with the risk.	2. Since property in the goods does not pass to the buyer,the tisk also does not pass to him.
3. A subsequent loss or destruction of the goods is the liability of the buyer.	3. Such loss or destruction is the liability of the seller.
4. Breach on the part of the seller gives the buyer double remedy, a suit for damages against the seller and the propriety remedy goods from third parties who bought them.	4. The seller, being still the owner of the goods, may dispose of them as he likes, and the buyer's remedy would be to file a suit for damages only.
5. The seller can sue the buyer for the price of the goods because of the passage of the property therein to the buyer.	5. The aggrieved party can sue for damages only, not for the price, unless the price was payable at a stated date.

Meaning of goods and Classifications of goods:

The goods are the subject matter of the contract of sale. According to Section 2(7), "Goods means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or

forming part of the land which are agreed to be severed before sale or under the contract of sale." Thus every kind of moveable property except actionable claims and money is regarded as 'goods'. Trademarks, copyrights, patent rights, goodwill, electricity, water, gas are all goods.

Actionable claims and money are not goods. An actionable claim means a claim to any debt or any beneficial interest in movable property not in possession (Sec.3 of the Transfer of Property Act, 1882). It is something which can only be enforced by action in a Court of law. A debt due from one person to another is an actionable claim and cannot be brought or sold as goods. It can only be assigned. Money here means current money and not old rare coins.

The definition of the term 'goods' also suggests that it includes stocks and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be served from the land before sale. Growing crops and grass are included in the definition of the term goods because they are to be several from land. Trees which are agreed to be severed before sale or under the contract of sale are goods.

Classification of Goods:

i). **Existing Goods:** These are such goods which are in existence at the time of contract of sale, i.e. those owned or possessed by the seller (Section 6).

ii). **Future Goods:** Future Goods mean goods to be manufactured or produced or acquired by the seller after making the contract of sale [Section 2(6)]. Thus under the Act, a contract of sale of future goods, e.g. 1,000 quintals of potatoes to be grown on A's field, is not illegal, though the actual sale of future goods is not possible. This is an example of agreement to sell.

iii). **Specific Goods:** Specific Goods mean goods identified and agreed upon at the time the contract of a sale has been made [Section 2(14)].

iv). **Contingent Goods** - Contingent goods are the goods the acquisition of which by the seller depends upon a contingency which may or may not happen. Contingent goods are a part of future goods.

DOCUMENTS OF TITLE TO GOODS

A document of title to goods may be described as any document used as proof of the possession or control of goods, authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented. The following are documents of title to goods: Bill of Lading, Dock Warrant, Warehouse keeper's Certificate, Wharfinger's Certificate, Railway Receipt, Warrant or order for the delivery of goods; and any other document used in the ordinary course of business as a document of title:

CONDITIONS AND WARRANTIES

A stipulation in a contract of sale with reference of goods, which are the subject thereof, may be a condition or a warranty. In a contract of sale, parties make certain stipulations, i.e., agree to certain terms. Some of them may be intended by the parties

NOTES

to be of a fundamental nature, e.g., quality of the goods to be supplied. The stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated and to claim damages. Such stipulations are known as 'Conditions'.

In contrast, warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated (Section 12(3) of the Sale of Goods Act, 1930).

DISTINCTION BETWEEN 'CONDITION' AND 'WARRANTY'

Condition	Warranty
1. A condition is essential to the main purpose of the contract.	1. It is only collateral to the main purpose of the contract.
2. The aggrieved party can repudiate the claim damages or both in the case of breach of condition.	2. The aggrieved party can claim only damages in case of breach of warranty.
3. A breach of condition may be treated as a breach of warranty.	3. A breach of warranty cannot be treated as a breach of condition.

WHEN CONDITION TO BE TREATED AS WARRANTY [SECTION 13]

In the following cases, a contract is not avoided even on account of a breach of a condition:

1) **Voluntary waiver of Condition:** Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may:

   i. Waives the condition, or

   ii. Elects to treat the breach of the condition as a breach of warranty [Section 13(1)]. If the buyer decides to waive the condition, he cannot afterwards insist on its fulfillment.

2) **Acceptance of Goods by Buyer:** Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty, unless there is a term of the contract, express or implied, to the contrary [Section 13(2)].

   The provision of section 13 does not affect the cases where the fulfillment of any condition or warranty is excused by law by reason of impossibility or otherwise [section 13(3)].

3) **Conversion of condition into warranty:** The buyer may choose to treat the condition in the contract as a warranty and demand damages for the loss suffered on account of violation of condition while continuing the contract.

EXPRESS AND IMPLIED CONDITIONS AND WARRANTIES

'Conditions' and 'Warranties' may be either express or implied. They are said to be "express" when the terms of the contract expressly provide to them. They are said to be 'implied' when, not being expressly provided for. Express conditions are those,

NOTES

which are agreed upon between the parties at the time of contract and are expressly provided in the contract. On the other hand, implied conditions are those, which are presumed by law to be present in the contract. It should be noted that an implied condition may be negated or waived by an express agreement.

IMPLIED CONDITIONS:

Following conditions are the implied in a contract of sale of goods unless the circumstances of the contract show a different intention:

1) **Condition as to Title [Section 14(a)]:** This implied condition focuses that when a person seeks to sell some goods, there is an unspoken assurance from him that he is entitled to sell them and pass the property to the buyer. The first implied condition on the part of the seller is that (a) in case of sale, he has a right to sell the goods, and (b) in the case of an agreement to sell, he will have the right to sell the goods at the time when the property is to pass. In simple words, the condition implied is that the seller has the right to sell the goods at the time when the property is to pass. If the seller's title turns out to be defective, the buyer must return the goods to the true owner and recover the price from the seller.

2) **Sale by Description [Section 15]:** In a sale by description there is an implied condition that the goods correspond with the description. This rule is based on the principle that "if you contract to sell peas, you cannot compel the buyer to take beans". The buyer is not bound to accept and pay for the goods which are not in accordance with the description of goods.

3) **Sale by sample [Section 17]:** In a contract of sale by sample, there is an implied condition:

   (a) the bulk shall correspond with the sample in quality,

   (b) the buyer shall have a reasonable opportunity of comparing the bulk with the sample, and

   (c) the goods shall be free from any defect rendering them unmerchantable, which would not be apparent on reasonable examination of the sample.

4) **Sale by sample as well as by description [Section 15]:** If the goods are sold by sample as well as by description the implied conditions is that the bulk of the goods supply must corresponds both with the sample and the description. In case the goods correspond with the sample but do not tally with description or vice-versa, the buyer can repudiate the contract.

5) **Condition as to Quality or Fitness [Section 16]:** There is no implied condition for the quality or fitness of the goods sold for any particular purpose. However, the condition as to the reasonable fitness of goods for a particular purpose may be implied if the buyer had made known to the seller the purpose of his purchase and relied upon the skill and judgment of the seller to select the best goods and the seller has ordinarily been dealing in those goods. Even this implied condition will not apply if the goods have been sold under a trademark or a patent name.

NOTES

6) **Conditions as to wholesomeness:** In case of eatables and provisions, in addition to the implied condition as to merchantability, there is another implied condition that the goods shall be wholesome.

IMPLIED WARRANTIES:

Section 14 and Section 16 of the Sale of Goods Act, 1930, disclosed the following implied warranties:

1. **Warranty as to undistributed possession:** An implied warranty that the buyer shall have and enjoy quiet possession of the goods. In simple words, if the right of possession of the buyer is distributed either by the seller or by any person, the buyer has right to sue the seller for the damage.

2. **Warranty as to non-existence of encumbrances:** The buyer is entitled to a further warranty that the goods he purchased are not subject to any charge or encumbrance in favor of any third party not declared or known to the buyer before or at the time when the contract is made.

   For Example – A purchased a second hand typewriter from B. A used it for some time and also spend some money on its repairs. The typewriter turned out to be stolen one and as such A had to return it to the true owner. It was held that A could recover damages from B amounting to the price paid and the cost of repair.

3. **Disclosure of dangerous nature of goods:** There is another implied warranty on the part of the seller that in case the goods are inherently dangerous or they are likely to be dangerous to the buyer and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If there is breach of this warranty, the seller will be liable for damages.

4. **Warranty as to quality or fitness by usage of trade** [Section 16(4)]: An implied warranty as to quality or fitness for particular purpose may be annexed by the usage of trade.

DOCTRINE OF CAVEAT EMPTOR:

The doctrine of 'Caveat Emptor' means 'let the buyer beware'. According to the doctrine of Caveat Emptor 'it is the duty of the buyer to be careful while purchasing goods of his requirement and, in the absence of any enquiry from the buyer, the seller is not bound to disclose every defect in goods of which he may be aware'. Caveat Emptor is a fundamental principle of the law of sale of goods. When the sellers display their goods in the open market, it is for the buyers to make a proper selection or choice of the goods. If the goods turn out to be defective he cannot hold the seller liable. The seller is in no way responsible for the bad selection of the buyer. The seller is not bound to disclose the defects in the goods which he is selling. Thus, the buyer purchases the goods at his own risk as regards the quality, price of the goods etc. The person who buys goods must keep his eyes open, his mind active, and should be cautions while buying the goods.

NOTES

The rule of Caveat Emptor is laid down in the Section 16, which states that, "subject to the provisions of this Act or of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale."

Exceptions: The doctrine of Caveat Emptor is, however, subject to the following exceptions;

1. Where the seller makes a false representation and the buyer relies on that representation, such a contract being voidable at the option of the innocent party, the buyer has a right to rescind the contract.
2. Where the goods are sold by description there is an implied condition that the goods shall correspond with the description [Section 15].
3. Where the buyer makes known to the seller the purpose for which he is buying the goods, and the seller happens to be a person whose business is to sell goods of that description, then there is an implied condition that the goods shall be reasonably fit for such purpose [Section 16(1)].
4. In case where the goods are purchased under its patent name or brand name, there is no implied condition that the goods shall be fit for any particular purpose [Section 16(1)].
5. When the goods are bought by sample, this rule of Caveat Emptor does not apply if the bulk does not correspond with the sample [Section 17].
6. Where the goods are bought by sample as well as description, the rule of Caveat Emptor is not applicable in case the goods do not correspond with both the sample and description [Section 15].

TRANSFER OF PROPERTY:

Transfer or passing of property constitutes the most important element and factor to decide the legal rights and liabilities of sellers and buyers. Passing of property implies passing of ownership and not the physical possession of goods. If the property has passed to the buyer, the risk in the goods sold is that of buyer and not of seller, though the goods may still be in the seller's possession. Thus, the term property in goods denotes the ownership whereas possession of goods refers to the custody of goods.

Legal Consequences of Transfer of Property:

Several consequences take place when the property in goods passes from seller to buyer:

1) **Risk passes with property:** An important consequence of the transfer of property is that the risk of loss from any damage to goods passes from the seller to the buyer.
2) **Insolvency:** In the event of insolvency of either buyer or seller, the official receiver or assignee for the insolvent would take charge of his assets.

NOTES

3) **Damages:** In case of damages to the goods by a third party, only owner can take action and therefore, it is very essential to know the ownership of the goods.

4) **Suit for price:** The seller can file a suit against the buyer for the price of the goods only after the property in goods is transferred to the buyer.

Passing of Property from Seller to the Buyer:

Section 18 of the Act states that where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained.

1) **Transfer of Property in specific or ascertained goods:**

Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made (Section 20). Deliverable state means such a state where that the buyer would under the contract be bound to take delivery of goods. The seller is bound to do something to the goods for the purpose of putting them into a deliverable state; the property does not pass until that thing is done. This 'something' may mean packing the goods, testing, polishing, and filling in cakes. It should be noted that the property shall not pass when the goods are made in deliverable state but shall pass only when the buyer has notice of it (Section21). But where they are in deliverable state, the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done.

2) **Transfer of Property in unascertained goods:**

(i) Where there is a contract for the sale of unascertained goods, no property the goods is transferred to the buyer until the goods are ascertained (Sec.18). Until the goods are ascertained there is merely an agreement to sell.

(ii) Where there is a contract for the sale of unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract by the seller, with the assent of the buyer, or by the buyer with the assent of the seller, property in the goods passes to the buyer. Such assent may be expressed or implied and may be given either before or after the appropriation.

The 'ascertainment of goods' and the unconditional'appropriations of the contract' are the two pre-conditions for the transfer of the property from the seller to the buyer in case of unascertained goods.

3) **Goods sent 'on approval' or 'on sale on return' basis:**

When goods are delivered to the buyer on approval or on sale or return or other similar terms, the property therein passes to the buyer:

(i) when he or she signifies his or her approval or acceptance to the seller or does any other act adopting the transaction [Section 24(a)].

NOTES

(ii) if he or she does not signify his or her approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of that time, and if no time has been fixed, on the expiration of a reasonable time [Section 24(b)].

Reservation of right of disposal (Section 25):

(1) Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled.

(2) In the case referred to in subsection (1), notwithstanding the delivery of the goods to the buyer or to a carrier or other bailee for the purposes of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled.

(3) Where goods are shipped and by the bill of lading the goods are deliverable to the order of the seller or his or her agent, the seller is prima facie deemed to reserve the right of disposal.

(4) Where the seller of goods sends a bill of exchange for the price of the goods to the buyer for his acceptance, together with the bill of lading or the railway receipt. The property in goods does pass to the buyer until he accepts the bill of exchange. The buyer is bound to return the bill of lading or railway receipt, if he or she does not honour the bill and if he or she wrongfully retains the bill of lading, the property in the goods does not pass to him or her [Sec.25(3)].

Risk prima facie passes with property:

According to Section 26, "Unless otherwise agreed, the goods remain at the seller's risk until the property in the goods is transferred to the buyer but when the property in the goods is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not".

Section 26 lays down in exception to the rule that 'risk follows ownership'. It provides that where delivery of the goods has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for that fault;

TRANSFER OF TITLE BY NON-OWNERS [Sections 27-30]

The general rule is that only the owner of goods can transfer a title of goods. No one can give a better title than he himself has. This rule is expressed by the Latin maxim "Nemo dat quod non habet" which means "that no one can give what he himself has not"

If the seller, therefore, has no title, or a defective title, the buyer's title will be equally wanting or defective as the case may be, though he may be a purchaser. Ex- A sells some stolen goods to B, who purchases it for value and in good faith, B will get no title to that and the true owner has a right to get back his goods from the third person.

NOTES

Exceptions to the Rule:

1. **Sale by Mercantile Agent:**

   The buyer of goods from a mercantile agent, who has no authority from the principal to sell, gets a good title to the goods if,

   a) the agent is in possession of the goods or documents of title to the goods with the consent of the owner;

   b) the agent sells the goods while acting in the ordinary course of business of a mercantile agent;

   c). the buyer has not at the time of the contract of sale notice that he has no authority to sell.

2. **Sale by a Joint-owner:**

   If any one of the joint-owners, in the possession of goods, sells the goods with the permission of the other joint owners, the buyer gets a good title to the goods.

3. **Sale by a person not the owner or the title by estoppels:**

   Where the owner by his conduct, or by an act or omission, leads the buyer to believe that the seller has the authority to sell and induces the buyer to buy the goods, he shall be estopped from denying the fact of want of authority of the seller. The buyer in such a case gets a better title than that of the seller.

4. **Sale by the Seller in Possession of Goods after Sale:**

   Where a seller, having sold goods, continues to be in possession of the goods or of the documents of title to the goods, and sells them either himself or through mercantile agent to the person who buys them in good faith and without notice of the previous sale, the buyer gets the good title.

5. **Sale by an unpaid seller:**

   Where an unpaid seller who has exercised his right of lien or stoppage in transit resell the goods, the buyer acquires a good title to the as against the original buyer.

PERFORMANCE OF THE CONTRACT:

Performance of the contract of sale means as regards the seller, delivery of the goods to the buyer, and as regards the buyer, acceptance of the delivery of goods and payment for them, in accordance with the terms of the Contract of Sale (sec.31). A contract of sale involves reciprocal promises. The seller promises to deliver the goods while the buyer promises to pay for the goods and to accept the delivery of goods.

Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, i.e. the seller must be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer must be ready and willing to pay the price in exchange for possession of the goods.

NOTES

Delivery of goods to buyer –

Delivery means voluntary transfer of possession of goods from one person to another [sec.2 (2)].Delivery of goods may be actual, symbolic, or constructive.

1. **Actual Delivery:**

   When the goods are handed over by the seller to the buyer or his duly authorized agent, the delivery is said to be actual.

2. **Symbolic Delivery:**

   When goods are heavy and incapable of actual delivery, the delivery may be symbolic. For Example: A sells to B 100 bags of wheat lying in C's warehouse and hand over the keys of C's warehouse to the buyer. In this case, there is the symbolic delivery of the goods to the buyer.

3. **Constructive Delivery:**

   Delivery is said to be constructive where a third person who is in possession of the goods of the seller at the time of the sale acknowledges to the buyer that he holds the goods on behalf of the buyer. This may happen in the following cases:

   - Where the seller in possession of the goods agrees to hold them on behalf of the buyer.
   - Where the buyer is in possession of the goods and the seller agrees to the buyer's holding the goods as owner.
   - Where a third person in possession of the goods acknowledges to the buyer that he holds them on his behalf.

Rules as to delivery of Goods:

1. **Modes of delivery (sec. 33):**

   Delivery should have the effect of putting the goods in the possession of buyer or his duly authorized agent. Delivery of goods may be actual, symbolic, or constructive.

2. **Effect of part delivery:**

   A delivery of the part of goods, taking place in the course of the whole, has the same effect for the purpose of passing the property in such goods as delivery of whole. But such part delivery, with the intention of severing it from the whole will not operate as a delivery of the remainder; it will be constructed as part delivery only (Section 34).

3. **Buyer to apply for delivery:**

   The seller of the goods is not obliged to deliver them until the buyer has applied for delivery, unless otherwise agreed (Section 35).

4. **Place of Delivery:**

   Where the place at which delivery of the goods is to take place is specified in the contract, the goods must be delivered at that place. Where there is no specific

NOTES

agreement as to place, the goods sold are to be delivered at the place at which they are at the time of sale. As regards the goods agreed to be sold, they are to be delivered at the place at which they are at the time of agreement to sell, or, if not then in existence, at the place at which they are manufactured or produced [Section 36(1)].

5. **Time of Delivery:**

When the time for sending the goods has not been fixed by the parties, the seller is bound to send them within a reasonable time [Section 36(2)].

6. **Goods in possession of the third party:**

Where the goods at the time of sale are in the possession of a third person, there is no delivery unless and until such third person acknowledges to the buyer that he or she holds the goods on his or her behalf. But where the goods have been sold by the issue or transfer of any document title of goods i.e. a railway receipt, bill of lading, such third party's consent is not required [Section 36(3)].

7. **Delivery of wrong quantity or description:**

(1) Where the seller delivers to the buyer a quantity of goods less than he or she contracted to sell, the buyer may reject them; but if the buyer accepts the goods so delivered, he or she must pay for them at the contract rate [section 37(1)].

(2) Where the seller delivers to the buyer a quantity of goods larger than he or she contracted to sell, the buyer may accept the ordered quantity and reject the rest, or he or she may reject the whole. If the buyer accepts the whole of the goods so delivered, he or she must pay for them the contract rate [section 37(2)].

(3) Where the seller delivers to the buyer the goods he or she contracted to sell mixed with goods of a different description, the buyer may accept the goods which are in accordance with the contract and reject the rest, or he or she may reject the whole [section 37(3)].

The provisions of section.37 are subject to any usage of trade, special agreement or course of dealing between the parties [section 37(4)].

8. **Delivery by installments**

(1) Unless otherwise agreed, the buyer of goods is not bound to accept delivery of the goods by installments.

(2) Where there is a contract for the sale of goods to be delivered by installments, the delivery should be in installments as stipulated in the contract.

The rights and liabilities in cases of delivery by installments and payments there on may be determined by the parties of contract (Section 38).

9. **Delivery to carrier**

(1) Where, in pursuance of a contract of sale the seller is authorized or required to send the goods to the buyer, delivery of the goods to a carrier whether named

NOTES

by the buyer or not, for the purpose of transmission to the buyer or to a wharfinger for safe custody, delivery of goods to them is prima facie deemed to be a delivery of the goods to the buyer.

(2) Unless otherwise agreed, where goods are sent by the seller to the buyer by a route involving sea transit, the seller must give such notice to the buyer to get the goods insured otherwise the goods will be at the seller's risk during such sea transit [sec.39(3)].

Acceptance of delivery of goods:

Receipt of goods by the buyer does not necessarily result in acceptance of goods by him under, and in performance of the contract of sale. Acceptance is something more than mere receipt or taking possession of the goods by the buyer, it means the final assent by the buyer that he has received the goods under, and in performance of, the contract of sale. Acceptance is deemed to take place when the buyer:

a) intimates to the seller that he had accepted the goods, or

b) does any act in relation to the goods, which is inconsistent with the ownership of the seller, or

c) retains the goods after the lapse of reasonable time, without intimating to the seller that he has rejected them [sec.42].

The seller cannot compel the buyer to return the rejected goods, but the seller is entitled to a notice of the rejection.

Liability of buyer for rejecting, neglecting or refusing to take delivery of goods:

When the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and the buyer does not take delivery of the goods within a reasonable time after the request, he or she is liable to the seller for any loss occasioned by his or her neglect or refusal to take delivery, and also for a reasonable charge for the care and custody of the goods.

DUTIES OF THE SELLER AND BUYER

Duty of the seller:

a) To deliver the goods, in accordance with the terms of the contract of sale.

b) Delivery and payment of price are concurrent conditions.

c) The seller of goods has the duty of giving delivery according to the terms of the contract.

Duty of the buyer:

a) Pay for the goods;

b) Accept delivery; and

c) Pay compensation to the seller in case he wrongfully refuses to accept delivery.

d) Take risk of deterioration in the course of transit.

NOTES

RIGHTS OF THE BUYER:

1. **Right to have delivery as per contract (Sec.31 and 32):**

   The first right of the buyer is to have delivery of the goods according to the terms of the contract.

2. **Right to reject the goods (sec.37):**

   The buyer may reject the goods, if the seller sends larger or lesser quantity of goods than he ordered.

3. **Right to repudiate [sec.38 (1)]:**

   Unless otherwise agreed, the buyer of the goods has a right not to accept the delivery of goods by installment.

4. **Right to notice of insurance** [sec.39 (3)]:

   Where goods are sent by the seller to the buyer by a sea route, the buyer has a right to be informed by the seller so that he may get the goods insured.

5. **Right to examine (sec. 41):**

   The buyer has a right to examine the goods which he has not previously examined before he accepr them [sec.41 (1)]. The seller is bound to give a reasonable opportunity of examining the goods to the buyer for the purpose of ascertaining whether they are in conformity with the contract [sec.41 (2)].

6. **Buyer's right against seller for breach of contract:**

   i) **Suit for damages for non-delivery (Sec. 57):**

   When the seller wrongfully refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.

   ii) Suit for **specific performance (Sec. 58):**

   Where there is a breach of contract for sale of specific goods, the buyer may file a suit for specific performance.

   iii) **Suit for damages for breach of warranty (Sec. 59):**

   Where there is a breach of warranty by the seller or where the buyer elects or is compelled to treat any breach of condition on the part of the seller as a breach of warranty, the buyer is entitled to reject the goods, but the buyer may:

   a). set up against the seller the breach of warranty in diminution or extinction of the price,

   b). sue the seller for the breach of warranty.

   The measure of damage for the breach of warranty is the estimated loss arising directly and naturally from the breach, which is prima facie the difference

between the value of goods at the time of the delivery and the value they would have had, if the goods had answered to the warranty.

iv). **Suit for recovery of price with interest (Sec. 61):**

If the buyer has already paid the price to the seller and the seller does not deliver the goods to the buyer, he can sue the seller for refund of price and interest at a reasonable rate.

Seller's Right against the buyer in case of breach of contract:

i). **Suit for the price:** Where the property in the goods has passed to the buyer or he has wrongfully neglected or refused to pay for the goods according to terms of the contract, the seller may sue him for the price of goods.

ii). **Damages for non-acceptance:** Where the buyer wrongfully neglects or refuses to accept and pay for the goods, then the seller may sue him for damages for non-acceptance

UNPAID SELLER:

A contract is comprised of reciprocal promises, in a contract of sale, if seller is under an obligation to deliver goods; buyer has to pay for it. In case buyer fails or refuses to pay, the seller is said to be an unpaid seller. The seller of goods is deemed to be an "unpaid seller" if:

(a) the whole of the price, has not been paid or tendered;

(b) when a bill of exchange or other negotiable instrument has been received as conditional payment, and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise [sec.45(1)].

An unpaid seller of goods is a person who has not been paid the whole of the price or to whom the whole of the price has not been tendered. Any person who is in a position of a seller, is also a seller, and may exercise the rights conferred upon an "unpaid seller". An agent of the seller, to whom the bill of lading has been endorsed, is in the position of seller and may exercise rights of 'unpaid seller'.

Features of the unpaid seller:

I. He must sell goods on the cash basis and must be unpaid.

II. If he sells on credit basis, he is not an unpaid seller during the period of credit.

III. The term of credit has expired and the price has not been paid to him.

IV. He must be unpaid wholly or partially. If a part of price remains unpaid, he is unpaid.

V. When the price is paid in the form of negotiable instruments and it has been dishonored.

VI. If buyer offers payment and seller refuses to accept, the seller is not an unpaid seller.

NOTES

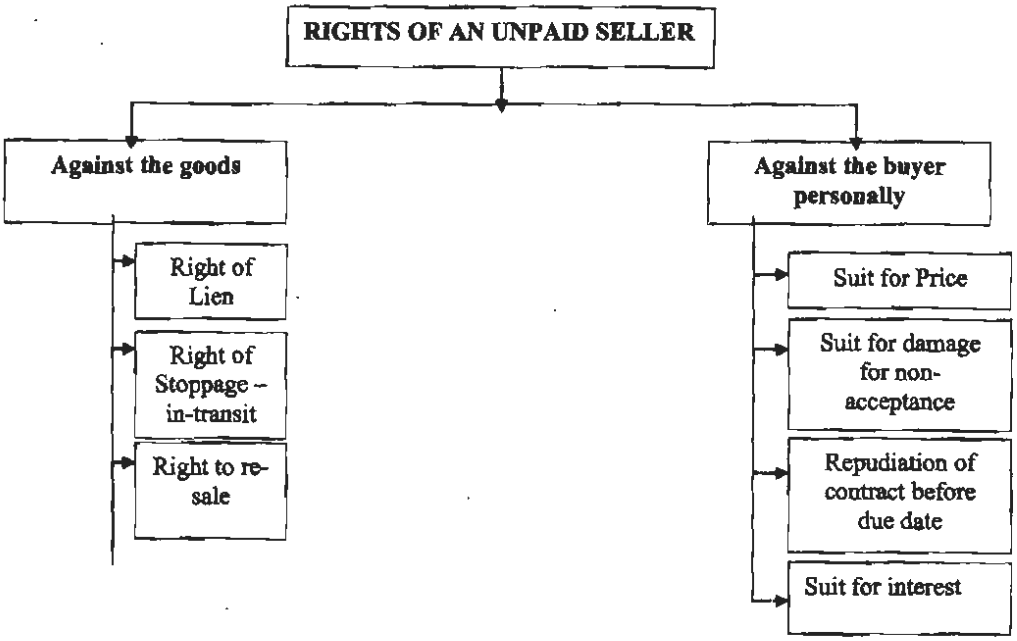
Example:

I. Party A sells a car on cash basis to party B and the price has not been received yet.

II. A sells good to B on 5 months credit period and B turns insolvent after 2 months.

III. A sells TV set to B for cheque, on the same day cheque is dishonored due to insufficient funds. A is an unpaid seller.

Rights of an unpaid seller:



Rights of an unpaid seller may broadly be classified under two heads namely:

1. Rights against goods:

An unpaid seller has the following rights against the goods:

i. Rights of lien,

ii. Right of stoppage of goods in transit,

iii. Right of resale.

i). Rights of lien:

The right of lien means lawfully right to retain possession of the goods until the full price is received. An unpaid seller can exercise his right of lien in following cases:

I. Where the goods have been sold without any stipulation as to credit,

II. Where the goods have been sold on credit basis and the term of credit has expired,

III. Where the buyer has become insolvent even if the period of credit has not been expired.

Rules regarding lien:

I. The unpaid seller must be in actual possession of the goods sold.

II. It can be exercised even if the documents of title have been delivered to the buyer.

III. It can be exercised for the price and not for other expenses.

IV. If the seller delivers some goods, it can be exercised on the remaining.

Termination of right of lien:

Seller's right of lien is terminated in following cases:

I. When he delivers the goods to the carrier or other bailee for transmission to the buyer without reserving the right of disposal.

II. When the buyer or his agent lawfully obtains the possession of the goods.

III. When seller waives his right of lien on the goods.

IV. The right of lien once lost will not be restored.

V. When the buyer further sells the goods and the seller agrees.

ii). Right of stoppage of goods in transit:

The right of stoppage in transit is a right of stopping the goods in transit after the unpaid seller has parted with the possession of goods. Unpaid seller can stop the goods in transit in the following cases:

I. the buyer becomes insolvent.

II. the goods are out of actual possession of seller, but have not reached buyer's possession i.e. goods are in transit with carrier.

III. The unpaid seller can stop the goods in transit only for payment of the price of the goods and not for any other charges.

The unpaid seller cannot stop goods in transit in following cases:

I. When the goods reaches the destination.

II. When the buyer or his agent takes possession of delivery even if it is not reached destination.

III. In case the carrier is agent of the buyer, the transit comes to an end.

Example: "A" sells TV set to "B". "A" delivers the TV to the carrier to carry it to "B". Later on gets news that "B" has become insolvent; "A" can stop delivery.

iii) Right of re-sale:

The unpaid seller has the right to resell the goods in the following circumstances:

a) Where the goods are of perishable nature.

b) Where the unpaid seller has expressly reserved his right of resale.

NOTES

c) Where seller gives notice to the buyer of his intension to resell and the buyer does not pay within a reasonable time, he can

a. Recover loss on resale of the goods, if any

b. Retain any surplus on resale of goods, if any

However if the seller sells without the notice to the buyer, he can not

a. Recover any loss of the goods, if any

b. Retain any surplus on the resale of the goods, if any

Example:

a) "X" sells vegetable to "Y" on credit, "Y" does not pay, "X" can resell to any other person.

b) "M" sells 100 blankets to "N" and gives him one week for payment. "N" does not pay. "M" can resell those to any other person.

2) Rights against buyer personally:

A buyer seller can enforce certain rights against the goods as well as against the buyer personally. The rights of the seller against the buyer personally are called rights in personam. The rights in personam are as follows:

i. Suit for price,

ii. Suit for damages for non-acceptance,

iii. Suit for special damages and interest.

i). **Suit for price (Sec. 55):**

Where ownership of the goods has passed to the buyer and the buyer refuses to pay the price according to the terms of the contract, the seller can sue the buyer for price, irrespective of delivery of the goods.

ii). **Suit for damages for non-acceptance (Sec. 56):**

Where the buyer refuses to accept and pay for the goods, the seller may sue him for damages for non acceptance. The seller can recover damages only and not the full price.

iii). **Repudiation of contract before due date (Section 60):**

Where the buyer repudiates the contract before the date of delivery, the seller may treat the contract as rescinded and sue damages for the breach.

iv). **Suit for special damages and interest (Sec. 61):**

Where there is specific agreement between the seller and the buyer as to interest on the price of the goods from the date on which payment becomes due, the seller may recover interest from the buyer. If there is no specific agreement to this effect, the seller may charge interest on the price when it becomes due from such day as he may notify to the buyer.

SALE BY AUCTION (Section 64):

Auction sale is special mode of sale. The sale is made in open after making public announcement. Buyers assemble and make offers on the spot. Person offering to pay highest price gets the goods. Usually, auctioneer is appointed to conduct auction. An auctioneer is an agent governed by the Law of Agency. When he sells, he is only the agent of the seller. He may, however, sell his own property as the principal. Higher and higher bids are offered and sale is complete when auctioneer accepts a bid.

Under section 64 of the Sale of Goods Act, 1930, in the case of an auction—

1) When the goods are put up for sale in lots, each lot is prima facie deemed to be the subject matter of a separate contract of sale;

2) At an auction, the sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner and until such announcement is made, any bidder may withdraw his bid.

3) A right to bid may be reserved expressly by or on behalf of the seller and where such right is expressly reserved, but not otherwise, the seller or any person on his behalf may bid at the auction;

4) Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid for himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any person representing him. Any sale contravening this rule shall be treated as fraudulent;

5) The sale may be notified to be subject to a reserved or upset price; and

6) If the seller makes use of pretended bidding to raise the price, sale is voidable at the option of the buyer.

Transfer of title:

Example:

1. A, the hirer of goods under a hire purchase agreement, sells them to B, then B though, a bonafide purchaser, does not acquire the property in the goods. At most he can acquire such an interest as the hirer had.

2. A finds a ring of B and sells it to a third person who purchases it for value and in good faith. The true owner, B can recover from that person, for A having no title to the ring could pass none the better.

Conditions and warranties:

Example:

A agreed to sell to B 25 tons of pepper of October shipment, & to declare the name of the vessel & other particulars to B within 60 days of bill of lading, only 20 tons were declared within 60 days, the remaining 5 tons having been declared subsequently. B refused to accept the goods, & it was held that he was justified in doing so.

NOTES

Stipulation not relating to time of payment, e.g. delivery of goods etc. as regards these stipulations, time may be of the essence of the contract but this essentially depends on the terms of the contract. In contract of sale, stipulations other than those relating to the time of payment are regarded as of the essence of the contract. Thus, if a time is fixed for the delivery of goods, the delivery must be made at the fixed time, otherwise the other party is entitled to out amend to the contract.

CASE STUDY:

1. Explain remedies available to purchasers who do not obtain title. This question asked for a discussion of the ways in which the SGA helps those people who could not claim ownership. In other words it was asking the students to discuss the rights of people who bought goods from someone who had no right to sell them. This called for an analysis of Section 12 of the SGA. Section 12 should have been discussed and the remedies available to purchasers who did not obtain title (including the right to damages) should have been analyzed.
2. In the case of (state of Madras Vs Gannon Dunkerley and Company Limited, 1958) the Supreme Court has held that according to the law, both of England and India, in order to constitute a sale, it is necessary that there should be an agreement between the parties for the purpose of transferring title to goods, which of course presupposed capacity to contract, that it must be supported by money consideration, that as a result of transaction, the property must actually pass in the goods. Unless all these elements are present there would be no sale.

SUMMARY

- Contract of Sale of Goods is a contract between buyer and seller intending to exchange property in goods for a price.
- Essential Elements of Contract of Sale: Two parties to contract i.e. a seller and a buyer, Goods, Price, Transfer of property, Essential elements of a valid contract.
- Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell.
- 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.
- A document of title to goods may be described as any document used as proof of the possession or control of goods, authorizing or purporting to

authorize, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented.

- The stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated and to claim damages. Such stipulations are known as 'Conditions'.
- warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.
- The doctrine of 'Caveat Emptor' means 'let the buyer beware'.
- Passing of property implies passing of ownership and not the physical possession of goods.
- The general rule is that only the owner of goods can transfer a title of goods.
- Performance of the contract of sale means as regards the seller, delivery of the goods to the buyer, and as regards the buyer, acceptance of the delivery of goods and payment for them, in accordance with the terms of the Contract of Sale (sec.31).
- Acceptance is something more than mere receipt or taking possession of the goods by the buyer, it means the final assent by the buyer that he has received the goods under, and in performance of, the contract of sale.
- An unpaid seller of goods is a person who has not been paid the whole of the price or to whom the whole of the price has not been tendered.
- Auction sale is special mode of sale. The sale is made in open after making public announcement.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. "Price" means the money consideration for a sale of goods [section 2(10)].
2. The doctrine of 'Caveat Emptor' means 'let the buyer beware'.
3. The seller of goods is deemed to be an "unpaid seller" if:

   (a) the whole of the price, has not been paid or tendered;

   (b) when a bill of exchange or other negotiable instrument has been received as conditional payment, and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise [sec.45(1)].
4. **Duty of the seller:**

   a) To deliver the goods, in accordance with the terms of the contract of sale.

   b) Delivery and payment of price are concurrent conditions.

   c) The seller of goods has the duty of giving delivery according to the terms of the contract.

NOTES

5. **Right to have delivery as per contract (Sec.31 and 32):** The first right of the buyer is to have delivery of the goods according to the terms of the contract.

TEST YOURSELF

1) Define Contract of Sale. What are its essential elements/
2) Explain meaning of goods and its classification.
3) Explain the meaning of Conditions and Warranties and differentiate it.
4) Write a short note on Doctrine of Caveat Emptor.
5) What are the legal Consequences of Transfer of Property?
6) Explain the rule Transfer of Title by Non-Owners with exceptions.
7) Write a short note on:
   i) Unpaid Seller
   ii) Sale by Auction

FURTHER READING

- *Mercantile Law:Sharma, Sareen, Gupta and Chawla*

3 Negotiable Instrument Act 1881

The Chapter Covers :

- Characteristics of Negotiable Instruments
- Presumption As To Negotiable Instrument
- Types of Negotiable Instruments
- Bill of Exchange
- Parties To The Bill of Exchange
- Cheques
- Hundis
- Holder And Holder In Due Course
- Holder In Due Course
- Negotiation And Assignment
- Endorsement
- Discharge of Negotiable Instruments

Introduction

The Negotiable Instruments Act was passed in 1881. Some provisions of the Act have become redundant due to passage of time, change in methods of doing business and technology changes. However, the basic principles of the Act are still valid and the Act has stood test of time. The Act extends to the whole of India. There is no doubt that the Act is to regulate commercial transactions and was drafted to suit requirements of business conditions then prevailing.

The instrument is mainly an instrument of credit readily convertible into money and easily passable from one hand to another.

Definition of Negotiable Instrument

According to section 13 of the Negotiable Instruments Act, 1881, a negotiable instrument means "promissory note, bill of exchange, or cheque, payable either to order or to bearer". This section does not prohibit any other instruments that satisfy the essential features of portability.

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Justice K. C. Willis defines these as, "one the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defect in title in the person from whom he took it."

Thomas defines it in his book "Commerce, Its theory and Practice "A negotiable instrument is one which is, by a legally recognized custom of trade or by law, transferable by delivery in such circumstances that (a) the holder of it for the time being may sue on it in his own name and (b) the property in it passes, free from equities, to a bona-fide transferee for value, notwithstanding any defect in the title of the transferor."

It:

1) entitles a person to a sum of money
2) is transferable (by customs of trade) by delivery, like cash, or by Endorsement and delivery and delivery, and
3) is capable of being used upon by the person holding for the time being i.e. the person to whom it is transferred becomes entitled to money and also a right to further transfer it.

CHARACTERISTICS OF NEGOTIABLE INSTRUMENTS

The important characteristics are as follows –

1) **Free Transferability:** A negotiable instrument may be transferred by delivery if it is a bearer instrument or by endorsement and delivery if it is an instrument payable to order. Thus, a Fixed Deposit Receipt, which is marked as *'not transferable'* is not a negotiable instrument. On the other hand all instruments which are transferable are not negotiable instruments e.g. share certificate. An instrument to be negotiable must possess other features also. Further, a negotiable instrument may be transferred any number of times till it is discharged. Usually, when we transfer any property to somebody, we are required to make a transfer deed, get it registered, pay stamp duty, etc. But, such formalities are not required while transferring a negotiable instrument. The ownership is changed by mere delivery (when payable to the bearer) or by valid endorsement and delivery (when payable to order). Further, while transferring it is also not required to give a notice to the previous holder.
2) **Title to transferee:** The transferee, who takes the instrument *bona fide* and for valuable consideration, obtains a good title despite any defects in the title of the transferor. To this extent, it constitutes an exception to the general rule that no one can give a better title then he himself has.
3) A negotiable instrument must be in writing. This includes handwriting, typing, computer printout and engraving, etc.
4) In every negotiable instrument there must be an unconditional order or promise for payment.
5) The instrumenr must involve payment of a certain sum of money only and nothing else. For example, one cannot make a promissory note on assets, securities, or goods.
6) The time of payment must be certain. It means that the instrument must be payable at a time which is certain to arrive. If the time is mentioned as 'when convenient' it is not a negotiable instrument. 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.

7) The payee must be a certain person. It means that the person in whose favour the instrument is made must be named or described with reasonable certainty. The term 'person' includes individual, body corporate, trade unions, even secretary, director or chairman of an institution. The payee can also be more than one person.

8) A negotiable instrument must bear the signature of its maker. Without the signature of the drawer or the maker, the instrument shall not be a valid one.

9) Delivery of the instrument is essential. Any negotiable instrument like a cheque or a promissory note is not complete till it is delivered to its payee. For example, you may issue a cheque in your brother's name but it is not a negotiable instrument till it is given to your brother.

10) Stamping of Bills of Exchange and Promissory Notes is mandatory. This is required as per the Indian Stamp Act, 1899. The value of stamp depends upon the value of the pronote or bill and the time of their payment.

PRESUMPTION AS TO NEGOTIABLE INSTRUMENT

For deciding cases in respect of rights of parties on the basis of a bill of exchange, the Court is entitled to make certain presumptions. These are briefly stated as follow:

1) **Consideration:** That every negotiable instrument is made or drawn for a consideration. Thus, this need not necessarily be mentioned.

2) **Date:** That the negotiable instrument was drawn on the date shown on the face of it.

3) **Acceptance before maturity:** That the bill of exchange was accepted before its maturity, i.e., before it became overdue.

4) **Transfer before maturity:** That the negotiable instrument was transferred before its maturity.

5) **Order of Endorsements:** That the Endorsements appearing upon a negotiable instrument were made in the order in which they appear.

6) **Stamping of the instrument:** That an instrument which has been lost was properly stamped.

7) **Holder is Holder in due course:** That the holder of a negotiable instrument is the 'holder in due course', except where the instrument has been obtained from its lawful owner or its lawful custodian by means of offence or fraud.

8) **Proof of 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. (Section 119)

Rules of estoppel applicable to negotiable instruments (Sections 120 to 122)

Certain rules of estoppel are applicable to negotiable instruments. These are as follows:

1) **Estoppel against denying original validity of instrument:** The maker of the note and drawer of the bill of exchange or cheque are directly responsible for the bringing into existence of the instrument and, thus, cannot be allowed afterwards to deny the validiry of the instrument. (Section 120)

NOTES

2) **Estoppel against denying capacity of the payee to endorse:** The maker of a promissory note or an acceptor of a bill shall not, in a suit by holder in due course, be allowed to deny the capacity of the payee to endorse the bill. (Section 121)

3) **Estoppel against denying signature or capacity of prior party:** An endorser of a negotiable instrument shall, in a suit thereon by the subsequent holder, be allowed to deny the signature or capacity to contract of any prior party to the instrument.

Payee in a negotiable instrument

All three kinds of negotiable instruments mentioned under section 13 of the Act could be made payable in any of the following ways –

- Payable to bearer; or
- Payable to order.

Payable to bearer: The expression "*bearer instrument*" signifies an instrument, be it promissory note, bill of exchange or a cheque, which is expressed to be so payable or on which the last endorsement is in blank. This character of the instrument can be altered subsequently e.g. an endorsee can convert an '*Endorsement in blank*' into an '*Endorsement in full*'. In such a case, the holder of the instrument would not be able to negotiate the instrument by mere delivery. He will be required to endorse the instrument before delivering it.

Payable to order: An instrument is payable to order when it is payable to:

i. the order of a specified person, or

ii. a specified person or his order, or

iii. a specified person without the addition of the words "*or his order*" and does not contain words prohibiting transfer or indicating an intention that it should not be transferable.

When an instrument is not payable to bearer, the payee must be indicated with reasonable certainty.

TYPES OF NEGOTIABLE INSTRUMENTS

According to the Negotiable Instruments Act, 1881 there are just three types of negotiable instruments i.e., promissory note, bill of exchange and cheque. However many other documents are also recognized as negotiable instruments on the basis of custom and usage, like hundis, treasury bills, share warrants, etc., provided they possess the features of negotiability.

PROMISSORY NOTE

The term Promissory note has been defined under Section 4 of the Negotiable Instruments Act, as under:

"A promissory note is an instrument (not being a bank note or a currency-note) in writing containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to, or to the order of a certain person, or to the bearer of the instrument."

The person who makes the promissory note and promises to pay is called the maker. The person to whom the payment is to be made is called the payee.

Suppose you take a loan of Rupees Five Thousand from your friend Ramesh. You can make a document stating that you will pay the money to Ramesh or the bearer on demand. Or you can mention in the document that you would like to pay the amount after three months. This document, once signed by you, duly stamped and handed over to Ramesh, becomes a negotiable instrument.

Now Ramesh can personally present it before you for payment or give this document to some other person to collect money on his behalf. He can endorse it in somebody else's name who in turn can endorse it further till the final payment is made by you to whosoever presents it before you. This type of a document is called a Promissory Note.

Specimen of Promissory Note:

Rs. 10,000/-	**New Delhi**
	September 25, 2002
On demand, I promise to pay Ramesh, s/o RamLal of Meerut or order a sum of Rs 10,000/- (Rupees Ten Thousand only), for value received.	
To, Ramesh	**Sd/ Sanjeev**
Address.....	**Stamp**

Parties to a Promissory Note

There are primarily two parties involved in a promissory note. They are

i. The Maker or Drawer – The drawer is the person who makes the note and promises to pay the amount stated therein. In the above specimen, Sanjeev is the maker or drawer.

ii. The Payee – The payee is the person to whom the amount is payable. In the above specimen it is Ramesh.

In course of transfer of a promissory note by payee and others, the parties involved may be -

a. The Endorser – the person who endorses the note in favour of another person. In the above specimen if Ramesh endorses it in favour of Ranjan and Ranjan also endorses it in favour of Puneet, then Ramesh and Ranjan both are endorsers.

b. The Endorsee – the person in whose favour the note is negotiated by endorsement. In the above, it is Ranjan and then Puneet.

Features of a promissory note:

Following are the features of a promissory note:

1) A promissory note must be in writing, duly signed by its maker and properly stamped as per Indian Stamp Act.

2) It must contain an undertaking or promise to pay. Mere acknowledgement of indebtedness is not enough. Fot example, if someone writes 'I owe Rs. 5000/- to Satya Prakash', it is not a promissory note.

NOTES

3) The promise to pay must not be conditional. For example, if it is written 'I promise to pay Suresh Rs 5,000/- after my sister's marriage', is not a promissory note.

4) It must contain a promise to pay money only. For example, if someone writes 'I promise to give Suresh a Maruti car it is not a promissory note.

5) The parties to a promissory note, i.e. the maker and the payee must be certain.

6) A promissory note may be payable on demand or after a certain date. For example, if it is written 'three months after date I promise to pay Satinder or order a sum of rupees Five Thousand only' it is a promissory note.

7) The sum payable mentioned must be certain or capable of being made certain. It means that the sum payable may be in figures or may be such that it can be calculated.

BILL OF EXCHANGE

A Bill of Exchange has been defined under section 5 of the Act 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 certain persons or to the bearer of the instrument."

In England it has been defined as "an unconditional order in writing, addresses by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed rate or determinable future time a sum certain in money or to the order of a specified person, or to the bearer."

Suppose Rajiv has given a loan of Rupees Ten Thousand to Sameer, which Sameer has to return. Now, Rajiv also has to give some money to Tarun. In this case, Rajiv can make a document directing Sameer to make payment up to Rupees Ten Thousand to Tarun on demand or after expiry of a specified period. This document is called a bill of exchange, which can be transferred to some other person's name by Tarun.

- A bill of exchange may be made payable to bearer on demand or after a definite period of time.
- A bill of exchange cannot be made payable to bearer on demand because section 31 of the Reserve Bank of India Act prohibits the issue of such bills of exchange.

Specimen of a bill of exchange

Rs. 10,000/-		New Delhi May 2, 2001
Five months after date pay Tarun or (to his) order the sum of Rupees Ten Thousand only for value received.		
To Sameer Address	Accepted Sameer	Stamp S/d Rajiv

PARTIES TO THE BILL OF EXCHANGE

1) **Drawer:** The maker of a bill of exchange or cheque is called drawer.
2) **Drawee:** The person who is directed to pay by the drawer.
3) **Acceptor:** One who accepts the bill. Generally the drawee is the acceptor but a stranger may accept it on behalf of the drawee.
4) **Payee:** Person to whom the sum stated in the bills is payable.
5) **Holder:** Section 8 of the Negotiable Instruments Act states that "The 'holder' of a promissory note, bill of exchange or cheque means *"any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto."*
6) **Holder in due course:** A person who for consideration becomes the possessor of a promissory note, bill of exchange or cheque (if payable to bearer).
7) **Endorser:** Holder who endorses the bill in favour of any other person.
8) **Endorsee:** Person in whose favour the bill is endorsed by the endorser.
9) **Drawee in case of need:** When in the bill or in any endorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need such person is called as the 'drawee in case of need'.
10) **Acceptor for honour:** When a bill of exchange has been noted and protested for non-acceptance or for better security, any other person accepts it supra protest for honour of the drawer or of any of the endorsers, such person is called the 'Acceptor for honour'.

Features of a bill of exchange

Following are the various features of a bill of exchange.

1) A bill must be in writing, duly signed by its drawer, accepted by its drawee and properly stamped as per Indian Stamp Act.
2) It must contain an order to pay. Words like 'please pay Rs 5,000/- on demand and oblige' are not used.
3) The order must be unconditional.
4) The order must be to pay money and money alone.
5) The sum payable mentioned must be certain or capable of being made certain.
6) The parties to a bill must be certain.

Special benefits of bill of exchange

Following special benefits associated with the bill of exchange:

1) A bill of exchange is a double secured instrument i.e. where the drawee fails to honour the order; the holder of the instrument may look to the drawer for payment.
2) In case of immediate requirement a Bill may be discounted with a bank.

NOTES

3) The drawer or any endorser thereof may mention a person as 'drawee in case of need' to be resorted to for payment by the payee in case of dishonour of the bill by the drawee.

Kinds of bills

(1) Accommodation Bill (Sections 43-45)

All bills are not genuine trade bills, as some times they may be drawn for accommodating a party. An accommodation Bill is quite similar to that of a bill of exchange but it is distinguished from an ordinary bill by the fact that such a bill is not supported by any consideration or transaction. The drawer does not give any consideration to the drawee. The relationship between the drawer and drawee are not that of a debtor and creditor.

The party lending his name to oblige the other party is known as the accommodation or accommodating party and the party being obliged is known as accommodated party. The accommodating party is not liable to the accommodated party on the instrument as there is no consideration and the instrument was drawn only to help the accommodated party. But the accommodating party is liable to the 'holder for value'.

Rules for Accommodation Bill

1) An accommodation bill creates no obligation of payment between the parties to the transaction. The accommodation party is not liable to the accommodated party on the maturity date.

2) No party fot whose accommodation a negotiable instrument has been made, drawn, accepted or endorsed can, if he has paid the amount thereof, recover thereon such amount from any person who became a party to such instrument fot his accommodation.

3) An accommodation bill can be negotiated even after its maturity i.e. when it becomes overdue, with all benefits of a 'holder in due course' to the transferee. (Section 59)

4) Non-presentment of the accommodation bill to the acceptor for payment does not discharge the drawer from his liability.

5) In the case of dishonour of an accommodation bill, failure to give notice of dishonour does not discharge the liability of prior parties as against the case in the Ordinary bill.

(2) Fictitious Bill

A bill of exchange in which the name of both the drawer and the payee are fictitious i.e. imaginary. Such a bill cannot be enforced by law but it is good in the hands of a holder in due course if it has been accepted by a genuine person. This is provided that he can show that the first Endorsement on the bill and the signature of the supposed drawer (being the holder as well) are in the same hand writing, and the acceptor is liable on the bill to him. In this connection section 42 of the Act states:

"An acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relived from the liability to any holder in due course claiming under an Endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer."

(3) Forged Bill

A bill in which name of the drawer or the payee has been forged. Such a bill cannot be enforced by law and does not hold good even in the hands of holder in due course.

Distinction between a promissory note and a bill of exchange

The distinctive features of these two types of negotiable instruments are tabulated below:

Promissory Note	Bill of Exchange
It contains a promise to pay.	It contains an order to pay.
The liability of the maker of a note is primary and absolute (S.32).	The liability of the drawer of a bill is secondary and conditional.
It is presented for payment without any previous acceptance by the maker.	If a bill is payable some time after sight, it is required to be accepted either by the drawee himself or by someone else on his behalf, before it can be presented for payment.
The maker of a promissory note stands in immediate relationship with the payee and is primarily liable to the payee or the holder.	The maker or drawer of an accepted bill stands in immediate relationship with the acceptor and the payee.
It cannot be made payable to the maker himself. The maker and the payee cannot be the same person.	The drawer and payee or the drawee and the payee may be the same person.
In the case of a promissory note there are only two parties, viz., the maker (debtor) and the payee (creditor).	There are three parties, viz, drawer, drawee and payee, and any two of these three capacities can be filled by one and the same person.
A promissory note cannot be drawn in sets.	The bills can be drawn in sets.
A promissory note can never be conditional.	A bill of exchange too cannot be drawn condi tionally, but it can be accepted conditionally with the consent of the holder.
In case of dishonour no notice of dishonour is required to be given by the Holder.	A notice of dishonour must be given in case of dishonour of a Bills of Exchange.

CHEQUES

"*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." *(section 6).*

(a) "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;

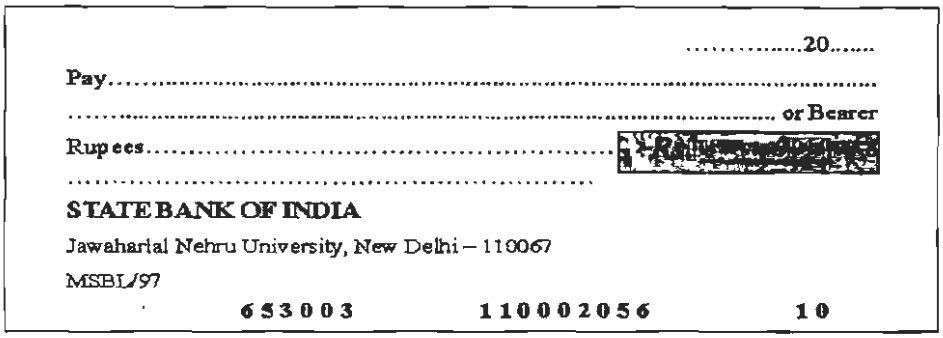
(b) "a truncated cheque" means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

(c) "clearing house" means the clearing house managed by the Reserve Bank of India or a clearing house recognized as such by the Reserve Bank of India.

Cheque is a very common form of negotiable instrument. If you have a savings bank account or current account in a bank, you can issue a cheque in your own name or in favour of others, thereby directing the bank to pay the specified amount to the person named in the cheque. Therefore, a cheque may be regarded as a bill of exchange; the only difference is that the bank is always the drawee in case of a cheque.

The Negotiable Instruments Act, 1881 defines a cheque as a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. Actually, a cheque is an order by the account holder 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.

Specimen of a Cheque


.....20.....

Pay.....

..... or Bearer

Rupees.....

.....

STATE BANK OF INDIA

Jawaharlal Nehru University, New Delhi – 110067

MSBL/97

653003 110002056 10

Types of Cheque

Broadly speaking, cheques are of four types.

a) Open cheque, and

b) Crossed cheque.

c) Bearer cheque

d) Order cheque

Let us know details about these cheques.

a) **Open cheque:** A cheque is called 'Open' when it is possible to get cash over the counter at the bank. The holder of an open cheque can do the following:

   i. Receive its payment over the counter at the bank,

   ii. Deposit the cheque in his own account

   iii. Pass it to someone else by signing on the back of a cheque.

b) **Crossed cheque:** Since open cheque is subject to risk of theft, it is dangerous to issue such cheques. This risk can be avoided by issuing another types of cheque called 'Crossed cheque'. The payment of such cheque is not made over the counter at the bank. It is only credited to the bank account of the payee. A cheque can be crossed by drawing two transverse parallel lines across the cheque, with or without the writing 'Account payee' or 'Not Negotiable'.

c) **Bearer cheque:** A cheque which is payable to any person who presents it for payment at the bank counter is called 'Bearer cheque'. A bearer cheque can be transferred by mere delivery and requires no endorsement.

d) **Order cheque:** An order cheque is one which is payable ro a particular person. In such a cheque the word 'bearer' may be cut out or cancelled and the word

'order' may be written. The payee can transfer an order cheque to someone else by signing his or her name on the back of it.

There is another categorization of cheques which is discussed below:

Ante-dated cheques:- Cheque in which the drawer mentions the date earlier to the date of presenting it for payment. For example, a cheque issued on 20th May 2003 may bear a date 5th May 2003.

Stale Cheque: - A cheque which is issued today must be presented before at bank for payment within a stipulated period. After expiry of that period, no payment will be made and it is then called 'stale cheque'. Find out from your nearest bank about the validity period of a cheque.

Mutilated Cheque: - In case a cheque is torn into two or more pieces and presented for payment, such a cheque is called a mutilated cheque. The bank will not make payment against such a cheque without getting confirmation of the drawer. But if a cheque is torn at the corners and no material fact is erased or cancelled, the bank may make payment against such a cheque.

Post-dated Cheque:- Cheque on which drawer mentions a date which is subsequent to the date on which it is presented, is called post-dated cheque. For example, if a cheque presented on 8th May 2003 bears a date of 25th May 2003, it is a post-dated cheque. The bank will make payment only on or after 25th May 2003.

Features of a cheque:

Following are some important features of a cheque:

1) A cheque must be in writing and duly signed by the drawer.
2) It contains an unconditional order.
3) It is issued on a specified banker only.
4) The amount specified is always certain and must be clearly mentioned both in figures and words.
5) The payee is always certain.
6) It is always payable on demand.
7) The cheque must bear a date otherwise it is invalid and shall not be honored by the bank.
8) The cheque is a revocable mandate and the authority can be revoked by countermanding payment.
9) The cheque is determined by notice of death or insolvency of the drawer.
10) All cheques are bills of exchange but all bills of exchange are not cheques.

DIFFERENCE BETWEEN CHEQUE AND BILL OF EXCHANGE

Cheque	Bill of Exchange
1. Drawee Cheque can be drawn only on a banker.	1 The drawee may be any person.
2. Time of payment A cheque is payable on demand.	2. A bill may be drawn payable on demand or on expiry of certain period after date or sight.
3. Grace period Cheque is payable on demand and no grace period is allowed.	3. While calculating maturity three day's grace is allowed.

4. Notice of dishonour Notice of dishonour is not necessary.	4. A notice of dishonour is required.
5. Payee A cheque can be drawn to bearer and made payable on demand.	5. A bill cannot be made bearer if it is payable on demand. A bill drawn 'payable to bearer on demand' is void.
6. Acceptance A cheque is not required to be presented for acceptance. It needs to be presented only for payment.	6. Bills sometimes, require presentment for acceptance and it is advisable to present them for acceptance even when it is not essential to do so.
7. Stamping No stamp duty is payable on cheques.	7. Affixation of proper stamps is necessary in case of Bills of Exchange.
8. Crossing A cheque may be crossed.	8. A bill of exchange cannot be crossed.
9. Noting and protesting There is no system for noting and protesting in case of dishonour.	9. In case of dishonour of a bill proper noting and protesting is necessary.
10. Discharge of drawer The drawer does not get discharged from his liability because of delay in presenting the cheque to the bank for payment.	10. The drawer of the bill stands discharged from his liability if it is not duly resented for payment.
11. Liability of drawee for dishonour In case of dishonour of cheque the drawee is liable to the drawer and not to the payee.	11. In case of dishonour of the bill by non-payment on an accepted bill of exchange the drawee becomes liable to the payee.
12. Validity period A cheque is usually valid for a period of six months.	12. A bill may be drawn for any period.

HUNDIS

A Hundi is a negotiable instrument by usage. It is often in the form of a bill of exchange drawn in any local language in accordance with the custom of the place. Sometimes it can also be in the form of a promissory note. A hundi is the oldest known instrument used for the purpose of transfer of money without its actual physical movement. The provisions of the Negotiable Instruments Act shall apply to hundis only when there is no customary rule known to the people.

Types of Hundis

There are a variety of hundis used in our country. Let us discuss some of the most common ones.

1) **Shah-jog Hundi:** This is drawn by one merchant on another, asking the latter to pay the amount to a Shah. Shah is a respectable and responsible person, a man of worth and known in the bazaar. A shah-jog hundi passes from one hand to another till it reaches a Shah, who, after reasonable enquiries, presents it to the drawee for acceptance of the payment.

2) **Darshani Hundi:** This is a hundi payable at sight. It must be presented for payment within a reasonable time after its receipt by the holder. Thus, it is similar to a demand bill.

Check Your Progress

1. Define negotiable instrument?
2. Define Holder?

3) **Muddati Hundi:** A muddati or miadi hundi is payable after a specified period of time. This is similar to a time bill.

There are few other varieties like Nam-jog hundi, Dhani-jog hundi, Jawabee hundi, Jokhami hundi, Firman-jog hundi, etc.

HOLDER AND HOLDER IN DUE COURSE

Holder: Holder is defined in Section 8 as:.

"The holder' of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto."

Where the note, bill or cheque is lost or destroyed, its holder is the person entitled at the time of such loss or destruction."

From the above definition it is clear that for being a holder a person must be entitled to –

a) the possession of the instrument in his own name; and

b) receive or recover the amount due thereon from the parties liable thereto.

'Possession' of the instrument by the holders refers to 'de facto' control and not the actual possession. The person must be named in the instrument either as a payee or as endorsee. The meaning of 'de facto' contract becomes clear in the event of death of the actual holder. The legal heir of a deceased holder does not have his name endorsed on the instrument but he becomes holder by operation of law.

Any person in wrongful possession of the instrument cannot be the holder. Therefore, the finder of a lost instrument payable to bearer, or a person in wrongful possession of such instrument, is not a holder.

Further, the possession of the instrument and being named in it as the payee does not make a person a 'holder' thereof. He shall also be entitled to receive payment and to give a valid discharge. Thus, a beneficiary cannot be termed as holder of the instrument and any payment by the drawer to the beneficiary cannot discharge him from his liability. *Bacha Prasad V. Janki Rai, 1957 BLJR 331 (FB).*

Any person who is in possession of the instrument as payee will not be a holder within the meaning of section 8 of the Act if he has been prohibited from receiving payment by an order of Court.

The payee may authorize his agent to receive payment and to give a valid discharge for the same but this does not make the agent the holder of the instrument since he cannot bring an action for recovery of money in the instrument in his own name.

HOLDER IN DUE COURSE

Section 9 of the Act defines a 'holder in due course' as:

"*Holder in due course means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer, or the payee or the endorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title."*

NOTES

Holder in due course means a holder who takes the instrument *bona fide* for value before it is overdue and without any notice of defects in the title of the person who transferred it to him.

Holder in due course for bearer instruments

In the case of an instrument payable to bearer, holder in due course means any person who for consideration became its possessor before the amount mentioned in it becomes payable.

Holder in due course for instruments payable to order

In the case of an instrument payable to order, "holder in due course" means any person who become the payee or endorsee of the instrument before the amount mentioned in it became payable.

Prerequisites for being holder in due course

A person who claims to be holder in due course' is required to prove:

1) That he is a holder.
2) That he is a holder for consideration.
3) Acquisition before maturity.
4) That he has no knowledge of defective title.
5) The instrument was complete at the time of possession.

Privileges of a "holder in due course"

1) **In case of an inchoate instrument:** As per section 20, a person, who signed and delivered to another a stamped but otherwise inchoate instrument, is estopped 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 stamps affixed. In addition, if a subsequent transferor completed the instrument for a sum greater than what was the intention of the maker, the right of a holder in due course to recover the money of the instrument is not affected (section 20).
2) **Fictitious name:** If a bill of exchange is drawn on behalf of a fictitious person and is payable to his order, the acceptor is not relieved of his liability to the holder in due course because of the fictitious name. It is essential though that the holder in due course proves that the document bears the endorsement with signature in the same hand as that of the drawer and purporting to be made by the drawer (Section 42).
3) **Title free from defects:** He possesses title free from all defects. He always possesses better title than that of the transferor or any of the previous parties and can give to subsequent parties the good title that he possesses.
4) **Lost or obtained by fraud or unlawful consideration:** A person liable on a negotiable instrument cannot defend himself against a holder in due course on the ground that the instrument was lost or obtained from him by means of an offence or for an unlawful consideration (Section 58)
5) **Estoppel against denying validity of the instrument originally made:** "*No maker of a promissory note and no drawer of a bill of exchange or cheque and*

no acceptor of a bill of exchange for the honour of the drawer shall in a suit thereon by holder in due course, be permitted to deny the validity of the instrument as originally made or drawn"(Section 120)

6) **Payees incapacity:** No maker of a promissory note and no acceptor of a bill of exchange payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity at the date of note or bill to endorse the same. (Section 121).

7) **All prior parties liable:** "Every prior party to a negotiable instrument (maker or drawee, acceptor or endorser) is liable thereon to a holder in due course until the instrument is duly satisfied (Section 36)."This means that a holder in due course can recover the amount of the negotiable instrument from any or all of the previous parties to the instrument.

8) **Title of previous parties:** No endorser of a negotiable instrument shall in a suit thereon by a subsequent holder, be permitted to deny the signature or capacity of any prior party to the instrument (section 122) .

Distinction between a holder and a holder in due course

1) ***Consideration:*** A holder may become the possessor or payee of an instrument even without consideration, whereas a holder in due course is one who acquires possession for consideration.

2) ***Time of possession:*** A holder in due course as against a holder, must become the possessor payee of the instrument before the amount thereon become payable.

3) ***Good faith:*** A holder in due course as against a holder, must have become the payee of the instrument in good faith i.e., without having sufficient cause to believe that any defect existed in the transferor's title.

Capacity to incur liability under negotiable instruments

Section 26 of the Act states that every person who is capable of entering into a contract and to bind himself can make, draw, accept or negotiate a negotiable instrument, Section 27 provides that the negotiable instruments may also be drawn, accepted, and negotiated by an authorized agent on behalf of the principal. Therefore, a person is not capable of entering into a contract cannot bind himself by being a party to the negotiable instrument.

Different cases of parties' capacity to incur liability under a negotiable instrument are discussed below:

Minor: A minor is not competent to contract and, therefore, he cannot bind himself by becoming a party to the negotiable instrument. Section 26 provides that "*A minor may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself.*" An instrument does not void just because a minor is party to it. It remains binding on all other parties.

Lunatics: A lunatic or drunken person who is incapable of understanding the effect of contracting on his interest is on the same footing as that of minor.

Corporation: the contractual capacity of a company or corporation depends on the provisions contained in its memorandum of association or the charter. It may become a party to the negotiable instrument only if so authorized by the charter of the company. In this connection section 26 provides that "*Nothing herein contained shall*

NOTES

be deemed to empower a corporation to make, endorse or accept such instrument except in cases in which, under the law for the time being in force, they are so empowered."

Agency: A person capable of contracting may also bind himself through his duly authorized agent acting in his name. But a general authority to transact business and to receive and discharge debts does not confer upon an agent the power of accepting or indorsing bills of exchange so as to bind the principal. Thus, an agent who has specifically been authorized to draw, accept and negotiate negotiable instruments only can bind his principal.

The agent has to make it clear that he is acting in a representative capacity. The form of signature must show that he intends to act as agent or that he does not intend to incur any personal liability. If this is not so done, he becomes personally liable. (Sections 27 and 28)

Legal representative : A legal representative of a deceased person who signs his personal name to a promissory note, bill of exchange or cheque is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him as such (Section 29),

The term "legal representative" includes heirs, executors and administrators.

LIABILITIES OF PARTIES TO NEGOTIABLE INSTRUMENTS

Liability of drawer

Section 30 of the Act states:

"The drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate to the holder, provided due notice of dishonour has been given to, or received by, the drawer as hereinafter provided."

(a) case of dishonour by non-acceptance

(b) case of dishonour by payment

Liability of drawee cheque

Section 31 of the Act states:

"The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque when duly required to do so, and in default of such payment, must compensate the drawer for any loss or damage caused by such default".

The drawee of a cheque who is always a banker is liable to the drawer if he, having sufficient funds of his customer, wrongfully refuses or fails to honour his customer's cheque.

The liability of the drawee arises only when the cheque has been dishonored by mistake. But where the cheque is dishonoured for any of the reasons explained earlier in this chapter, the banker does not incur any liability for rightful dishonour.

Liability of maker of note and acceptor of bill

Section 32 of the Act stats:

"In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount

thereof at maturity according to the apparent tenor of the note or acceptance respectively, and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand".

The maker of a promissory note is bound to pay the amount at maturity, according to the tenor of the note and in case of default of such payment; he is bound to compensate any party to the note for any loss sustained by reason of such default.

A promisor in case of promissory note and a drawer in the case of bill of exchange or cheque is the principal debtor. But after acceptance by the drawee the acceptor becomes the principal debtor. Therefore, in case of a bill the liability of the drawee arises only when he accepts the bills (Section 32). In the absence of a contract to the contrary, (An acceptor of a bill of exchange may become surety and the principle liability may have been agreed to be that of the drawer), the acceptor (drawee) of a bill is bound to pay the amount only at maturity, in accordance with the apparent tenor of the acceptance. In the event of the bill being accepted after maturity, he is bound for the amount to the holder on demand. In default of such payment, he is bound to compensate any party to the bill for any loss or damage caused to him by such a default.

The following persons incur liability by acceptance; (1) drawee (2) person named as drawee in case of need, and (3) acceptor for honour. Where there are several drawers, each can accept only for himself, unless they are partners.

Effect of forged Endorsement on acceptor's liability

An acceptor of a bill already endorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe that the Endorsement was forged when he accepted the bill (Section 41).

Liability of acceptor of a bill drawn in a fictitious name

Section 42 of the Act provides that an acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an Endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer.

Liability of endorser

The endorser of an instrument by endorsing and delivering the instrument, before maturity, undertakes the tesponsibility that –

1) That on the due presentment it shall be accepted, (if a bill), and paid; and
2) That if it is dishonoured by the drawee, acceptor or maker, he will indemnify the holder or subsequent endorsets who are compelled to pay, provided due notice of dishonour is received by him.

But he may or make his liability conditional. In this respect, his position is better than that of a drawer or an acceptor, neither of whom can exclude his liability.

Where the holder of a negotiable instrument, without the consent of the endorser, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder to the extent as if the instrument had been paid at matutity.

NOTES

Liability of parties to holder in due course

Every prior party (i.e. maker or drawer, acceptor and all intervening endorsers to an instrument is liable to a holder in due course until the instrument is satisfied (paid). Therefore, the maker and endorsers of a note are jointly and severally liable for the payment and may be sued jointly.

Liability on an instrument made drawn etc. without consideration

An instrument made, drawn accepted, endorsed or transferred without consideration creates no obligation of payment between the parties to the transaction. Further, a bill drawn or accepted without consideration does not impose any liability, either on the drawer or on the acceptor, to pay the holder. Similarly, if an instrument is endorsed without consideration, the endorser is not liable.

But if any party to such an instrument has transferred the instrument to a holder for a 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 from any party prior thereto.

NEGOTIATION AND ASSIGNMENT

Section 14 of the Negotiable Instruments Act defines negotiation as, "When a Promissory Note, Bill of Exchange or Cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated." The holder of the instrument also gets the right to recover the amount mentioned on it. Negotiation may be carried out by delivery or delivery and endorsement. On the other hand, an assignment can be defined as, when the possession of a negotiable instrument is transferred by writing a discrete deed of transfer.

Negotiable Instruments Act: Distinction between Negotiation and Assignment

The following table illustrates major differences between negotiation and assignment:

Negotiation	Assignment
Negotiation can be done either by delivery or by delivery and endorsement.	Written document duly signed by the transferor is mandatory for an assignment.
The consideration in case of negotiation is presumed.	The consideration has to be proved in case of an assignment.
A notice of transfer to the creditor is not mandatory.	Informing the creditor about the assignment is mandatory.
The Act governing negotiation of negotiable instruments is the Negotiable Instruments Act, 1881	The activities concerning an assignment are regulated by the Transfer of Property Act, 1882

Who may negotiate?

As per Section 51 of the Act a negotiable instrument may be negotiated by the following person :

(1) Sole maker,

(2) Drawer,

(3) Payee,

(4) Endorsee,

(5) All of several joint makers, drawers, payees or endorsees.

A maker of drawer can negotiate only when the instrument is drawn to his own order. In case of restrictive Endorsements the endorsee must exercise his power of negotiation strictly in accordance with the express terms of his authority. Therefore, if negotiability is excluded by the respective endorsement, the endorsee, as holder, cannot negotiate.

Further, explanation to section 51 provides that a maker or a drawer or endorsee or negotiate an instrument, only if –

1. the instrument falls into his possession in a lawful manner; or
2. he is the holder thereof.

Time of negotiation

Section 60 of the Act provides that a negotiable instrument may be negotiated until the payment or satisfaction thereof by the maker or drawer or acceptor or drawee, as the case may be, at or after the maturity but not after the payment. Thus, negotiability of negotiable instruments terminates only on payment or satisfaction at or after maturity. Any payment before maturity does not stop negotiability of the instrument.

Types of negotiation

Under the Act, negotiable instruments may be negotiated either

1. by delivery when these are payable to bearer; or
2. by endorsement and delivery when these are payable to order.

ENDORSEMENT

As per section 15 of the Act Endorsement means –

"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 of or on a slip of a 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."

Form of Endorsement

The Act does not lay down any directions about the form of Endorsement. Only requirement of Endorsement is that the transferor shall use appropriate writing on an instrument so as to transfer his right, title and interest therein to some other person.

Liability of endorser on dishonour

Under Section 35 that except in the case of a contract to contrary, every endorser of a negotiable instrument is liable to every subsequent party to it provided due notice of dishonour is given to or received by him.

Illustration: A bill is drawn by A upon B and is payable to C or order. C endorses the bill to D, who in turn endorses it to E. If B dishonours the bill, the holder, E has a right of action against all the parties i.e. D, C and A.

NOTES

Effect of endorsement

(a) The endorsement of an instrument, followed by delivery, transfers to the endorsee the property in the instrument with right of further negotiation i.e. the endorse may further endorse it to some other person.

(b) A holder of an instrument deriving title from a holder in due course has rights thereon of the holder in due course (Section 53).

NEGOTIATION BY UNAUTHORIZED PARTIES

Right and liabilities in case of loss of instrument

1. The holder of negotiable instrument shall give a notice to all parties liable on the instruments. He shall also give a public notice.
2. Under Section 45A, the loser of a bill of exchange has a right to apply to the drawer for a duplicate of the lost bill, giving security to the drawer to indemnify him against all persons. If the drawer does not grant the application the loser may compel him to provide him with a duplicate.
3. When a negotiable instrument payable to order has been lost, the finder or the endorsee from the finder, is not entitled to receive the amount of it from maker, acceptor or holder, or from any party prior to such holder. He is bound to return the instrument to the real owner.
4. If the instrument lost by one is payable to bearer or endorsed in blank, the third person acquiring it bona fide and for valuable consideration before maturity, is entitled both to retain the instrument against the real owner and to compel payment from the prior parties thereon i.e. if the possessor of a lost instrument is a holder of it in due course, he is entitled to receive the amount due thereon from the acceptor or holder or from any party prior to such holder.
5. The holder of the lost instrument shall give a notice for payment on maturity date to the drawer. If the drawer or acceptor refuses payment, he must give notice of dishonour to the drawer, acceptor as well as to all prior parties failing which he will lose his right to take against the person liable on the instrument.

Check Your Progress

3. Explain Cheques?
4. Who is Minor?
5. What is MuddatiHundi?

Stolen instrument

The position in case of stolen instrument is same as in the case of lost instrument. The thief does not get any title to the instrument. But, if a stolen instrument, payable to bearer, is negotiated to a holder in due course, such holder in due course gets a good title.

Instruments obtained by fraud

Free consent of parties is one of the most important for a valid contract. Absence of consent or absence of free consent vitiates all contracts including contracts relating to negotiable instruments. Thus, if an instrument is obtained from any maker, acceptor or holder by means of an offence or fraud, the possessor is not ordinarily

entitled to receive the amount under it from the acceptor or holder, or from any party prior to such holder. But if such instrument, payable to bearer is transferred to holder in due course he will get good title. Even if the instrument is negotiated by endorsement, the holder in due course gets good title. The endorsement will be valid though the title of the endorser is defective.

Rights and obligations of a person who has obtained an instrument by unlawful consideration

A negotiable instrument given for a consideration which is illegal either because it is immoral and contrary to public policy or because it is specially interdicted or prohibited by the statute is void and creates no obligations between the parties. If the possessor endorses it in favor of some other person, the endorsee also would not be entitled to claim payment, unless he is holder in due course. The endorsee would be regarded as a holder in due course if it is endorsed to him for valuable consideration without any notice having been received by him as to the consideration being unlawful.

Effect of forgery

Forged instrument: In relation to negotiable instruments forgery means fraudulent making or altering writing on the instruments to the prejudice of another man's right. If the signature of the maker, drawer or acceptor is forged on the instrument, it is said to be a forged instrument and, in the eyes of law, a negotiable instrument with forged signature is a null and void. Such an instrument fails to create any right or obligations. In the case of forged instrument even a holder in due course also does not get a good title. It is also to be noted here that a forgery cannot be ratified since the forger does not act and does not purport to act on behalf of the person whose signature he forges.

Forged Endorsement: When signature of the endorser is forged on the instrument it is said to be a forged endorsement. In the eyes of law, a forged endorsement is not an endorsement at all.

If the instrument is payable to a person or to his order, it cannot be negotiated except with the signature of the person. Therefore, if the instrument is negotiated under the forged signature of the person to whom the instrument has been made payable the endorsee does not receive any title even though he is a purchaser for value and in good faith, for the endorsement is a nullity. But in case of bearer instrument or instruments endorsed in blank which can be negotiated by mere delivery, a forged endorsement is immaterial and it does not affect the title of the holder because he derives his title through delivery and not through Endorsement.

Negotiation of Overdue and Dishonoured Instruments

Negotiation after maturity does not convey a good title to the transferee because of defective title of the transferor himself. Only a holder in due course gets a good title even if title of the transferor is defective but to become holder in due the instrument should have been acquired before maturity.

However, in case of Accommodation Bills, the proviso to Section 59 lays down that, any person who becomes holder of an accommodation bill after maturity, in good faith for consideration becomes the holder in due course.

NOTES

Negotiable instruments without consideration

A negotiable instruments made, drawn, accepted or negotiated without consideration or for a consideration which fails, creates no obligation of payment between the parties but if such an instrument is transferred for a valuable consideration, such holder and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor.

DISCHARGE OF NEGOTIABLE INSTRUMENTS

An instrument is said to be discharged when –

(a) All the rights under it are extinguished.

(b) It ceases to be negotiable.

(c) Even a holder in due course does not acquire any right under it.

In short, an instrument is discharged only when the part primarily and ultimately liable on the instrument is freed from liability.

Discharge of a party to an instrument does not discharge the instrument itself. Consequently, the holder in due course may proceed against the other parties liable for the instrument.

Different modes of discharge from liability

Parties to negotiable instruments are discharged from liabilities when the right of action on the instrument is extinguished. The right of action on a negotiable instrument is extinguished by the following methods:

(a) **By payment in due course:** The parties primarily liable to make payment on an instrument are discharged from liability to all parties if the instrument is payable to bearer or endorsed in blank, and such maker, acceptor or endorser makes payment in due course of the amount due thereon i.e. when the payments have been made to the holder of the instrument at or after maturity in good faith and without notice of any defect in the title to the instrument (Section 82).

(b) **By cancellation of acceptor's endorser's name :** The maker, acceptor and endorser respectively of a negotiable instrument are discharged from liability to a holder who cancels the acceptor's or endorser's name with the intent to discharge him and to all parties claiming under such holder i.e. if the holder of a bill cancels the signature of acceptor with an intention to discharge him, both maker and the acceptor of such negotiable instrument are discharged from the liability to the holder and to all parties claiming under such a holder [Clause (a) Section 82)]. However, it is to be noted that any cancellation under mistake or without the authority of the holder is inoperative.

(c) **By release:** the holder of an instrument may release any of the parties to the instrument by any method other than cancellation of names e.g. a separate agreement of waiver, or release. The release may be express or implied [Clause (b) of Section 82]. The party so released and all subsequent parties

who have a right against the party so released will also stand released and discharged from the liability.

(d) **By allowing more than 48 hours to the drawee for acceptance :** If the holder of a bill of exchange allows the drawee more than forty-eight hours, exclusive of public holidays to decide whether he will accept the bill, all prior parties not consenting to such an allowance of more than 48 hours are discharged from liability to such holder. This is because the holder must treat the instrument as dishonoured if the drawee fails to signify his acceptance within forty-eight hours, and then the holder must give notice to the drawer and to all prior parties, and must not allow time unless they give their consent that more time should be allowed (Section 83).

(e) **Dissenting parties discharged by qualified or a limited acceptance:** The holdet of a bill is entitled to unqualified acceptance. If he elects to take a qualified acceptance, he does so at his own peril and discharges all parties prior to himself unless he obtains their consent to such an acceptance are discharged. All previous parties are discharged in the following cases:

(1) when acceptance is qualified,

(2) when acceptance is fot a part of the sum,

(3) when acceptance substitutes a different place or time of payment,

(4) when acceptance is not signed by the drawee not being partners.

But, if the prior parties subsequently approve of such acceptance by the holder, they will not be discharged.

(f) **By payment, alteration not being apparent :** If a person makes payment on an altered note, bill or cheque, and the alteration is such that it is not apparent the payment is deemed to have been made in due course and the person (banker or other person) who is liable to pay the amount is protected (Section 89).

Where the cheque is an electronic image of a truncated cheque, any difference in apparent tenot of such electronic image and the truncated cheque shall be a material alteration and it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image.

Any bank or a clearing house which receives a transmitted electronic image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same."

(g) **By negotiation back :** If a bill of exchange which has been negotiated is, at or after maturity held by the acceptor in his own right all right to action thereon are extinguished (Section 90).

(h) **By delay in presenting the cheque within a reasonable time:** If a cheque is not presented for payment within a reasonable time after its issue the drawer is not liable for the delay. However, if the drawer suffers some loss due to failure of the bank, the drawer is discharged as against the holder to the extent of losses suffered by him.

For example, if X draws 10 cheques of Rs.250 each, but when the cheques ought to be presented, has only Rs.2,000 at the bank and subsequently the bank fails before the cheques are presented, X will be released from liability to the extent of Rs.2,000 but will remain liable for the balance. If he had the full amount of Rs.2, 500 at the bank, he will be discharged in full.

(i) **By operation of law:** A negotiable instrument is also discharged by operation of law under any of the following circumstances:

(a) By lapse of time i.e., when the claim under the instrument becomes barred by the Limitation Act on the expiry of the period prescribed for the recovery of the amount due on the instrument; or

(b) By merger, i.e., when the debt, under the instrument is merged in the judgement debt obtained against the acceptor make or endorser.

(c) Under the law of insolvency i.e. when the acceptor, maker, or endorser, who becomes insolvent, is discharged by an order of the Court made in the insolvency proceedings.

(j) **By payment by the drawee of a cheque payable to order or to bearer:** Payment in due course discharges the bank from liability even if the payment is made to a wrong person. A cheque is said to have been paid in due course when it has been paid in good faith, after taking proper care to ascertain the genuineness of the endorsements. But if the drawer's signatures are forged, the banker can, under no circumstances, claim discharge on payment.

The bank is discharged by payment in due course to the bearer notwithstanding any endorsement thereon, whether in full or in part and whether or not such endorsement purports to restrict or exclude further negotiation. The endorsee under an endorsement in full cannot recover the amount from the banker who has paid it to the bearer (Section 85).

The rule of the discharge applicable to a cheque payable to order also applies, to a draft drawn by one of the bank upon another payable to order or demand (Section 85A).

(k) **By material alteration of the instrument without assent of all parties liable:** Material alteration is that change in the negotiable instrument which affects the validity of the instrument or rights of the parties thereto. Validity of the instrument is affected only when the alteration is material. Any material alteration of a negotiable instrument renders the same void as against anyone who is party thereto at the time of making such alterations. Following have been held to be material alterations:

1. Alterations of the date of the instrument
2. Alteration of the sum payable
3. Alteration of the time of payment
4. Alteration in the place of payment
5. Alteration in the rate of interest
6. Alteration by addition of new party
7. Alteration by adding the place of payment
8. Tearing off the material part of the instrument

A change is said to be material when –

(a) it changes the identity of the contract between the parties

(b) it changes the rights and liabilities of the parties of the parties or any of the parties of the instrument.

(c) It alters the operation of the instrument.

Alterations not considered as material alterations: Certain alterations, though material, do not have the effect of vitiating the instrument. Those are as under:

1. Alterations made before the issue of instrument
2. Alterations made to correct a mistake
3. Alterations made to carry out common intention of parties
4. Alterations made with the consent of the parties
5. Alterations which are not considered material e.g.

(a) Filing up of amount in an inchoate instrument

(b) Conversion of an Endorsement in blank into an Endorsement in full

(c) Crossing of a cheque after it has been issued.

DISHONOR OF NEGOTIABLE INSTRUMENT

A bill may be dishonoured for non-acceptance as well as non-payment. Cheques and promissory notes may be dishonoured by non-payment only. When a negotiable instrument is dishonoured the holder is required to give a notice to all the previous parties so as to make them liable to the instrument. Except in the cases where notice of dishonour is waived, the holder's failure to give notice of dishonour to previous parties, he loses his right to bring any action against them.

Kinds of Dishonour

1. Dishonour by non-acceptance
2. Dishonour by non-payment

Dishonour by non-acceptance: Section 91 provides that –

NOTES

"A bill of exchange is said to be dishonoured by non-acceptance when the drawee, or one of the several drawees not being partners, makes default in acceptance upon being duly required to accept the bill, or where the presentment is excused and the bill is not accepted.

Where the drawee is incompetent to contract, or the acceptance is qualified, the bill may be treated as dishonoured".

A dishonour by non-acceptance may take place in any one of the following circumstances:

(a) when the drawee either does not accept the bill within forty-eight hours of presentment or refuses to accept it;

(b) when one of several drawees, not being partners, makes default in acceptance;

(c) when the drawee gives a qualified acceptance;

(d) when presentment for acceptance is excused and the bill remains unaccepted;

(e) when the drawee is incompetent to contract;

(f) when the drawee is a fictitious person and could not be found after reasonable search.

Presentment for acceptance is not necessary: Presentment of the bill for acceptance is not necessary to treat an instrument as dishonoured in any of the following cases:

(i) Where the drawee cannot be found, or

(ii) Where the drawee is incompetent to contract, or

(iii) Where the drawee is a fictitious person.

Effect of dishonour for non-acceptance: In the case of dishonour by non-acceptance, the holder becomes entitled immediately to have recourse against the drawer or the endorser. Dishonour by non-acceptance constitutes a material ground entitling the holder to take action against the drawer and he need not wait till the maturity of the bill.

Dishonour by non-payment

In accordance with the provisions of Section 92 of the Act –

"A promissory note, bill of exchange or cheque is dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same".

Thus, an instrument is said to have been dishonoured by non-payment only when the party primarily liable i.e.

(a) the acceptor of a bill,

(b) the maker of a note, and

(c) the drawee of a cheque,

Distinction between dishonour by non-acceptance and by non-payment

In case of dishonour of a bill by non-acceptance no action lies against the drawee as he is not a party to the bill. The holder of the bill can proceed only against the drawer or endorser, if any. In the case of dishonour of a bill by non-payment action lies against the drawee also as he becomes a party to the instrument. On dishonour by non-payment the drawee can be sued.

Notice of dishonour

By whom notice to be given

When an instrument is dishonoured either by non-acceptance or by non-payment:

1. The holder thereof or some party thereto who remains liable thereon must give notice of dishonour (Section 93).
2. Any party receiving notice of dishonour must also transmit it ro within a reasonable time to all the parties prior to him in order to render them liable to himself unless such party otherwise received due notice as provided under Section 93 (Section 95).

Illustration: A draws a bill in favour of B on X: B endorses it to C; C endorses it to D; D endorses it to E; E endorses it to F.

If the bill is dishonoured by X, F, the holder, may give notice to all his prior parties to make all of them liable to himself. But if he gives notice of dishonour only to E and A his right to claim will be valid against E and A only.

In this case if E does not transmit the notice to D, C, and B he will not have any claim against them. In order that E also has right of action against D, C and B, E must transmit to all his prior parties i.e. D, C and B.

Where several persons are required to give notice of dishonour to their prior parties, a person may take advantage of notice of dishonour served by other person to any person to whom he is also required to give notice. Thus, serving of notice of dishonour is necessary and not the fact that who serves the notice.

Notice by agent

Notice for dishonour can also be given by a duly authorized agent. When an instrument is deposited with the agent for presentment and if the instrument is dishonoured, the agent himself can give notice of dishonour to all prior parties on behalf of the holder. Further the agent may also give such notice to his principal who, in turn, may serve notice to all his prior parties (Section 96).

To whom notice is to be given

Notice must be given to all such parties to whom the holder proposes to charge with liability severally or jointly, e.g., the drawer and the endorsers. Notice may be given either to the party himself or to his agent, or to his legal representative on this death, or to the official assignee on his insolvency. It is not necessary to give notice to the maker of a note or the drawee or acceptor of a bill or cheque (Section 93).

Where the party to whom notice is to be given is dead, the notice addressed to him due to ignorance will not become invalid and such a notice is sufficient to bind the

NOTES

estate of the agent. However, where the holder or any other person who is giving notice is aware of the fact of the death of the party to whom notice is to be given, in that case the notice shall be addressed to his legal representative otherwise it will not be treated as a valid notice. Similarly, in case of insolvency the notice must be given to the Official Assignee.

Effect of non-service of notice

Notice of dishonour is so necessary that an omission to give notice discharges all parties. The parties are discharged not only on the bill but also in respect of the original consideration. Notice of dishonour is a condition precedent to the continuation of the liability of the drawer under Section 30 and of the endorsee under Section 35 of the Act.

Contents of notice

The notice of dishonour may be given in any form but it must inform the party to whom it is given, either in express terms or by reasonable intendment. The notice need not be signed but it must inform the party to whom it is given:

(a) that a specified instrument has been dishonoured

(b) that the instrument has been dishonoured by non-acceptance or non-payment

(c) that he will be held liable thereon.

The notice must give an exact description of the instrument dishonoured, for misdescription, which misleads the addressee, vitiates the notice.

Place of service of notice

The notice, if in writing, may be given by post at the place of business or at the residence of party for whom it is intended. The notice is not rendered invalid by miscarriage in post. Parties may also fix by an agreement a place to which notice of dishonour may be forwarded and a notice sent to such specified place is valid even if it takes longer time. If the holder does not know the place at which the notice of dishonour shall be served, he must exercise due diligence to ascertain the place.

Time of serving the notice

After dishonour of the instrument a notice of dishonour shall be given within a reasonable time. In determining what reasonable time for giving notice of dishonour is regarded must be had to the nature of the instrument and the usual course of dealing with respect to similar instrument. In calculating such time, public holidays are excluded.

Under section 106 of the Act, the reasonable time for giving notice of dishonour of an instrument is as under:

(a) Where the holder of the instrument and the party to whom notice is given carry on business or live in different places, the notice of dishonour must be posted by the next post, if there be one on the same day. In other case, on the next day after the day of the dishonour.

(b) If the parties live or carry on business in the same place, it is sufficient if the notice is dispatched so that it reaches its destination on the day next after the day of dishonour.

NOTES

(c) A party receiving notice of dishonour, who seeks to enforce his right against the prior party, transmit the notice within a reasonable time if he transmits it within the same time after its receipt as he would have had to give notice if he had been the holder (Section 107).

When notice of dishonour is unnecessary (Section 98)

In a suit against the drawer or endorser on an instrument being dishonoured, the notice of dishonour is not necessary in the following cases:

(a) When it has been dispensed with by an express waiver by the party entitled to it.

(b) When the drawer has countermanded payment of a cheque.

(c) When the party charged would not suffer damage for want of notice.

(d) When the party entitled to notice after due search, cannot be found.

(e) Where there are been accidental omission to give the notice, provided the omission has been used by an unavoidable circumstances, e.g., death or dangerous malady of the holder or his agent, or other inevitable accident or over whelming catastrophe not attributable to the default, misconduct or negligence of the party tendering notice.

(f) When one of the drawers is acceptor.

(g) Where the drawer and the acceptor are the some person. However, any partnership between the drawer and drawee of a bill does not give rise to the presumption that they are partners in respect of the drawing of the bill, or that the bill was drawn by one of them on behalf of both. In this type of case the rule mentioned above does not apply.

(h) In the case of promissory note which is not negotiable.

(i) When the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument.

Duties of holder on dishonour of an instrument

The holder shall take the following steps in case of dishonour of an instrument:

1) Notice of dishonour:

The holder shall send a notice of dishonour to all the parties to whom he desires to charge in accordance with the provisions of the Act.

2) Noting and protesting:

When a bill is dishonoured by non-acceptance and a promissory note is dishonoured by non-payment the holder may cause such dishonour to be noted and/or by the notary public.

3) Suit for recovery:

After fulfilling the formalities of noting and protesting the holder may bring a suit against the parties liable to pay for the recovery of the amount due on the negotiable instrument.

Example:

1. A issues an open 'bearer' cheque for Rs.10,000 in favour of B who strikes out the word 'bearer' and crosses the cheque. The cheque is thereafter negotiated to C and D. When it is finally presented by D's banker, it is returned with remarks "payment countermanded" by drawer. In response to a legal notice from D, A pleads that the cheque was altered after it had been issued and therefore he is not bound to pay the cheque.

CASE STUDY:

Arvind is the holder of a bill for Rs.5,000. He makes an indorsement stating that, 'pay Rs.3,000 to Bandhan or order and pay Rs.2,000 to Chinmay or order'. Which of the following statements is true with respect to the indorsement under the Negotiable Instruments Act, 1881?

(a) The indorsement is invalid being a partial indorsement prohibited by the Act

(b) The indorsement to Bandhan is not valid as in case of partial indorsement only the subsequent indorsement is valid

(c) The indorsement to Chinmay is not valid as only Bandhan can indorse the balance in favour of Arvind

(d) The indorsement is valid as partial indorsement is valid under the law

(e) For a partial indorsement to be valid, it must be in equal proportions.

According to section 56 of the Negotiable Instruments Act, 1881, no writing on a negotiable instrument is valid for the purpose of negotiation if such writing purports to transfer only a part of the amount appearing to be due on the instrument; but where such amount has been partly paid, a note to that effect may be endorsed on the instrument, which may then be negotiated for the balance. According to the later part of Section 56, a bill which has been endorsed 'pay or order Rs.500 being unpaid residue of the bill' is a valid endorsement. Therefore, in the given instance, even though the total amount of the bill has been negotiated Bandhan and Chinmay are endorsees for only a part of the amount, the indorsement is invalid as it is a partial indorsement prohibited by the Negotiable Instruments Act, 1881. Hence, option 'A' is correct answer.

CASE STUDY 2

Madhuri Technologies Ltd. has an account in City Bank. Rohit, an executive of the company, had committed forgeries for over two years and withdrew some amounts from the company account. However, the company did not raise any objection to the entries made by the banker in the account during that period. The

banker provided statement of account to the company regularly, mentioning by way of note that any discrepancies noticed should be immediately brought to the notice of the bank, failing which the transactions are assumed to be final. There was no ratification of the entries by the company. After some time, on knowing the facts, Madhuri Technologies Ltd., wants to sue the City Bank for loss caused to the company. Which of the following statements is true in respect of the course of action available to Madhuri Technologies Ltd., under the Negotiable Instruments Act, 1881?

(a) City Bank cannot escape its liability even though the company did not raise any objection to the entries in the statement of accounts

(b) Madhuri Technologies Ltd., cannot sue the City Bank as it had not raised any objections to the entries made by the bank in its account

(c) Madhuri Technologies Ltd., cannot sue City Bank as the bank is absolved of its liabilities by virtue of the note in its statements

(d) Madhuri Technologies Ltd., cannot recover the amount from City Bank as the bank had been regular in sending the statement of account

(e) Madhuri Technologies Ltd., cannot recover the amount from City Bank as the bank had made payment in good faith without negligence.

CASE STUDY 3:

Mukesh stole a cheque that was payable to bearer and crossed generally with the words 'not negotiable' and indorsed the cheque in favour of Manohar, who took it in good faith and for valuable consideration. Manohar deposited the cheque into his bank account and the cheque was duly collected by his bank. Which of the following statements is true in respect of the recovery of money by the true owner of the cheque under the Negotiable Instruments Act, 1881?

(a) As Manohar does not acquire a good title to the cheque, he shall be liable to refund the money to the true owner

(b) As Manohar is a holder in due course who has obtained the cheque in good faith and for valuable consideration, he shall not liable to refund anything to any person

(c) The banker of Manohar, being the collecting banker shall be liable to refund the money to the true owner

(d) The paying banker shall be liable to refund the money to the true owner as the payment made by him does not amount to payment in due course

(e) As Mukesh had stolen the cheque he only shall be liable to refund the money and the owner has to file a police complaint.

A person who takes a cheque that bears the words "not negotiable" acquires no better title than that of his immediate transferor. The true owner of the instrument

NOTES

can claim the instrument or the money from the said person. However, under Sections 128 and 131, the paying and collecting bank will be exonerated from any liability if it can be proved that the payment and collection were made in good faith and without negligence. For example, a cheque that is payable to bearer and crossed generally with the words "not negotiable" is stolen and subsequently comes into the hands of 'B' who takes the instrument in good faith and gives value for it. 'B' pays the cheque into his own account and his bank collects the payment from the drawee bank. By virtue of Sections 128 and 131, the drawee bank and the collecting bank are exonerated from liability on the cheque. However, as 'B' does not acquire a good title to the cheque, he is liable to refund the money to the true owner. The cheque in the given case is not negotiable and therefore as regards the true owner, 'B' is in no better position than his immediate transferor. Hence, in the given instance, as Manohar does not acquire a good title to the cheque, he is liable to refund the money to the true owner.

SUMMARY

- A negotiable instrument means "promissory note, bill of exchange, or cheque, payable either to order or to bearer".
- A negotiable instrument may be transferred by delivery if it is a bearer instrument or by endorsement and delivery if it is an instrument payable to order.
- A negotiable instrument must be in writing. This includes handwriting, typing, computer printout and engraving, etc.
- In every negotiable instrument there must be an unconditional order or promise for payment.
- A promissory note is an instrument (not being a bank note ot a currency-note) in writing containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to, or to the order of a certain person, or to the bearer of the instrument.
- A Bill of Exchange has been defined under section 5 of the Act 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 certain persons or to the bearer of the instrument."
- A cheque in the electronic form means a cheque which contains the exact mirror image of a papet 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 hundi is the oldest known instrument used for the purpose of transfer of money without its actual physical movement.
- Holder in due course means a holder who takes the instrument *bona fide* for value before it is overdue and without any notice of defects in the title of the person who transferred it to him.

- As per section 15 of the Act Endorsement means – "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 of or on a slip of a 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."
- Negotiation after maturity does not convey a good title to the transferee because of defective title of the transferor himself. Only a holder in due course gets a good title even if title of the transferor is defective but to become holder in due the instrument should have been acquired before maturity.
- An instrument is discharged only when the part primarily and ultimately liable on the instrument is freed from liability.
- A bill may be dishonoured for non-acceptance as well as non-payment. Cheques and promissory notes may be dishonoured by non-payment only. When a negotiable instrument is dishonoured the holder is required to give a notice to all the previous parties so as to make them liable to the instrument.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. According to section 13 of the Negotiable Instruments Act, 1881, a negotiable instrument means "promissory note, bill of exchange, or cheque, payable either to order or to bearer".
2. Holder: Section 8 of the Negotiable Instruments Act states that "The 'holder' of a promissory note, bill of exchange or cheque means "any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto."
3. "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." (section 6).
4. Section 26 provides that "A minor may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself."
5. Muddati Hundi: A muddati or miadi hundi is payable after a specified period of time. This is similar to a time bill.

TEST YOURSELF

1) What do you mean by the term 'Negotiable Instrument'?
2) Discuss different characteristics of negotiable instruments?
3) What are the presumptions as to negotiable instrument?
4) Explain rules of estoppel applicable to negotiable instruments.
5) Stare different types of Negotiable Instruments.

NOTES

6) What are different kinds of bills?

7) Discuss various types of Cheques.

8) What is the difference between Cheques and Bill of Exchange?

9) What do you mean by Hundis?

10) Write a short note on:

a) Holder and Holder In Due Course

b) Endorsement

c) Discharge of Negotiable Instruments

d) Dishonor of Negotiable Instrument

FURTHER READING

- *Mercantile Law:Sharma, Sareen, Gupta and Chawla*

4 Company Law

NOTES

The Chapter Covers :

- Meaning of Company:
- Definition of A "Company":
- Formation of A Company
- Memorandum of Association:
- Clauses of Memorandum
- Share And Share Capital
- Share:
- Equity Shares:
- Issue of Shares:
- Share Capital:
- Borrowing Power:
- Resolutions:
- Directors
- Duties of Directors:

Introduction:

After having sufficient knowledge about Contracts, Agreements, Sellers' Duties and Ways of Payment it is the time to study where all these meet together that is a Company.

Meaning of Company:

In common parlance, a company means the group of persons associated together for the attainment of a common objective. A company is a voluntary association of individuals formed for some common purpose. It has capital divisible in parts, known as shares. It is an artificial person created by a process of law. It has a perpetual succession and a common seal.

NOTES

Definition of a "Company":

Lindley, L.J. defines the company as "an association of many persons who contribute money or money's worth to a common stock, and employ it in a common trade or business (i.e. for a common purpose), and who share the profit or loss (as the case may be) arising there from. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted."

Characteristics of a Company:

1. **Incorporated Association:** A company must be incorporated or registered under the Companies Act. Minimum number required for the purpose is 7, in. case of a public company, and 2, in case of a private company [Section 12].

2. **Separate legal entity:** A company is regarded as an entity separate from its members. In other words, it has an independent corporate existence. Any of its members can enter into contracts with it in the same manner as any other individual can and he cannot be held liable for the acts of the company even if he holds the entire share capital of the company.

3. **Artificial Person:** A company is registered as an artificial person as it is created by the law and not by natural birth. It has no body, no soul, and no conscience; still it is in a position to exist.

4. **Limited Liability:** A company may be a company limited by shares or a company limited by guarantee. In a company limited by shares, the liability of the members is limited to the unpaid value of shares. In a company limited by guarantee, the liability of the members is limited to such amount as the members may undertake to contribute to the assets of the company, in the events of its being wound-up.

5. **Perpetual existence:** A company being an artificial person cannot be injured by illness and it does not have an allotted span of life. A company is unaffected by the death, insolvency or retirement of its members. Members may come and go but the company can go forever.

6. **Separate property:** As a company is a legal person distinct from its members, it is capable of owing, enjoying, and disposing of property in its own name.

COMPARISON BETWEEN COMPANY AND PARTNERSHIP:

1) A company can be created only by certain prescribed methods – most commonly by registration under the Companies Act 1985. A partnership is created by the express or implied agreement of the parties, and requires no formalities.

2) A company is an artificial legal person distinct from its members. Although a partnership has a separate legal personality by virtue of sec.4 (2) of the Partnership Act 1890,

3) The minimum number of members in a private company is 2 and maximum number of members in the private company is 50 and in case of a public company minimum number of members is 7 and there is no upper limit on membership in the public company. A partnership must have at least two members and has an upper limit of 20 (with some exceptions).

4) Shares in a company are normally transferable (must be so in a public company). In partnership a partner cannot transfer his share without the consent of all the other partners.

5) Members of a company are not entitled to take part in the management of the company unless they are also directors of it. Every partner is entitled to take part in the management of the partnership business unless the partnership agreement provides otherwise.

6) A member of a company who is not also a director is not regarded as an agent of the company, and cannot bind the company by his actions. A partner in a firm is an agent of the firm, which will be bound by his acts.

7) The powers and duties of a company are closely regulated by the Companies Acts and by its own constitution as contained in the Memorandum and Articles of Association. Partners have more freedom to alter the nature of their business by agreement and without formality.

8) A company must fulfill all formalities regarding the keeping of registers and the auditing of accounts which do not apply in partnership firms.

9) A company can create a security over its assets called a floating charge, which permits it to raise funds without impeding its ability to deal with its assets. A partnership cannot create a floating charge.

10) A company cannot normally be wound up by a single member, and the death, bankruptcy or insanity of a member will not result in its being wound up. A partnership (unless entered into for a fixed period) can be dissolved by any partner, and is automatically dissolved by the death or bankruptcy of a partner.

Types / Classification of Company:

1. **Classification on the basis of Incorporation:**

   a) **Chartered Companies:** Those companies, which are incorporated under a special charter granted by the King and Queen of England.

   b) **Statutory Companies:** These companies are formed by a special Act of Parliament. These are mostly concerned with public utilities such as gas, electricity and railways.

   c) **Registered Companies:** Such companies, which are incorporated under the Companies Act 1956, or registered under any previous Companies Act. Registration is the most commonly used means of forming a company and virtually the only method now used to form a trading company.

2. **Classification on the basis of Liability:**

   a) **Limited Company** – In case of such companies the liability of each member (shareholder) is limited to the extent of a face value of share held by him.

b) **Unlimited Company:** Section 12 specifically provides that any 7 or more persons (2 or more in case of a private company) may form an incorporated company, with or without limited liability. A company without limited liability is known as an unlimited company. In case of such a company, every member is liable for the debts of the company. An unlimited company may or may not have a share capital.

c) **Guarantee Company:** Where the liability of the members of the company is limited to the fixed amount which the members undertake to contribute to the assets of the company in case of its winding-up, the company is called a company limited by guarantee [section 12 (2)(b)]. The liability of its members is limited. The articles of such company must state the numbers of the members with which the company is to be registered [Section 27(2)].

3. **Classification on the basis of Number of Members:**

i. **Private Company:** A private company is defined as "any company that is not a public company". Private companies have no authorized minimum share capital. According to the Sec 3(1) a 'private company' means a company which has a minimum paid up capital of Rs. 1,00,000 or such higher paid-up capital as may be prescribed, and by its Articles:

a) restricts the right of the members to transfer its shares. This restriction is meant to reserve the private character of the company;

b) limits the number of its members to 50 not including its employee members (present or past).

c) prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company.

d) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

e) A private company must have its own Articles of Association which contains the conditions as laid down in Sec. 3(1)(iii).

ii. **Public Company:** A public company means a company which:

a) is not a private company;

b) has a minimum paid-up capital of five lakh rupees or such higher paid-up capital as may be prescribed;

c) is a private company which is a subsidiary of a company which is not a private company.

Thus, Section 3(1) (iv) (c) implies that any private company which is a subsidiary of a public company is also treated as a public company as a result of amendments in the Companies Act in 2000.

4. **Classification on the basis of Control:**

1) **Holding Company:** Section 4 of the Companies Act of 1956 implies that a company is deemed to be the holding company of another if that other is its subsidiary. Thus, a holding company can be defined as the company if which has a control over a subsidiary company.

2) **Subsidiary Company:** A company is known as the subsidiary of another company when control is exercised by the latter (called holding company) over the former called a subsidiary company. According to Sec. 4(1), a company is deemed to be a subsidiary of another company in the following three cases:

   a. **Company controlling composition of Board of Directors:** Where a company (Company A) controls the composition of Board of Directors of another company (Company B), the latter company (Company B) becomes the subsidiary of the former (Company A).

   b. **Holding of Majority of Shares:** Where a company (Company A) holds more than half in nominal value of equity share capital of another company (Company B), the latter (Company B) becomes the subsidiary of the former (Company A). The words 'nominal value of equity capital' in Sec.4 means the face value of the equity capital which has been subscribed for.

   c. **Subsidiary of another Subsidiary:** Where a company (Company A) is subsidiary of another company (like Company B1) which is itself subsidiary of the controlling company (Company B), the former company (Company A) becomes the subsidiary of the controlling company (Company B).

FORMATION OF A COMPANY

Before a company is formed, certain preliminary steps are necessary, for example, whether it should be a private company or a public company, what its capital should be, and whether it is worthwhile forming a new company or taking over the business of an already established concern. All these steps are taken by certain persons known as 'promoters'. They do the entire necessary preliminary work incidental to the formation of the company.

A private company can commence its business immediately after obtaining the certificate of incorporation. But a public company has ro obtain a certificate to commence the business from the Registrar of Companies before it can commence business.

Important Stages Involved in the Process of Formation of a Company:

1. **Promoters:** Promotion of a company is concerned with taking the steps necessary for incorporation. It is the firsr important preliminary stage in the process of formation of the company. A promoter is a person who does the necessary preliminary work incidental to the formation of the company.

   Duties of Promoters: The promoter of a company decides its name and ascertains that it will be accepted by the Registrar of the Companies. He settles the details of the company's Memorandum and Articles, the nomination of directors, solicitors, bankers, auditors, and secretary and the registered office of the company. The promoter will have to ready the following documents:

   i) **Memorandum of Association:** Laying down the constitution of the company.

   ii) **Articles of Association:** Prescribing regulations of internal management.

NOTES

iii) **Prospectus:** For public issue of capital.

iv) **Preliminary Contracts:** Contracts of purchase of property and assets.

v) **Underwriting Contract:** To insure capital issue.

Payment of Promoters: A company cannot enter into a contract before incorporation so a promoter has no legal claim against the company for fees and expenses.

2. **Registration:** A company is registered by filing certain documents with the Registrar. The following documents duly stamped together with the necessary fees are to be filed with the Registrar:

   (a) **Memorandum of Association:** The Memorandum of Association of a company is very important and fundamental document of the company. A public company's memorandum must be in accordance with Table F of the Regulations. It should be duly stamped, signed by the subscribers, two for a private company and seven for a public company, and attested by the signature of a witness. The subscribers to the memorandum are termed as original members of the company.

   (b) **Articles of Association:** This document should be properly stamped, duly signed by the signatories of the Memorandum and also attested. A public company may have its own articles of association. If the company does not have its own articles, it may adopt Table A as given in Schedule I to the Companies Act of 1956.

   (c) **Notice of address of registered office:** A statement giving the address of the company's registered office and the details (name, address, nationality, occupation and date of birth) of the company's first directors and secretary must be signed by the subscribers to the memorandum.

   (d) **Statutory Declaration of Compliance:** This declaration will announce that all the requirements of the Act have been duly fulfilled. It may be signed by an advocate, solicitor or by a proposed director or secretary named in the Articles, as such director or secretary of the company.

   (e) **The consent to act as director of the company:** A separate written consent is necessary to be signed by every proposed director in the case of the public company limited by shares. This is not so necessary for other companies, other than public limited company.

3. **Certificate of Incorporation:** If Registrar is satisfied that requirements of the Act have been met, he registers the documents and issues a certificate of incorporation. This is the company's "birth certificate". The certificate of incorporation is a very important document which certifies that the company has been registered with the Registrar of Companies under the Companies Act of 1956 on a particular date. As and from that date of the issue of the certificate of incorporation, the company obtains a legal status and a distinct corporate personality. This certificate is conclusive evidence that registration requirements have been met. It is also conclusive evidence as to the date of incorporation. Registrar is entitled ro refuse to register a company where it has been formed for an unlawful purpose.

4. **Commencement of Business:** A private company can commence its business immediately after obtaining the certificate of incorporation. A public company must obtain a 'Certificate to Commence Business' from the Registrar before it can commence business. The Registrar will grant this certificate only when:

   i) the minimum subscription has been allotted;

   ii) the directors have taken up and paid for the qualification shares;

   iii) the statutory declaration and the prospectus or statement in lieu of prospectus have been filed.

PROSPECTUS:

After the receipt of certificate of incorporation, if the promoters of a public limited company wishes to issue shares to the public, he will issue a document called prospectus. It is an invitation to the public to subscribe to the share capital of the company. The companies Act, 1956 defines prospectus as "any document described or issued as a prospectus and includes any notice, circular, advertisement or other documents inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of, a corporate body." In simple words, any document inviting deposits from the public for the subscription of shares of debentures of a company is a prospectus. It is circulared among the public in printed pamphlets. It gives all necessary information about the company so that the prospective shareholders may fully understand the objectives and the plans of the company. These documents describe to buyers and participants about mutual funds, bonds, stocks and other forms of investments that are offered by the company. A prospectus is generally accompanied by basic performance and financial information about the company.

Objectives:

Prospectus is issued with the following broad objectives:

- It informs the company about the formation of a new company.
- It serves as written evidence about the terms and conditions of issue of shares or debentures of a company.
- It induces the investors to invest in the shares and debentures of the company.
- It describes the nature, extent and future prospectus of the company.
- It maintains all authentic records on the issue and it make the directors liable for the misstatement in the prospectus.

Contents:

The following important matters are included in the prospectus:

- The prospectus contains the main objectives of the company, the name and addresses of the signatories of the memorandum of association and the number of shares held by them.
- The name, addresses and occupation of directors and managing directors.
- The number and classes of shares and debentures issued.

- The qualification share of directors and the interest of directors for the promotion of company.
- The name and addresses of the vendors of any property acquired by the company and the amount paid or to be paid.
- Particulars about the directors, secretaries and the treasures and their remuneration.
- The amount for the minimum subscription.
- If the company carrying on business, the length of time of such businesses.
- The estimated amount of preliminary expenses.
- Name and address of the auditors, bankers and solicitors of the company.
- Time and place where copies of balance sheets, profits and loss account and the auditors report may be inspected.
- The auditor's report so submitted must deal with the profit and loss of the company for each year of five financial years immediately preceding the issue of prospectus.
- If any profit or reserve has been capitalized, the particulars of such capitalization will be stated in the prospectus.

MEMORANDUM OF ASSOCIATION:

The first thing in the formation of a Joint Stock Company is the preparation of the Memorandum of Association. It is a document which sets out the constitution of the company. It is the principal document of the company and no company can be registered without the memorandum of association. It defines the scope of the company's activities as well as its relation with the outside world. That is why Memorandum of Association has often been called the charter of the company.

According to Lord Macmillan, "The purpose of the memorandum is to enable the shareholder, creditors and those who deal with the company to know what is permitted range of enterprise."

According to Charles Worth, "the memorandum of association is the company's charter and defines the limitations of its powers. Its purpose is to enable shareholders; creditors and those who deal with the company, to know what its permitted range of enterprise is. It is the document which informs all persons dealing with the company, what the company is formed to do. How capital will it raise its nationality is? It regulates the company's external affairs, while the articles of association regulate its internal affairs."

This is an exhaustive definition which explains the nature and scope of memorandum.

Section 2 (28) of the Companies Act defines a memorandum as "the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous Company Law or of this Act."

Purpose

The main purpose of the memorandum is to explain the scope of activities of the company. The prospective shareholders know the areas where company will invest their money and the risk they are taking in investing the money. The outsiders will

understand the limits of the working of the company and their dealings with it should remain within the prescribed scope.

Importance of Memorandum

NOTES

Memorandum is the fundamental document of a company which contains conditions upon which the company is incorporated. This document is important for the following reasons:

- Memorandum defines the limitations on the powers of the company established under the Act.
- The whole structure of the company is built upon memorandum.
- It explains the scope of activities of the company. The investment knows where their money will be spent and outsiders also know the nature of activities the company is authorized to take up.
- It is a basic document of the company with regard to its constitution.
- It is a charter of the company which sets out its written goals.

CLAUSES OF MEMORANDUM

The contents of the memorandum are explained in Section B of the Act. The promoters of the company prepare this document. The Memorandum of association must contain the following clauses:

1. Name Clause:

A company being a separate legal entity must have a name. A company may select any name which does not resemble the name of any other company and it should not contain the words like king, queen, emperor, government bodies and the names of world bodies like UNO, WHO, World Bank etc. The name should not be objectionable in the opinion of the government. The word 'limited' must be used at the end of the name of a Company. These words are used to ensure that all persons dealing with the company should know that the liability of its members is limited. The name of the company must be painted outside every place where business of the company is carried on. If the company has a name which is undesirable or resembles the name of any other existing company, this name can be changed by passing an ordinary resolution.

2. Registered Office Clause:

Every company should have a registered office from the day on which it begins to carry on business, or as from the 30th day after the date of its incorporation, whichever is earlier. All communication and notices are to be addressed to that registered office. This helps the Registrar to have correspondence with the company. A company can shift its registered office from one place to another in the same town with the suggestion to the Registrar. But if the company wants to shift its registered office from one town to another town in the same state, a special resolution is required to be passed. If the office is to be shifted from one state to another state it involves alteration in the memorandum.

3. Object Clause:

This is one of the important clauses of the Memorandum of Association. It determines the rights and powers of the company and also defines its sphere of activities.

The object clause should decide carefully because it is difficult to alter this clause later on. No activity can be taken up by the company which is not mentioned in the object clause. Moreover, the investors i.e., shareholders will know the sphere of activities which the company can undertake.

The object clause in the Memorandum of every company has to state (a) main objects, and (b) other objects.

a) Main objects of the company to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects.

b) Other objects will include all other objects which are not included in the main objects.

The object clause offers protection to the shareholders by ensuring that the funds raised for the undertaking are not going to be risked in any other undertaking. The creditors also feel protected by this clause. By confining the activities within a specified field, it serves the public interest also.

4. Liability Clause:

This clause states that the liability of the members is limited to the value of shares held by them. It means that the members will be liable to pay only the unpaid balance of their shares. The liability of the members may be limited by guarantee. It also states the amount which every member will undertake to contribute to the assets of the company in the event of its winding up.

5. Capital Clause:

This clause states the total capital of the proposed company. The division of capital into equity share capital and preference share capital should also be mentioned. The number of shares in each category and their value should be given. This clause must contain a statement as to the amount of capital with which the company proposes to be registered and the division thereof into shares at certain fixed amount.

6. Association Clause:

This clause contains the names of signatories to the memorandum of association. The memorandum must be signed by at least seven persons in the case of public limited company and by at least two petsons in the case of private limited company. Each subscriber must take at least one share in the company. The subscribers declare that they agree to incorporate the company and agree to take the shares stated against their names. The signatures of subscriber are attested by at least one witness each. The full addresses and occupations of subscribers and the witnesses are also given.

DOCTRINE OF ULTRA VIRES:

The company's activities are confined strictly to the objects mentioned in its Memorandum, and if they go beyond these objects, then such acts will be ultra vires. The object of declaring such acts as ultra vires is to protect the interests of shareholders and all other who deal with the company. Some points worth noting as regards doctrine of ultra vires are:

i) A company exists only for the objects which are expressly stated in its objects clause or which are incidental to or consequential upon these specified objects.

ii) Any act done outside the express and implied objects is ultra vires.

iii) The ultra vires acts are null and void ab initio. The company is not bound by these acts; and neither the company nor the other contracting party can sue upon it.

NOTES

Alteration of a Memorandum of Association

Memorandum of Association is a basic document of the company. Any change in various clauses of memorandum may have an adverse effect on any of the parties connected with the company. Company Law has prescribed a particular procedure for making a change in the memorandum. The following procedure is followed for carrying out a change in the memorandum:

1. Name clause (Section 25):

A company may change its name by passing a special resolution and with the prior approval of the Central government. If the company is registered with an undesirable name then it can change it with an ordinary resolution with the approval of the Central Government. The Central Government can also direct the company within 12 months of its registration to change its name and this will have to be done within three months. The change in name will be effective when it is resisted with the Registrar.

2. Registered Office (Section 17):

The change in registered office place from one state to another requires a change in memorandum. This change affects the interests of shareholders, investors, creditors, employees etc. This change can be affected only with the approval of Company Law Board.

3. Object Clause (Section 17):

The object clause is the most important clause in the memorandum; its change may affect the activities of the company. This clause is a limitation on the company beyond which it cannot carry its activities. The object clause can be changed by passing a special resolution and by getting the permission of the Company Law Board. A copy of the resolution should be filed with the Registrar within 30 days of passing the resolution. A petition is also made to the Company Law Board for issuing a confirmation. When this change is allowed by the Board, then printed copy of the Memorandum as altered must be filed with the Registrar within three months of the order. The change in situation and objects clause is allowed only under certain situations. It will be allowed when it necessary for any of the following reasons:

- The change is necessary to allow the company to carry on its business more economically or efficiently.
- The company will be able to attain its objectives by new and improved means.
- The company may enlarge the local area of its operations.
- The company is allowed to carry on some new business which under existing circumstances may conveniently and advantageously be combined with the objects specified in the memorandum.

Check Your Progress

1. What do you mean by a Company?
2. Explain Prospectus?

NOTES

- To restrict or abandon any of the objects specified in the memorandum.
- To sell whole of part of the company's property.
- To amalgamate with any other company or body of persons.

4. Liability clause:

If articles so permit, the liability of the Directors Managing Directors or Manager can be made unlimited by passing a special resolution. The officer concerned should also accord his consent for making the liability unlimited.

5. Capital Clause:

A change in capital clause involves an increase in the authorized capital and it can be affected by passing an ordinary resolution in the general Meeting.

When a company resolves to alter its memorandum, a copy of the resolution, and the amended memorandum, must be sent to the Registrar within 15 days.

Article of Association

The rules and regulations which are framed for the internal management of the company are set out in a document named Articles of Association. The articles are framed to help the company in achieving its objectives which are set out in a memorandum of association. It is a supplementary document to the memorandum.

According to Section 2(2) of the Companies Act, "Articles of association of the company as originally framed or as altered from time to time in pursuance of any previous companies' law or of this act."

The private companies limited by shares, companies limited by guarantee and unlimited companies must have their articles of association. A public company limited by shares may or may not have its own Articles. As per Section 26 of Companies Act, it is not obligatory on the part of a public company limited by shares to prepare and register Articles of Association along with Memorandum of Association. However, such a company may adopt all or any of the regulations contained in the model set of Articles given in table A in the Schedule I of the Act. It means the company can partly frame its own articles and partly incorporate some of the regulations in Table A.

The articles cannot contain anything contrary to the Companies Act and also to the memorandum of association. If the document contains anything contrary to the Companies Act or memorandum, it will be inoperative. When articles are proposed to be registered, they must be printed, divided into paragraphs and numbered consecutively. Each subscriber to the memorandum must sign the articles in the presence of at least one witness.

The nature of Articles may be explained as follows:

- Articles of association are subordinate to memorandum of association.
- The articles are controlled by memorandum.
- Articles help in achieving the objectives laid down in the memorandum.

- Articles are only internal regulation over which members exercise control.
- Articles lay down the regulations of governance of the company.

Contents

Some of the contents of articles of association are follows:

- The amount of share capital issued, different types of shares, calls on shares, forfeiture of shares, transfer and transmission of share and rights and privileges of different categories of shareholders.
- Powers to alter as well as reduce share capital.
- The appointment of directors, powers, duties and their remuneration.
- The appointment of manager, managing director, etc.
- The procedure for holding and conducting of various meetings.
- Matters related to maintaining of accounts, declaration of dividends and keeping of reserves, etc.
- Procedure for winding up the company.

Alteration of Articles of Association

Companies have been given very wide power to alter their Articles. The articles of association can be altered by assign a special resolution. A copy of every special resolution altering the Articles shall be filed with the Registrar within 30 days of its passing and attached to every copy of the Articles issued thereafter.

Limitations to alteration:

- The change should not be violating the provisions of the Companies Act.
- It should not be contrary to the provisions of the memorandum of association.
- The alteration must not have anything illegal.
- The alteration should not adversely affect the minority shareholders.
- The alteration must be for the benefit of the company.

Difference between Memorandum of Association and Articles of Association

Memorandum of Association	Articles of Association
1. It defines the scope of the activities of the Company, or the area beyond which the actions of the company cannot go.	1. They are the rules for carrying out the objects of the company as set out in the Memorandum.
2. It is the charter of the company indicating the nature of its business, its nationality, and its capital. It also defines the company's relationship with the outside world.	2. They are the regulations for the internal management of the company and are subsidiary to the Memorandum.
3. Every company must have its own Memorandum.	3. A company limited by shares need not have Articles of its own. In such a case, Table A applies.

4. There are strict restrictions on its alteration. Some of the conditions of incorporation contained in it cannot be altered except with sanction of the Company Law Board.	4. They can be altered by a special resolution, to any extent, provided they do not conflict with the Memorandum and the Companies Act.
5. It, being the charter of the company, is the supreme document.	5. They are the subordinate to the memorandum.

Legal Effect of Memorandum and Articles:

The memorandum and articles operate as a contract between the company and its members, which both parties are bound to do.

The effect of this is:

(a) Each member, in his capacity as a member, is bound to the company as if he personally had signed the memorandum and articles.

(b) The company is bound to each member in his capacity as a member.

(c) The memorandum and articles do not constitute a contract binding the company or any member to an outsider.

(d) Provisions of the memorandum or articles can sometimes form part of an extrinsic contract between the company and an outsider.

This can happen in one of three ways:

(i) Where provisions of the memorandum or articles are expressly incorporated into an express contract between the company and the outsider.

(ii) Where there is no express contract but a provision in the memorandum/articles is incorporated by implication from the conduct of the parties.

(iii) Where there is an express contract which is silent on a particular matter and relevant provisions in the articles or memorandum are used to fill in any gaps.

The company is not actually liable to the outsider on the basis of the articles.

(e) A member has a right to compel the company to act according to the articles even if not enforcing a right which is personal to himself as a member.

(f) The memorandum and articles constitute a contract between each member and every other member.

Memorandum and Articles of Association Advantages:

- Minimum subscription is not required.
- Company's can easily raise the sufficient capital through shares.
- These are appropriate for the business persons who have the limited capital.
- Accounts of any currency can be freely transferable without any exchange control restrictions.

Memorandum and Articles of Association Disadvantages:

- The expenses for the company formation are very high.

- The alteration of memorandum is not so easy.
- The procedure for the establishment and the legal formalities are very complicated.
- The administrative costs and the tax payment are very high.
- In the private company shares cannot be sold to the public.
- The problem of management occurs when directors are not able to manage the company as the sole traders do.

SHARE AND SHARE CAPITAL

SHARE:

A share is a fractional part of the capital which provides the basis of ownership. As per Section 2(46) of the companies act, 1956, a share means share in company's share capital and includes stock except where a distinction between stock and share is expressed or implied. The persons who hold share in their names are known as shareholders.

According to Justice Farewell, " A share is the interest of shareholder in the company measured by a sum of money for the purpose of liabiliry in the first place and of interest(dividend) in the second."

Nature of Share:

- Share is a movable property in the eyes of law.
- Share offers some right to and imposes some liabilities on the shareholders.
- Share is transferable.

Types of Shares:

As per the provision of Companies Act, 1956, a company can issue following two types of shares,

- Preference Shares
- Equiry Shares

The share capital consisting from preference shares is called preference share capital and that consisting from equity shares is called equity share capital.

PREFERENCE SHARES:

According to section 85 of the Companies Act, 1956, persons holding preference shares are called preference shareholders. A preference share is one which has the following two rights:

- A right to receive dividend at a stipulated rate or a fixed amount before any dividend is paid on equity shares,
- A right to receive repayment of capital in the event of winding up of the company.

Types of Preference Shares: The preference shares may be of the following types:

1. **Cumulative Preference Shares:** When profits of the company are distributed amongst the shareholders, the holder of these shares is entitled to get dividend at a fixed rate. If in any year the company does not pay dividend and the

preference shares are cumulative, the dividends on such shares will get accumulated. Such dividend is called arrears of dividend. The company must pay such arrears in future, before the other shareholders participate in the profits. These shares are called cumulative preference shares because dividend for the years of non-payment goes on accumulating. The arrears of dividend on cumulative preference shares are shown as a contingent liability in the Balance Sheet.

2. **Non-Cumulative Preference Shares:** Holders of such shares are entitled to take dividend only out of current year's profits. In case no dividend is declared in a year due to any reason, the right to receive such dividend for that particular year expires. It implies that the holder of such a share is not entitled to arrears of dividend in future.

3. **Participating Preference Shares:** A participating preference share is a share which carries the right of sharing surplus profit which remains after paying equity and preference dividends at specified rates.

4. **Non-participating Preference Shares:** A non participating preference share is the share which does not carry the right to share in the surplus profit after paying specified dividend to preference and equity shareholders. Unless otherwise specified, the preference shares are generally non-participating.

5. **Redeemable Preference Shares:** If a company is authorized by its Article of Association, it may issue Redeemable Preference Shares. Redeemable Preference Shares are those shares which are to be redeemed either at the fixed date or after a certain period of time during the life time of the company. After the commencement of The Companies (Amendment) Act 1988, no company can issue any preference share which is irredeemable. In India, companies can now issue only this category of preference shares.

6. **Convertible Preference Shares:** These shares give the right to the holder to get them converted into equity shares according to the terms and conditions of their issue.

7. **Non-Convertible Preference Shares:** If the right of conversion is not available to preference shareholders, the shares are called non-convertible preference shares. Unless otherwise stated, a preference share is always deemed to be a non-convertible one.

EQUITY SHARES:

According to section 85(2) of the Indian Companies Act, 1956 equity shares are those shares, which are not the preference shares. In other words, they do not enjoy any preferential right in the matter of payment of dividend or repayment of capital. Equity shares do not carry a fixed rate of dividend. The rate of dividend on equity shares is recommended by the Board of Directors and may vary from year to year. These shares carry voting rights. If the company issued only one type of share-capital, then it is known as equity share capital irrespective of the fact whether the word 'equity' appears in the name of share capital or not.

ISSUE OF SHARES:

A public company issues a prospectus inviting general public to subscribe for its shares. In most of the cases, issue price of the share is demanded in various install-

ments and each installment is called by a standard name. For example, first installment is known as 'Application Money' and the second one is termed as 'Allotment Money'. Subsequent installments are called as 'first call', 'second call' and so on. The number of last call should be suffixed by the word 'and final call'. For example, if there is only one call, it will be termed as 'first and final call' and if second call happens to be the last call, it will be expressed as "second and final call' and so on.

Procedure for Share Issue:

- Share Application: Any person willing to purchase shares of that company has to fill a printed application form and send it with necessary money directly to the company. The amount payable with application form is called share application money. Application Money cannot be less than 5% of the face-value of shares.
- Share Allotment: After receipt of application for shares, allotment of shares is made in accordance with the terms mentioned in the application form. After allotment, the applicant becomes the shareholder and there becomes a contract between shareholder and company.
- Share-Calls: After receipt of application money and allotment of shares, the company collects the balance amount unpaid on shares allotted in accordance with the terms of issue. Whatever amount is demanded after allotment is known as 'call-money'.

SUBSCRIPTION OF SHARES:

Meaning of over subscription: Shares are said to be oversubscribed when the number of shares applied is more than the number of shares offered. For example, a company offered 5000 shares to the public but the public applied for 6000 shares, it is called the case of over-subscription.

Meaning of Under-subscription: Shares are said to be under-subscribed when the number of shares applied is less than the number of shares offered. For example, if a company offered 5000 shares to the public but the public applied for 4500 shares only, it is the case of under-subscription. In such a case, it must be ensured that the company has received the minimum subscription.

Meaning of Minimum Subscription: The term minimum subscription refers to the amount which, in the opinion of the Board of Directors, must be raised by the issue of shares. A company cannot make any allotment of shares unless the amount of minimum subscription stated in the prospectus has been subscribed and the sum payable as application money on such shares has been paid to and received by the company. The amount of minimum subscription is disclosed in the prospectus by the Board of Directors taking into account the following:

- *Preliminary expenses of the company,*
- *Commission payable on issue of shares,*
- *Cost of fixed assets purchased or to be purchased,*
- *Working Capital requirements of the company*

NOTES

SHARE CAPITAL:

Share capital refers to the portion of a capital that has been obtained by issuing the shares to the shareholder. The amounts invested by the shareholders towards the face value of shares are collectively known as share capital. In other words, share Capital is the fund raised by a company through the issuance of common or preferential shares to individuals or institutional investors for the growth and expansion of the company. It is also known as Equity Financing through which the shareholders of the issued capital receive rights of ownership in the concerned company by buying shares of the same. Buyers of the Share Capital become owners of the company.

Types of Share Capital: Share capital of a company is divided into following categories:

- **Authorized Share Capital:** Authorized capital refers to that amount which is stated in the 'Capital Clause' of the 'Memorandum of Association' as the share capital of company. It is the maximum amount of share capital, which a company is authorized to raise through issue of shares. It is also known as registered capital or nominal capital.
- **Issued Share Capital:** A company may not issue total authorized capital. Issued capital refers to that portion of authorized capital which is issued by the company. Issued capital will always be less than or equal to the authorized capital.
- **Subscribed Share Capital:** It is that portion of issued capital which has actually been subscribed by the public and has been allotted to them. It is also known as allotted capital. If all issued capital is fully subscribed, then the term 'issued capital' and 'subscribed capital' carry the same meaning.
- **Called up Share Capital:** The portion of the subscribed capital which a company has demanded or called from the shareholders is known as Called -up capital and the balance, which the company has decided ro demand in future, may be referred to as Uncalled Capital.
- **Paid up Share Capital:** It is the part of called up capital which is paid by the shareholders. Sometimes shareholders fail to pay the amount demanded from them as call, that amount is known as 'unpaid call' or 'call in arrears'. Thus, call in arrears means the amount not paid although it has been demanded by the company. To calculate paid up capital, the amount of call in arrears is deducted from called up capital.
- **Reserve Share Capital:** According to Section 99 of the Companies Act, 1956, a company may decide by passing a special resolution thar a certain portion of its subscribed uncalled capital can be called only in the event of winding up of the company. Thus, the portion of uncalled capital which a company has decided to call only in case of liquidation of the company is called Reserve Liability or Reserve Capital. It is not necessary to create reserve capital.

Alternation of capital:

A company limited by shares can alter the capital clause of its Memorandum in any of the following ways provided that such alteration is authorized by the articles of association of the company:-

1. Increase nominal share capital by issuing new shares.
2. Consolidate and divide all or any part of its share capital into shares of larger amount than its existing shares. For e.g., if the company has 100 shares of Rs.10 each (aggregating to Rs. 1000/-) it may consolidate those shares into 10 shares of Rs100 each.
3. Convert all or any of its fully paid shares into stock and re-convert stock into fully paid shares of any denomination.
4. Subdivide shares or any of shares into smaller amounts fixed by the Memorandum.
5. Cancel shares which have not been taken or agreed to be taken by any person and diminish the amount of its authorized share capital by the amount of the shares so cancelled.

The alteration of the capital of the company in any of the manner specified above can be done by passing a resolution at the general meeting of the company and does not require any confirmation by the court. Notice of alteration to share capital is required to be filed with the registrar of the company in Form no 5 within 30 days of the alteration of the capital clause of the Memorandum of Association. The Registrar shall record the notice and make necessary alteration in Memorandum and Articles of Association of the company.

Conversion of shares into stocks: Conversion of fully paid shares into stock may likewise be affected by the ordinary resolution of the company in the general meeting. Notice of the conversion must be given to the Registrar within 30 days of the conversion; the stock may be converted into fully paid shares according to the procedure and notice given to the Registrar in Form no 5. In this connection, the following provisions are important:-

1. Only fully paid shares can be converted into stocks.
2. Direct issue of stock to members is not lawful and cannot be done.
3. Articles of the company may give the authority to Board of Directors to fix minimum amount of stock transferable.
4. Since stock is not divided into different units it is not required to be numbered. Shares on the other hand must be numbered.

Reduction of share capital with sanction of the Court

A company can reduce its capital if so authorized by its articles and the reduction is confirmed by the court. It also requires alteration of the share capital as stated in the memorandum. This needs a special resolution. Reduction of the share capital can be effected only in the manners specified in Section 100-104 of the Act or by way of buy back under Section 77A and 77B of the Act. Under Sec. 100, a company limited by the shares or a company limited by guarantee and having share capital may reduce its share capital, subject to confirmation by the court, in any of the following three ways:

(a) extinguish or reduce the liability on any of its shares in respect of share capital not paid-up;

(b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital which is lost, or is unrepresented by available assets; or

(c) either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company.

NOTES

Procedure for Reduction of Share Capital (Sections. 100 to 103)

The procedure for reduction of share capital is as follows:

1. **Special Resolution:** A company shall first pass a special resolution for reduction of capital.
2. **Application to the court:** The Company shall then apply to the court by petition for an order confirming the reduction.

   Conflicts of Interest: If reduction of capital involves diminution of liability on any shares in respect of uncalled capital or repayment of any amount already paid on any shares, there arises the conflict between the interest of creditors and shareholders. The main duty of the court is to look after the interests of the creditors and different classes of shareholders. The court may fulfill this duty towards them in the following manner:

   i) **Interest of Creditors:**

      a) Every creditor of the company can object to the reduction, where reduction involves diminution of liability on any shares in respect of unpaid capital, or repayment of amount already paid on any share.

      b) The court shall settle a list of creditors who are entitled to object. It may publish notice, fixing a day or days within which creditors not entered on this list may claim to be so entered. Otherwise they may be debarred from the right of objecting to the reduction.

      c) Where a creditor entered on the list does not consent to reduction and his debt is not discharged or determined by the company, the Court may either have his interest secured or, if it thinks fit, dispense with his consent.

   ii) **Interest of Shareholders:** When the creditors are not affected at all, the only question is to be considered by the court is whether the reduction is fair and equitable as between the different classes of the shareholders.

3. **Registration of order of Court with Registrar:** The order of the court confirming the reduction shall be produced before the registrar and the certified copy thereof shall be filed with him for registration. With such a copy shall also be filed the minute showing with respect to the share capital of the company as altered by the order:

   i) the amount of the share capital,

   ii) the number of shares of it is to be divided,

   iii) the amount of each share,

   iv) the amount, if any, at the date of the registration deemed to be paid on each share.

Check Your Progress

3. What is Memorandum of Association?
4. Define Share?
5. Define Article of Association?

When reduction takes effect: The resolution for reducing capital is confirmed by the order of the court shall take effect on its registration by the Registrar. Notice of the registration shall be published in such manner as the court may direct.

Certification of registration by the Registrar: The registrar shall certify the registration of the order and the minute under his hand. This certificate is the conclusive evidence that all the requirements of the Act with regard to reduction of share capital have been complied with and that the share capital is such as is stated in the minute.

Reduction of capital without the sanction of the court

Reduction of capital can take place without the sanction of the court in the following cases

1. **Buy back of shares:** A company may purchase its own shares, subject to fulfillment of conditions laid down in Sec. 79-A (2), purchase its own shares.
2. **Forfeiture of shares** - A company may if authorized by its articles forfeit shares for non-payment of calls by the shareholders. Such proceedings amount to reduction of capital but the act does not require court sanction for this purpose.
3. **Valid surrender of the shares** - A company may accept the surrender of partly paid shares.
4. **Cancellation of shares** - A company may cancel the shares which has not been taken up or agreed to be taken by the person and diminish the amount of its share capital by the amount of the shares so cancelled.
5. **Purchase of shares by the company under Section 402(b):** The Company Law Board may order the purchase of shares of any member of the company by the company.
6. **Redemption of redeemable preference shares:** Where redeemable preference shares are redeemed, it actually amounts to reduction of the capital. However, this does not require the sanction of the court.

BORROWING POWER:

Every trading company has an implied power to borrow, as borrowing is implied in the object for which it is incorporated. A trading company can exercise this power even if it is not included in the Memorandum. However non-trading company has no implied power to borrow and such power can be taken by it implied power to borrow and such power can be taken by it by including a clause to that effect in the Memorandum.

Restrictions on borrowing power

1) A public company can borrow only after the receipt of Commencement Certificate [Section 149(1)]. But a private company can borrow immediately after the incorporation
2) The Board of Directors may borrow moneys by passing a resolution passed at the meetings of the Board. The board may delegate its borrowing powers to a Committee of Directors. Such a resolution should specifically mention the aggregate amount upto which the moneys can be borrowed by the

NOTES

Committee, the Managing Director, Manager or any other principal officer of the company on such conditions as it may prescribe [Section292 (1) (c)]

3) The moneys borrowed together with the moneys already borrowed by the company (excluding loans obtained from banks i.e. working capital) shall not exceed the aggregate of the paid up capital and the free reserves.[Section 293(1)(d)]

4) It may be noted that a company may borrow in excess of its paid up capital and free reserves if it is so consented and authorized by the shareholders at a general meeting.

Transactions, which are not borrowing

- Temporary loans (repayable within six months or on demand) obtained from the company's banker in the ordinary course of business.
- Borrowing of money by a banking company in the ordinary course of business.
- Hire purchase and leasing transactions.
- Purchase of machinery on deferred payment

MEETINGS AND RESOLUTIONS

A meeting can be defined as a gathering or an assembly or getting together of a number of persons for transacting a lawful business having certain purpose or purposes. The meetings of a company are of different types or kinds which are mentioned as follows:

1) Board Meetings.
2) Meetings of the Committees of the Board.
3) Meetings of the debenture holders.
4) Meetings of the creditors for the purpose other than winding up and for the purpose of winding up.
5) Meetings of Contributories in winding-up.
6) Shareholders meetings i.e.
   i). Statuary Meeting,
   ii). Annual General Meetings, and
   iii). Extraordinary Meetings.

1). **Statuary Meeting (Sec. 165):** Statuary meeting is held only once during the lifetime of the company. The main object of the statuary meeting is to enable the members to know the financial position and prospectus of their company at an early date. This meeting has to be called within six months from the date on which the company becomes entitled to commence its business, but it cannot be held within one month from that date.

Statutory Report: The Board of Directors shall, at least 21 days before the day on which the meetings is to be held, forward a report, called the statutory report, to every members of the company.

Contents of the Statutory Report: The statuary report of a company contains all the necessary information relating to the formational aspects of the company. It includes the following information:

i) Number of total shares allotted,

ii) The total amount of cash received by the company,

iii) The name, address and occupation of the directors, auditors, and managers of the company.

iv) The particulars of any commission and brokerage in connection with the sale or issue of shares and debentures to any director.

v) The arrears due on calls from every director and from the manager.

2). **Annual General Meeting (Section 166 and 167):** An Annual General Meeting must be held every calendar year with not more than 15 months between meetings. A newly incorporated company must hold its first AGM within 18 months of incorporation. Every AGM shall be called during business hours on a day that is not a public holiday. It shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered of the company is situate. A general meeting of a company may be called not less than 21 days notice in writing. It may be called with a shorter notice if it is agreed to by all the members entitled to vote in the meeting. If a company does not hold an AGM as required, any member can apply to the Secretary of State to call or to direct the calling of the meeting. If it is impracticable to call a meeting or conduct a meeting in the manner prescribed by the company's articles, any member or director who would be entitled to vote can apply to the court which can order the meeting to be called or held.

3) **Extraordinary General Meeting (Section 169):** Any meeting other than these meeting is called an extraordinary general meeting. It is called for transacting some urgent or special business which cannot be postponed till the next annual general meeting. It may be convened:

i) by the Board of Directors on its own or on the acquisition; or

ii) by the requisitionists themselves on the failure of the Board of Directors to call the meeting.

The power of the court to order the holding of an AGM also applies to EGMs. The public company must hold an EGM if the company's net assets have fallen to less than half of its called up capital. Meeting must be called within 28 days of the directors becoming aware of the loss of capital, and must be held within 56 days of that date.

Essentials of a Valid Meeting:

A meeting, whether of directors, or of shareholders or any other meeting of a company must be duly convened, legally constituted and properly conducted without which the decisions taken in the meeting or business conducted in the meeting are not considered as valid. The important requisites of a valid meeting are as follows:

NOTES

1) **Proper authority to convene and hold a company meeting:** Every meeting of a company must be properly convened and duly constituted. The proper authority to convene the meeting is the Board of Directors, Shareholders, or the Company Law Board.

2) **Notice:** Proper and adequate notice of the meeting is required to be given to all shareholders, directors and auditors under the Companies Act of 1956. Notice must be given at least 21 days for an AGM, or 14 days for an EGM.

3) **Quorum:** The term "Quorum" denotes the minimum number of persons who must be present in order to constitute a valid meeting. The quorum is generally fixed by the Articles. The purpose to maintain the quorum is to avoid the decisions being taken at a meeting by a small minority which may be unacceptable to the vast majority of shares. A meeting held without a quorum cannot validly transact any business.

4) **Chairman:** A chairman is necessary to conduct a meeting. He is the presiding officer of the meeting. Therefore, there must be a proper person in the chair who may be designated or elect to preside over and conduct the proceedings of a meeting as per the rules.

5) **Minutes:** Minutes are a record of what the company and directors do in meetings. The object of minutes is to preserve a clear, concise and accurate written record of business done and decisions taken in a meeting. Chairman signs the minutes of every meeting. Companies must keep minutes of general meetings at the registered office for inspection by members.

6) **Proxy:** All companies must allow a member who cannot attend a meeting to allow a proxy to vote in his place. In other words, proxy is a person who is authorized to attend the meeting on behalf of a member. Appointment of proxy must be in writing and lodged at the company's registered office at least 48 hours before the meeting. He cannot be appointed to attend the board meeting.

7) **Resolutions:** The questions which generally come for consideration at the general meeting of a company are presented in the form of proposal called motions. A motion may be proposed by the chairman of the meeting or by any other member of the company. Once the motion has been put to the members and they vote in favour of it, it becomes a resolution. Such resolution may be ordinary resolution, special resolution and resolution requiring special notice.

RESOLUTIONS:

1) **Ordinary Resolution [Sec.189 (1)]:** An ordinary resolution is the resolution passed at the general meeting of a company by a simple majority of votes, including the casting vote of the chairman, if any. The votes may be cast by members in person or by proxy, where proxies are allowed. Ordinary resolution requires simple majority - 50% + 1 vote of members present in person or by proxy. Ordinary resolution is necessary for the following among other purposes:

   - Issue of shares at a discount.
   - Alteration of share capital.

- Re-issue of redeemed debentures.
- Adoption of statuary report.
- Appointment of auditors and fixation of their remuneration.
- Appointment of first directors who are liable to retire by rotation.
- Appointment of managing/whole-time director.
- Increase or decrease in the numbers of directors within the limit fixed by the Articles.
- Winding-up a company voluntary in certain events.
- Nomination of a liquidator in a creditor's voluntary winding-up.

2) **Special Resolutions:** A special resolution is one which satisfies the following conditions:

a) The intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting.

b) The notice has been duly given of the general meeting.

c) An explanatory statement setting out all material facts concerning the subject matter of the special resolution including, in particular, the nature of the concern or interest of every director and the manager, if any, shall be annexed to the notice of the meeting.

A copy of every special resolution together with the copy of explanatory statement shall be filed with the registrar, within 30 days of the passing of the resolution. It requires vote of 75% of members present in person or by proxy, who are entitled to vote and do vote. Meeting at which resolution is proposed must have had at least 21 days notice. Certain matters can only be decided by special resolution and the articles cannot provide to the contrary.. Special resolution is necessary for the following among other purposes:

- Alteration of Memorandum for changing the place of registered office from one state to another with the leave of the Company Law Board.
- Special Resolution is required for the changing the 'object clause' of the Memorandum.
- Change in the name of the company with the consent of the Central Government.
- Alteration of the Articles of a company.
- Reduction of the Share Capital.
- Variation of the Shareholder's right.
- Payment of interest out of Capital.

3) **Extraordinary Resolutions:** Same requirements as for special resolution except for notice period required, which depends on type of meeting. (21 days for AGM, 14 days for EGM - shorter notice possible by agreement). Extraordinary resolution must be used:

NOTES

- for voluntary winding up when company cannot pay its debts.
- to authorize a liquidator to make an arrangement with creditors in members' voluntary winding up.

DIRECTORS

The directors are the brain of a company. They occupy the pivotal position in the structure of the company. They are in fact the mainspring of the company.

Sec.2 (13) defines a director as including "any person occupying the position of director, by whatever name called."

Number of Directors: The articles of the company generally prescribe the number of directors that may be appointed; a public company must have at least three directors and a private company including a private company which is regarded as a public company under section 43 A, must have at least two directors (Section 252). Only an individual-A man or a woman-Can be a director (Section 253).

POWERS OF DIRECTORS

The director's powers are normally set out in the articles. Section 291 of Companies Act, 1956 provides for general powers of the Board of directors. It mandates that the Board is entitled to exercise all such powers and do all such acts and things, subject to the provisions of the Companies Act, as the company is authorized to exercise and do. However, the Board shall not exercise any power and do any act or things which is required whether by the Act or by the memorandum or articles of the company or otherwise to be exercised or done by the company in general meeting. Unless the Act or the articles otherwise provide, the decisions of the Board are required to be the majority decisions only. Individual directors do not have any general powers. They shall have only such powers as are vested in them by the Memorandum and Articles.

Section 292(1) of the Companies Act, 1956 provides that the Board of directors of a company shall exercise the following powers on behalf of the company and it shall do so only by means of resolution passed at meeting of the Board:

(a) the power to make calls on shareholders in respect of money unpaid on their shares;

(b) the power to issue debentures;

(c) the power to borrow moneys otherwise than on debentures;

(d) the power to invest funds of the company; and

(e) the power to make loan.

(g) the power to inspect the company's accounting records, assisted by an accountant.

(h) to claim reimbursement for expenses incurred.

(i) to discharge their duties without interference from co-directors.

(j) to participate in the strategic management of the company and attend the board meetings.

(k) to receive reasonable notice of meetings.

(l) to take independent professional advice at the expense of the company.

DUTIES OF DIRECTORS:

NOTES

1. **Statutory Duties:**

   (A) **To file return of allotment:** Section 75 of the Companies Act, 1956 requires a company to file with the Registrar, within a period of 30 days, a return of the allotments stating the specified particulars. Failure to file such return shall make the directors liable as officer in default. A fine up to Rs. 5000/ - per day till the default continues may be levied.

   (B) **Not to issue irredeemable preference share or shares or share redeemable after 20 years:** Section 80, as amended by Amendment Act, 1996, forbids a company to issue irredeemable preference shares or preference shares redeemable beyond 20 years. Directors making any such issue may be held liable as officer in default. And may be subject to fine up to Rs. 10,000/.

   (C) **To disclose interest (Section 299-300):** In respect of contracts with director, Section 299 casts an obligation on a director to disclose the nature of his concern or interest (direct or indirect), if any, at a meeting of the Board of directors. Every director who fails to fulfill with the aforesaid requirements as to disclosure of concern or interest shall be punishable with fine, which may extend to Rs. 50,000/-.

   (D) **To disclose receipt from transfer of property (sec. 319):** Any money received by the directors from the transferee in connection with the transfer of the company's property or undertaking must be disclosed to the members of the company and approved by the company in general meeting. Otherwise, the amount shall be held by the directors in trust for the company.

   (E) **Duty to attend Board meetings:** A director may not be able to attend all the meetings but if he must attend three consecutive meetings or all meetings for a period of three months whichever is longer.

2. **General Duties:**

   (A) **Duty of good faith:** The directors must act in the best interest of the company. Interest of the company implies the interest of the present and future members of the company on the footing that company would be continued as going concern.

   (B) **Duty of care:** A director must display care in performance of work assigned to him. He is, however, not expected to display an extraordinary care but that much care which a man would take ordinary care in his own case.

   (C) **Duty not to delegate:** Director being an agent is bound by the maxim 'delegatus non potest delegare' which means a delegatee cannot further delegate. Thus, a director must perform his functions personally. However, he may delegate his in certain conditions.

NOTES

LIABILITES OF DIRECTORS

1. Liability to the company:

(A) Breach of fiduciary duty: Where a director acts dishonestly to the interest of the company, he will be held liable for breach of fiduciary duty. Most of the powers of directors are powers in trust and therefore, should be exercised in the interest of the company and not in the interest of the directors or any section of members.

(B) Ultra vires acts: Directors are supposed to act within the parameters of the provisions of the Companies Act, Memorandum and Articles of Association, since these lay down the limits to the activities of the company and consequently to the powers of the Board of directors. Further, the powers of the directors may be limited in terms of specific restrictions contained in the Articles of Association. The directors shall be held personally liable for acts beyond the aforesaid limits, being ultra vires the company or the directors.

(C) Negligence: As long as the director's act within their powers with reasonable skill and care as expected of them as prudent businessman, they discharge their duties to the company. But where they fail to exercise reasonable care, skill and diligence, they shall be deemed to have acted negligently in discharge of their duties and consequently shall be liable for any loss or damage resulting therefrom.

(D) Breach of Trust: Directors of a company, being in a fiduciary position, hold the position of trustees as regards its money and property which comes into their hands and of the powers entrusted to them by the Articles. They must discharge their duties as such trustees in the best interest of the company. They are liable to the company for any loss resulting from breach of trust. They are also accountable to the company for any secret profits they might have made in course of performance of duties on behalf of the company.

2. Liability to third parties:

Liability under the Companies Act:

(A) Prospectus: Failure to state any particulars as per the requirement of the section 56 and Schedule II of the act or mis-statement of facts in prospectus renders a director personally liable for damages to the third party. Section 62 provides that a director shall be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage he may have sustained by reason of any untrue or misleading statement included therein.

(B) With regard to allotment: Directors may also incur personal liability for:

(a) Irregular allotment, i.e., allotment before minimum subscription is received (Section 69), or without filing a copy of the statement in lieu of prospectus (Section 70) - [Section 71(3)] - Under section 71(3), if any director of a company knowing breach or willfully authorizes or permits the breach of any of the provisions of section 69 or 70 with respect to all allotment, he shall

be liable to compensate the company and the allottee respectively for any loss, damages which the company or the allottee may have sustained or incurred thereby.

(b) For failure to repay application money in case of minimum subscription having not been received within 120 days of the opening of the issue: Under section 69(5) read with SEBI guidelines, in case moneys are not repaid within 130 days from the date of the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that money with interest at the rate of 6 % per annum on the expiry of 130th day. However, a director shall not be liable if he proves that the default in repayment of money was not due to any misconduct or negligence on his part.

NOTES

3. Liability for breach of statutory duties:

The Companies Act, 1956 imposes numerous statutory duties of the directors which they must carry out. Most of these duties relate to maintenance of proper accounts, filing of returns or observance of certain statuary formalities. If they fail to perform these duties, they render themselves liable to penalities.

4. Liability for acts of co-directors:

A director is not liable for the acts of his co-directors. In the absence of a director from meeting of the Board does not make him liable for the fraudulent act of a co-director.

PREVENTION OF OPPRESSION AND MISMANAGEMENT

Meaning of Oppression

Oppression is the exercise of authority or power in a burdensome, cruel, or unjust manner. It can also be defined as an act or instance of oppressing, the state of being oppressed, and the feeling of being heavily burdened, mentally or physically, by troubles, adverse conditions, and anxiety.

The Supreme Court in Daleant Carrington Investment (P) Ltd. v. P.K. Prathapan, held that increase of share capital of a company for the sole purpose of gaining control of the company, where the majority shareholder is reduced to minority , would amount to oppression. The director holds a fiduciary position and could not on his own issue shares to himself. In such cases the oppressor would not be given an opportunity to buy put the oppressed.

Section 397 of the companies act, 1956 provides relief to the oppressed minority. Basically oppression means exercise of power in an unjust manner. The law has not defined oppression for purposes of this section, and it is left to Courts to decide on the facts of each case whether there "oppression" under section 397 has been committed or not. Although the word 'oppressive is not defined, it is possible, by way of illustration, to figure a situation in which majority shareholders, by an abuse of their predominant voting power, are treating the company and its affairs as if they were their own property to the prejudice of the minority share-holders. In ***Scottish Co-operative Whole Sale Society Ltd. v. Meyer*** (1958) 3 All ER 66 (HL)) it was held that oppression is the lack of probity and fair dealing in the affairs of a company to the prejudice of some portion of its members or to public interest. ***In Elder v. Elder***

NOTES

& Watson Ltd., oppression has been defined as ""...the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to the company is entitled to rely." The oppressed minority has to show the conduct which is unfair to him and causes prejudice to him in the exercise of his legal and proprietary rights as a shareholder.

Prevention of oppression

Section 397(1) of the Companies Act provides that any member of a company who complains that the affair of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members may apply to the Tribunal for an order thus to protect his /her statutory rights.

Sub-section (2) of Section 397 lays down the circumstances under which the tribunal may grant relief under Section 397, if it is of opinion that:-

a) the company's affairs are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members ; and

b) to wind up the company would be unfairly and prejudicial to such member or members , but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound.

Conditions for Granting Reliefs

To obtain relief under section 397 the following conditions should be satisfied:-

1) **There must be "oppression"**- The Punjab and Haryana High Court in Mohan Lal Chandmall v. Punjab Co. Ltd has held that an attempt to deprive a member of his ordinary membership rights amounts to "oppression". Imposing of more new and risky objects upon unwilling minority shareholders may in some circumstances amount to "oppression". However, minor acts of mismanagement cannot be regarded as "oppression". The Court will not allow that the remedy under Section 397 becomes a vexatious source of litigation. But an unreasonable refusal to accept a transfer of shares held as sufficient ground to pass an order under Section 397 of the Companies Act, 1956. Thus to constitute oppression there must be unfair abuse of the powers and impairments of the confidence on the part of the majority of shareholders.

2) **Facts must justify winding up**- It is well settled that the remedy of winding up is an extreme remedy. No relief of winding up can be granted on the ground that the directors of the company have misappropriated the company's fund; as such act of the directors does not fall in the category of oppression or mismanagement. To obtain remedy under Section 397 of the Companies Act, the petitioner must show the existence of facts which would justify the winding up order on just and equitable ground.

3) **The oppression must be continued in nature** – It is settled position that a single act of oppression or mismanagement is sufficient to invoke Section 397 or 398 of the Companies Act. No relief under either of the section can

be granted if the act complained of is a solitary action of the majority. Hence, an isolated action of oppression is not sufficient to obtain relief under Section 397 or 398 of the Act. Thus to prove oppression continuation of the past acts relating to the present acts is the relevant factor, otherwise a single act of oppression is not capable to yield relief.

4) **The petitioners must show fairness in their conduct**-It is settled legal principle that the person who seeks remedy must come with clean hands. The members complaining must show fairness in their conduct. For ex-Mere declaration of low dividend which does not affect the value of the shares of the petitioner, was neither oppression nor mismanagement in the eyes of law.

5) **Oppression and mismanagement should be specifically pleaded**- It is settled law that , in case of oppression a member has to specifically plead on five facts:-

- what is the alleged act of oppression ;
- who committed the act of oppression;
- how it is oppressive;
- whether it is in the affairs of the company;
- and whether the company is a party to the commission of the act of oppression.

Prevention of Mismanagement

The present Company Act does provide the definition of the expression 'mismanagement'. When the affairs of the company are being conducted in a manner prejudicial to the interest of the company or its members or against the public interest, it amounts to mismanagement.

Section 398(1) of the Companies act provides that any members of a company who complain:- that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company; or a material change has taken place in the management or control of the company, whether by an alteration in its Board of directors, or manager or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company; may apply to the Company Law Board for an order of relief provided such members have a right so to apply as given below.

If, on any such application, the Company Law Board is of opinion that the affairs of the company are being conducted as aforesaid or that by reason of any material change as aforesaid in the management or control of the company, it is likely that the affairs of the company will be conducted as aforesaid, the court may, with a view to bringing to an end or preventing the matters complained of or apprehended, make such order as it thinks fit.

NOTES

Right to complain mismanagement-

1. The following members of a company shall have the right to apply as above:-
   a) in the case of a company having a share capital, not less than one hundred members of the company or not less than one tenth of the total number of its members, whichever is less, or any member or members holding not less than one-tenth of the issued share capital of the company, provided that the applicant or applicants have paid all calls and other sums due on their shares;
   b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.
2. Where any share or shares are held by two or more persons jointly, they shall be counted only as one number.
3. Where any members of a company, are entitled to make an application, any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.
4. The Central Government may, if in its opinion circumstances exist which make it just and equitable so to do, authorize any member or members of the company to apply to the Company Law Board, notwithstanding that the above requirements for application are not fulfilled.
5. The Central Government may, before authorizing any member or members as aforesaid, require such member or members to give security for such amount as the Central Government may deem reasonable, for the payment of any costs which the Court dealing with the application may order such member or members to pay to any other person or persons who are parties to the application.
6. If the managing director or any other director, or the manager, of a company or any other person, who has not been impleaded as a respondent to any application applies to be added as a respondent thereto, the Company Law Board may, if it is satisfied that there is sufficient cause for doing so, direct that he may be added as a respondent accordingly.

Notice to be given to Central Government of application

The Company Law Board must give notice of every application made to it as above to the Central government, and shall take into consideration the representations, if any, made to it by that Government before passing a final order.

Right of Central Government to apply

The Central Government may itself apply to the Company law Board for an order, or because an application to be made to the Company Law Board for such an order by any person authorized be it in this behalf.

Powers of Tribunal

Under Section 402 of the Companies Act ,1956 the powers of the Tribunal under Sections 397 and 398 are very wide .These are :-

1) the regulation of the conduct of the company's affairs in future;

2) the purchase of the shares or interests of any members of the company by other members thereof or by the company;

3) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;

4) the termination, setting aside or modification of any agreement, howsoever arrived at, between the company on the one hand, and any of the following persons, on the other namely:-

   a) the managing director;

   b) any other director;

   c) the manager;

Upon such terms and conditions as may, in the opinion of the Company Law Board, be just and equitable in all the circumstances of the case ;the termination, setting aside or modification of any agreement between the company and any person not referred to in clause (d), provided that no such agreement shall be terminated, set aside or modified except after due notice to the party concerned and provided further that no such agreement shall be modified except after obtaining the consent of the party concerned; the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference. Any other matter for which in the opinion of the Company Law Board it is just and equitable that provision should be made.

Effect of alteration of memorandum or articles of company by order:

Where an order makes any alteration in the memorandum or articles of a company, then, notwithstanding any other provision of this Act, the company shall not have power, except to the extent, if any permitted in the order, to make without the leave of the Company Law Board, any alteration whatsoever which is inconsistent with the ordet, either in the memorandum or in the articles. The alterations made by the order shall, in all respects, have the same effect as if they had been duly made by the company in accordance with the provisions of this Act.A certified copy of every order altering or giving leave to alter, a company's memorandum or articles, must within thirty days after the making thereof, be filed by the company with the Registrar who shall registrar the same. If default is made in complying with the above provisions, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five thousand rupees.

Consequences of termination or modification of certain agreements:

Where an order terminates, sets aside or modifies an agreement:- the order shall not give rise to any claim whatever against the company by any person for damages or for compensation for loss of office or in any respect, either in pursuance of the agreement or otherwise; no managing or other director or manager whose agreement is so terminated or set aside, shall for a period of five years from the date of the order terminating the agreement, without the leave of the Company Law Board, be appointed, or act, as the managing or other director or manager of the company. Any

NOTES

person who knowingly acts as a managing or other director or manager of a company in contravention of the above provision, every director of the company, who is knowingly a party to such contravention shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to five thousand rupees, or with both. The Company Law Board will not grant leave for appointment as managing director or director or manager of the company unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given an opportunity of being heard in the matter.

Powers of Central Government to prevent oppression or mismanagement:

The Central Government may appoint such number of persons as the Company Law Board may, by order in writing, specify as being necessary to effectively safeguard the interests of the Company or its shareholders or public interests, to act as directors thereof for such period not exceeding 3 years on any one occasion as it deems fit if the Company Law Board:-

On a reference being made to it by the Central Government ; or on an application of not less than one hundred members of the company or of members of the company holding not less than one-tenth of the total voting power therein, is satisfied, after such inquiry as it deems fit to make, that it is necessary to make the appointment or appointments in order to prevent the affairs of the company being conducted either in a manner which is oppressive to any members of the company or in a manner which is prejudicial to the interests of the company or to public interest.

However, in lieu of passing order as aforesaid, the Company Law Board may, if the company has not availed itself of the option given to it of proportional representation to minority shareholders on the Board of the company, direct the company to amend its articles in the manner provided section 265 and make fresh appointments of directors in pursuance of the articles as so amended within such time as may be specified in that behalf by the Company Law Board.

In case the Central Government passes such an order it may, if thinks fit, direct that until new directors are appointed in pursuance of the order aforesaid, not more than two members of the company specified by the Company law Board shall hold office as additional directors of the company. The Central Government shall appoint such additional directors on such directions.

The person appointed as a director by the Central Government in accordance with the above provisions, need not hold any qualification shares or need to retire by rotation. However, his office as director may be terminated at any time by the Central Government and another person appointed in his place. No change in the constitution of the Board of Directors can take place after an additional director is appointed by the Central Government in accordance with these provisions unless approved by the Company Law Board. The Central Government in such cases may also issue such directions to the company as it may consider necessary or appropriate in regard to its affairs.

Power of the Tribunals to prevent change in Board of Directors:

Where a complaint is made to the Company Law Board by the managing director or any other director or the manager of a company that, as a result of a change which has taken place or is likely to take place in ownership or any shares held in the company, a change in the Board of directors is likely to take place which (if allowed) would affect prejudicially the affairs of the company, the Company Law Board may, if satisfied, after such inquiry as it thinks fit to make that it is just and proper to do so, by order direct that no resolution passed or that may be passed or no action taken or may be taken to effect a change in the Board of directors after the date of the complaint shall have effect unless confirmed by the Company Law Board.

Any such order shall have effect notwithstanding anything to the contrary contained in any other provision of this Act or in the memorandum or articles of the company, or in any agreement with, or any resolution passed in general meeting by, or by the Board of directors or, the company. The Company Law Board shall have power when any such complaint is received by it, to make an interim order to the effect set out above, before making or completing the inquiry aforesaid. Nothing contained above shall apply to a private company, unless it is a subsidiary of a public company.

Powers of Inspectors [S.240]:

Where an inspector investigating the affairs of the company thinks it necessary to investigate the affairs of another company in the same management or group, he is empowered to do so. However as mentioned in section 239(2), he has to obtain prior approval of the Central Government for that purpose. Section 240 has been amended by the Amendment of 2000 .Sub-section (1) was substituted. The new sub-section provides that it shall be the duty of all officers and other employees and agents of the company and those of any other body corporate whose affairs are being investigated under Section 239:

a) to preserve and to produce to an inspector or any other person authorized by him in this behalf with the previous approval of the Central Government, all books and papers of or relating to the other body corporate, which are in their custody or power; and

b) otherwise to give to the inspector, all assistance in connection with the investigation which they are reasonable able to give.

For facilitating the task of the inspector it is the duty of all officers in charge of the management of the company to produce to the inspector all books and papers of the company which are in the custody and power and to give to the inspector all assistance in connection with the investigation which they are reasonably able to give. The inspector may examine on oath any such person and for this purpose require his personal attendance. If a person required to appear or to produce books, makes a default that is a punishable offence. Where an inspector finds a person, whom he has no power to examine on oath, ought to be so examined the inspector may do so with the previous approval of the Central Government. Notes of any such examination are to be taken in writing and signed by the person examined and may be used in evidence against him. A refusal to answer any question is also punishable.

NOTES

WINDING UP OF A COMPANY:

Winding up of a company is defined as a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors. An administrator, called the liquidator, is appointed and he takes control of the company, collects its assets, pays debts and finally distributes any surplus among the members in accordance with their rights. At the end of winding up, the company will have no assets or liabilities. When the affairs of a company are completely wound up, the dissolution of the company takes place. On dissolution, the company's name is struck off the register of the companies and its legal personality as a corporation comes to an end.

The procedure for winding up differs depending upon whether the company is registered or unregistered. A company formed by registration under the Companies Act, 1956 is known as a registered company. It also includes an existing company, which had been formed and registered under any of the earlier Companies Acts.

Winding up a Registered Company

The Companies Act provides for two modes of winding up a registered company.

Grounds for Compulsory Winding Up or Winding up by the Tribunal

- If the company has, by a Special Resolution, resolved that the company be wound up by the Tribunal.
- If default is made in delivering the statutory report to the Registrar or in holding the statutory meeting. A petition on this ground may be filed by the Registrar or a contributoty before the expiry of 14 days after the last day on which the meeting ought to have been held. The Tribunal may instead of winding up, order the holding of statutory meeting or the delivery of statutory report.
- If the company fails to commence its business within one year of its incorporation, or suspends its business for a whole year. The winding up on this ground is ordered only if there is no intention to carry on the business and the Tribunal's power in this situation is discretionary.
- If the number of members is reduced below the statutory minimum i.e. below seven in case of a public company and two in the case of a private company.
- If the company is unable to pay its debts.
- If the tribunal is of the opinion that it is just and equitable that the company should be wound up.
- Tribunal may inquire into the revival and rehabilitation of sick units. It its revival is unlikely, the tribunal can order its winding up.
- If the company has made a default in filing with the Registrar its balance sheet and profit and loss account or annual return for any five consecutive financial years

- If the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.

The petition for winding up to the Tribunal may be made by :-

- The company, in case of passing a special resolution for winding up.
- A creditor, in case of a company's inability to pay debts.
- A contributory or contributories, in case of a failure to hold a statutory meeting or to file a statutory report or in case of reduction of members below the statutory minimum.
- The Registrar, on any ground provided prior approval of the Central Government has been obtained.
- A person authorized by the Central Government, in case of investigation into the business of the company where it appears from the report of the inspector that the affairs of the company have been conducted with intent to defraud its creditors, members or any other person.
- The Central or State Government, if the company has acted against the sovereignty, integrity or security of India or against public order, decency, morality, etc.

Voluntary Winding Up of a Registered Company

When a company is wound up by the members or the creditors without the intervention of Tribunal, it is called as voluntary winding up. It may take place by:-

- By passing an ordinary resolution in the general meeting if: - (i) the period fixed for the duration of the company by the articles has expired; or (ii) some event on the happening of which company is to be dissolved, has happened.
- By passing a special resolution to wind up voluntarily for any reason whatsoever.

Within 14 days of passing the resolution, whether ordinary or special, it must be advertised in the Official Gazette and also in some important newspaper circulating in the district of the registered office of the company.

The Companies Act (Section 484) provides for two methods for voluntary winding up:-

Members' voluntary winding up

It is possible in the case of solvent companies which are capable of paying their liabilities in full. There are two conditions for such winding up:-

- A declaration of solvency must be made by a majority of directors, or all of them if they are two in number. It will state that the company will be able to pay its debts in full in a specified period not exceeding three years from commencement of winding up. It shall be made five weeks preceding the date of resolution for winding up and filed with the Registrar. It shall be accompanied by a copy of the report of auditors on Profit & Loss Account and Balance Sheer, and also a statement of assets and liabilities upto the latest practicable date; and

NOTES

- Shareholders must pass an ordinary or special resolution for winding up of the company.

The provisions applicable to members' voluntary winding up are as follows:-

- Appointment of liquidator and fixation of his remuneration by the General Meeting.
- Cessation of Board's power on appointment of liquidator except so far as may have been sanctioned by the General Meeting, or the liquidator.
- Filling up of vacancy caused by death, resignation or otherwise in the office of liquidator by the general meeting subject to an arrangement with the creditors.
- Sending the notice of appointment of liquidator to the Registrar.
- Power of liquidator to accept shares or like inrerest as a consideration for the sale of business of the company provided special resolution has been passed to this effect.
- Duty of liquidator to call creditors' meeting in case of insolvency of the company and place a statement of assets and liabilities before them.
- Liquidator's duty to convene a General Meeting at the end of each year.
- Liquidator's duty to make an account of winding up and lay the same before the final meeting.

Creditor's voluntary winding up

It is possible in the case of insolvent companies. It requires the holding of meetings of creditors besides those of the member's right from the beginning of the process of voluntary winding up. It is the creditors who get the right to appoint liquidator and hence, the winding up proceedings are dominated by the creditors.

The provisions applicable to creditors' voluntary winding up are as follows:-

- The Board of Directors shall convene a meeting of creditors on the same day or the next day after the meeting at which winding up resolution is to be proposed. Notice of meeting shall be sent by post to the creditors simultaneously while sending notice to members. It shall also be advertised in the Official Gazette and also in two newspapers circulating in the place of registered office.
- A statement of position of the company and a list of creditors along with list of their claims shall be placed before the meeting of creditors.
- A copy of resolution passed at creditors' meeting shall be filed with Registrar within 30 days of its passing.
- It shall be done at respective meetings of members and creditors. In case of difference, the nominee of creditors shall be the liquidator.
- A five-member Committee of Inspection is appointed by creditors to supervise the work of liquidator.
- Fixation of remuneration of liquidator by creditors or committee of inspection.

- Cessation of board's powers on appointment of liquidator.

As soon as the affairs of the company are wound up, the liquidator shall call a final meeting of the company as well as that of the creditors through an advertisement in local newspapers as well as in the Official Gazette at least one month before the meeting and place the accounts before it. Within one week of meeting, liquidator shall send to Registrar a copy of accounts and a return of resolutions.

Winding up an Unregistered Company

According to the Companies Act, an unregistered company includes any partnership, association, or company consisting of more than seven persons at the time when petition for winding up is presented. But it will not cover the following:-

- A railway company incorporated by an Act of Parliament or other Indian law or any Act of the British Parliament;
- A company registered under the Companies Act, 1956;
- A company registered under any previous company laws.
- An illegal association formed against the provisions of the Act.

However, a foreign company carrying on business in India can be wound up as an unregistered company even if it has been dissolved or has ceased to exist under the laws of the country of its incorporation.

The provisions relating to winding up of a unregistered company:-

- Such a company can be wound up by the Tribunal but never voluntarily.
- Circumstances in which unregistered company may be wound up are as follows:-
    - If the company has been dissolved or has ceased to carry on business or is carrying on business only for the purpose of winding up its affairs.
    - If the company is unable to pay its debts.
    - If the Tribunal regards it as just and equitable to wind up the company.
- Contributory means a person who is liable to contribure to the assets of a company in the event of its being wound up. Every person shall be considered a contributory if he is liable to pay any of the following amounts:-
- Any debt or liability of the company;
- Any sum for adjustment of rights of members among themselves;
- Any cost, charges and expenses of winding up;
- On the making of winding up order, any legal proceeding can be filed only with the leave of the Tribunal.

CASE STUDY:

There was a closely held company floated by all family members. All the family members own shares in the Company. The family has active participation in other companies too. In the company as referred to, few members are actively involved in

day-to-day management of the company and few other members are not involved in day-to-day management. While this is the case, one of the family members who are qualified to approach the Company Law Board under section 399 of the Companies Act, 1956, approaches the Company Law Board alleging some mismanagement in the Company. The applicant before the Board refers to many irregularities and especially the action of the majority in selling the company properties for throw away price. The majority has taken a stand denying the allegation that the properties of the company are sold for a throw away price and also specifically alleges that the applicant before the CLB did not participate in the day-to-day affairs of the Company. The Board has given an exit option to the applicant rather looking into the issue of irregularities.

The issues for consideration in the above case are like:

1. Will the majority be allowed to contend that they are privileged in the company as they run the company and participate in the day- to-day affairs of the company?
2. How to deal with the issue of undervaluation of company properties in the given case?
3. Whether the applicant before the Board be forced to exercise exist option on the ground that he did not participate in the day-to-day affairs of the Company.

SUMMARY

- A company means the group of persons associated together for the attainment of a common objective. A company is a voluntary association of individuals formed for some common purpose.
- The company as "an association of many persons who contribute money or money's worth to a common stock, and employ it in a common trade or business (i.e. for a common purpose), and who share the profit or loss (as the case may be) arising there from.
- Prospectus is an invitation to the public to subscribe to the share capital of the company. After the receipt of certificate of incorporation, if the promoters of a public limited company wishes to issue shares to the public, he will issue a document called prospectus.
- The first thing in the formation of a Joint Stock Company is the preparation of the Memorandum of Association. It is a document which sets out the constitution of the company. It is the principal document of the company and no company can be registered without the memorandum of association. It defines the scope of the company's activities as well as its relation with the outside world.
- **Doctrine of Ultra Vires:** The Company's activities are confined strictly to the objects mentioned in its Memorandum, and if they go beyond these objects, then such acts will be ultra vires. The object of declaring such acts as ultra vires is to protect the interests of shareholders and all other who deal with the company.

- Article of Association is a document in which rules and regulations framed for the internal management of the company are set out. The articles are framed to help the company in achieving its objectives which are set out in a memorandum of association. It is a supplementary document to the memorandum.
- A share is a fractional part of the capital which provides the basis of ownership. As per Section 2(46) of the companies act, 1956, a share means share in company's share capital and includes stock except where a distinction between stock and share is expressed or implied. The persons who hold share in their names are known as shareholders.
- A preference share is one which has the following two rights: A right to receive dividend at a stipulated rate or a fixed amount before any dividend is paid on equity shares, and A right to receive repayment of capital in the event of winding up of the company.
- According to section 85(2) of the Indian Companies Act, 1956 equity shares are those shares, which are not the preference shares.
- Share capital refers to the portion of a capital that has been obtained by issuing the shares to the shareholder.
- A meeting can be defined as a gathering or an assembly or getting together of a number of persons for transacting a lawful business having certain purpose or purposes.
- Oppression is the exercise of authority or power in a burdensome, cruel, or unjust manner. It can also be defined as an act or instance of oppressing, the state of being oppressed, and the feeling of being heavily burdened, mentally or physically, by troubles, adverse conditions, and anxiety.
- The present Company Act does provide the definition of the expression 'mismanagement'. When the affairs of the company are being conducted in a manner prejudicial to the interest of the company or its members or against the public interest, it amounts to mismanagement.
- Winding up of a company is defined as a process by which the life of a company is brought to an end and its property administered for the benefit of its members and creditors.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. In common parlance, a company means the group of persons associated together for the attainment of a common objective.
2. The companies Act, 1956 defines prospectus as "any document described or issued as a prospectus and includes any notice, circular, advertisement or other documents inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of, a corporate body."
3. **According to Lord Macmillan,** "The purpose of the memorandum is to enable the shareholder, creditors and those who deal with the company to know what is permitted range of enterprise."

NOTES

4. **According to Section 2(2) of the Companies Act,** "Articles of association of the company as originally framed or as altered from time to time in pursuance of any previous companies' law or of this act."
5. **According to Justice Farewell,** " A share is the interest of shareholder in the company measured by a sum of money for the purpose of liability in the first place and of interest(dividend) in the second."

TEST YOURSELF

1) Define 'Company'. Explain various types of company.
2) What are the various stages involved in the process of formation of the company?
3) What is the meaning and objectives of Prospectus?
4) Explain Memorandum of Association and its various clauses.
5) What do you mean by Article of Association?
6) Explain the difference between Memorandum of Association and Article of Association.
7) What do you mean by Share Capital? Explain various types of Share Capital.
8) Explain various types of meetings. What are the essentials of a valid meeting?
9) Describe various types of Resolutions.
10) Explain the duties and liabilities of Directors.
11) Briefly describe the meaning of Winding up of a company.

FURTHER READING

- *Mercantile Law:Sharma, Sareen, Gupta and Chawla*

5 Bailment and Pledge

NOTES

The Chapter Covers :

- Meaning and Definition of Bailment
- Essential Elements of a Bailment
- Kinds of Bailment
- Rights and Duties of Bailor and Bailee
- Types of Lien
- Termination of Bailment
- Meaning of Pledge (or Pawn) [Section 172]
- Meaning of A Pawnor (or Pledgor) [Section 172]
- Meaning of Pawnee (or Pledgee) [Section 172]
- Essentials of Pledge
- Who May Pledge?
- Rights And Duties of Pawnor And Pawnee
- Pledge By Non-owners

INTRODUCTION

After learning about company, it is clear that every deal happening in a company is legal and bound by certain fixed terms and regulations. Bailment and Lien are certain type of promises made by one party to another.

MEANING AND DEFINITION OF BAILMENT

The word 'bailment' is derived from the French word 'ballier' which means 'to deliver'. Sec. 148 defines 'bailment' as rhe delivery of goods by one person to another from some purpose, when the purpose is accomplished, the goods is returned to or otherwise disposed off according to the direction of the person delivering them. In bailment, possession of goods is transferred, but ownership is not transferred. Bailment means act of delivering goods for a specified purpose on trust. The goods are to be returned after the purpose is over. Bailment is a matter of property law, and not criminal law. Bailment is another type of special contract.

NOTES

Since it is a 'contract', naturally all basic requirements of contract are applicable. A bailment occurs when an individual in lawful possession of a piece of personal property (the bailor) gives over possession to another individual (the bailee) for a specific purpose, with the understanding that once the purpose has been achieved, the personal property shall be surrendered back to the bailor. The person delivering the goods is called the "bailor". The person to whom they are delivered is called the "bailee.

Bailment can be only of 'goods'. As per section 2(7) of Sale of Goods Act, 'goods' means every kind of movable property other than money and actionable claim. Thus, keeping money in bank account is not 'bailment'. Asking a person to look after your house or farm during your absence is not 'bailment', as house or farm is not a movable property.

According to Section 148 of the Act "Bailment is the delivery of goods by one person to another for some purpose upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them".

The person delivering the goods is called the 'Bailor'. The person to whom they are delivered is called the 'Bailee'.

According to the explanation attached to this section, if already certain goods of one person are in the possession of another, they are bailor and bailee.

A 'Bailment' is thus the delivery of goods for some specific purpose under a contract on the condition that the same goods are to be returned to the bailor or are disposed of according to the directions of the bailor. In bailment only the possession of the goods is given to the bailee and the ownership rights remain with the bailor.

Examples

1) A hand over a piece of cloth to B, a tailor, for making a shirt.
2) A delivers his wrist watch to B, a repairer, for repairing.
3) A gives his book to his friend B, for preparing lessons of an examination.
4) A gives his car to B on hire, on payment of hire charges.
5) A hand over gold ornaments to B, a bank, as security for loan.
6) Goods sold but delivery has not been taken by the buyer A and the goods are lying with the seller B.
7) A, a dealer, sends a TV set to B, a potential buyer on hire purchase basis.

In each of the above cases, A is the bailor and B is the bailee. Each case is a particular type of bailment.

ESSENTIAL ELEMENTS OF A BAILMENT

1) **Agreement:** There must be an agreement between the bailor and the bailee. This agreement may be either express or implied. However, a bailment may be implied by law also. For example, bailment between a finder of goods and owner of goods.
2) **Delivery of Goods:** A contract of bailment requires the delivery of goods by one person to another. It involves only the change of possession and not the change

of ownership. Mere custody of goods without possession will not constitute bailment. A servant or a guest using his masters or host goods will not be bailee. In this connection, the following points may be noted:

i) The delivery must be voluntary; e.g., the delivery of jewellery by its owner to a thief who shows a revolver does not create a bailment because the delivery is not voluntary.

ii) Delivery may be actual or constructive.

a) **Actual Delivery:** A delivery is said to be actual where the goods are physically handed over by one person to another. For example, delivery of a car for repair to a workshop dealer.

b) **Constructive Delivery [Section 149]:** A delivery is said to be constructive where it is made by doing anything which has the effect of putting goods in the possession of the intended bailee or of any person authorized to hold them on his behalf. For example, delivery of the key of a car to a workshop dealer for the repair of car.

3) **Movable Property:** Goods referred to under the definition of bailment are the goods as defined by section 2(7) of the Sale of Goods Act, 1930, according to which "goods" means every kind of movable property other than actionable claims (i.e., claims to be settled by the Court) and money. Hence, bailment of immovable property like land and building cannot be made.

4) **Definite Purpose:** In bailment, the goods are delivered to the bailee for some specific purpose which is generally in view of both the bailor and the bailee. The purpose may include repair of goods; or changing their forms, such as by tailoring, by carpentry, etc., or transporting of goods; or security of the goods; or deposit of security for a debt, etc.

5) **Return of Specific Goods:** The goods which form the subject matter of a bailment must be returned to the bailor or otherwise disposed off according to the directions of the bailor, after the accomplishment of purpose or after the expiry of period of the bailment. It may be noted that the same goods (which were delivered by bailor to bailee) must be returned in their original form or desired form (if any required by the bailor). Thus, goods must be returned in specie (same) though they may undergo a change of form.

Example 1: Delivery of old gold jewellery to a banker for safe custody creates a bailment because same old gold jewellery in its original form is to be returned.

Example 2: Delivery of old gold jewellery to a goldsmith for melting and making new one out of it also creates a bailment even though the same old gold is returned in the form of new jewellery.

6) **Essentials of a Valid Contract:** The contract of bailment must fulfill all other essential conditions of a valid contract, such as capacity of parties, lawful object and consideration, etc.

7) **Ownership not Transferred:** In bailment the ownership remains with the person who delivers the goods, i.e., with the bailor. The title of goods is not transferred to the bailee. (Where the title, i.e., ownership is also transferred with the delivery of goods, such contracts are called contracts of sales).

Check Your Progress

1. Define Bailment?
2. What is Lien?

NOTES

Kinds of Bailment

1) **On the Basis of Reward:** There are two kinds of bailment on the basis of reward or charges as follows:

   i) **Gratuitous Bailment:** A gratuitous bailment is that in which neither the bailor nor the bailee is entitled to any remuneration. It is a bailment without any charges or reward or consideration. **For example,** lending of a scooter to a friend, or borrowing some books from a friend, or lending of V.C.R. (Video Cassette Recorder) by a person to his neighbor are the cases of gratuitous bailment because no exchange of money or any other consideration is involved in these cases. None of the parties, i.e., friends or neighbors will be entitled to any charges. In such contract, parting with the possession of goods amounts to sufficient consideration to support the promise of the bailee to return them.

Basis of Distinction	Gratuitous Bailment	Non-Gratuitous Bailment
1) Consideration	No consideration passes between the bailor and the bailee.	Some consideration passes between the bailor and the bailee.
2) Benefit	It is for the exclusive benefit of the bailor or bailee.	It is for the mutual benefit of the bailor and bailee.
3) Liability of bailor for unknown defects [Section151]	The bailor is not liable to the bailee for the loss due to defects in the goods if he does not know those defects.	The bailor is liable to the bailee for the loss due to defects in the goods whether he knows those defects or not.
4) Bailor's duty to bear expenses [Section 158]	The bailor must repay to the bailee all the necessary expenses which the bailee has already incurred for the purposes of bailment.	The bailor must repay to the bailee only the extraordinary expenses which the bailee has already incurred for the purpose of bailment.
5) Bailment for a specified eriod/purpose	It can be terminated at any time even though the bailment was for a specified period or specified purpose.	It is terminated on the expiry of specified period or on the fulfillment of the specified purpose.
6) Effect of death of bailor/bailee	It is terminated by the death of bailor or bailee.	It is not terminated by the death of bailor or bailee.

   ii) **Non-Gratuitous Bailment:** A non-gratuitous bailment is that in which either the bailee or the bailor is entitled to some remuneration. It is a bailment which involves reward or payment of charges or consideration. **For example,** giving of scooter, etc., for repairs, or handing over of cloth for stitching, or taking a cycle on hire (here bailor is entitled to agreed charges), etc.

2) **On the Basis of Benefit:** On the basis of benefit accruing to parties, the contract of bailment may be divided into three following types:

   i) **Bailment for the Exclusive Benefit of the Bailor:** It is a bailment where the goods are delivered by the bailor to the bailee only for the benefit of the bailor himself and the bailee does not derive any benefit from it. **For example,** David is going out of station. He leaves his valuable goods with his neighbor for safety. Here, David alone is being benefited by this bailment.

   ii) **Bailment for the Exclusive Benefit of the Bailee:** It is a bailment where the goods are delivered by the bailor to the bailee only for the exclusive benefit

of the bailee. For example, lending of a scooter to a friend for some time without any charges.

iii) **Bailment for the Mutual Benefit of Bailor and Bailee:** It is a bailment where goods are delivered by the bailor to the bailee for the mutual benefit of both of them. For example, giving cloth to a tailor for stitching shirt (bailor gets shirt and bailee gets stitching charges); hiring a cycle; or giving a television for repairs, etc.

RIGHTS AND DUTIES OF BAILOR AND BAILEE

Duties of Bailor

1) **To Disclose Known Faults:** It is the first and foremost duty of the bailor to disclose the known faults about, the goods bailed to the bailee, If he does not make such disclosure, he is responsible for any damage caused to the bailee directly from such faults (Section 150). **Example:** A lends a horse which he knows to be vicious, to B. He does not disclose that the horse is vicious. The horse runs away and B is thrown and injured. A is responsible to B for damage sustained.'

2) **To Bear Extraordinary Expenses of Bailment:** The bailee is bound to bear ordinary and reasonable expenses of the bailment but for any extraordinary expenses the bailor is responsible. **Example:** A lends his horse to B, a friend, for two days. The feeding charges are to be paid by B. But if the horse meets with an accident, A will have to repay B medical expenses incurred by B.

   Where in case of a gratuitous bailment, the goods are to be kept or to be carried, or some work is to be done upon the goods by the bailee for the bailor, the bailor must repay to the bailee all the necessary expenses incurred by him for the purpose of the bailment (Section 158).

   Example: A leaves his car with B, a friend, for safe custody for two months. B has to pay Rs.100 per month to the night watchman for keeping a watch over the car. It is the duty of A to pay B the necessary expenses incurred by B.

3) **To Indemnify Bailee for Loss in Case of Premature Termination, of Gratuitous Bailment:** A

   Gratuitous bailment can be terminated by the bailor at any time even though the bailment was for a specified time or purpose. But in such a case, the loss accruing to the bailee from such premature termination should not exceed the benefit he has derived out of the bailment. If the loss exceeds the benefit, the bailor shall have to indemnify the bailee (Section 159).

   Example: A lends an old discarded bicycle to B gratuitously for three months. B incurs Rs.120 on its repairs. If A asks for the return of the bicycle after one month, he will have to compensate B for expenses incurred by B in excess of the benefit derived by him.

4) **To Receive Back the Goods:** It is the duty of the bailor to receive back the goods when the bailee returns them after the expiry of the term of the bailment or when the purpose for which bailment was created has been accomplished. If the bailor refuses to receive back the goods, the bailee is entitled to receive compensation from the bailor for the necessary expenses of custody.

5) **To Indemnify the Bailee:** Where the title of the bailor to the goods is defective and the bailee suffers as a consequence, the bailor is responsible to the bailee for

NOTES

any loss which the bailee may sustain by reason that the bailor was not entitled to make bailment, or to receive back the goods, or to give directions respecting them (Section 164).

Rights of Bailor:

1) **To Enforce Bailee's Duties:** The bailor has a right to enforce the duties of the bailee such as:

   i) Right to claim damages for loss caused to the goods by the negligence of bailee;

   ii) Right to claim compensation for loss caused by an unauthorized use of the goods bailed;

   iii) Right to claim damages arising out of mixing the goods of the bailor with his own goods.

2) **To Terminate the Contract of Bailment:** The bailor has a right to terminate the contract of bailment if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment. **For example,** A lets to B, for hire, a horse for his own riding. B drives the horse in his carriage. A has a right to terminate the bailment.

3) **To Demand Back Goods:** In case of gratuitous (without reward) bailment of goods, the bailor can demand back the goods at any time even though the goods were bailed for a specified time or purpose. But if the bailee had acted in such a manner that the return of the goods before the stipulated time would cause loss exceeding the benefit which he has derived from using the goods, the bailor is duty bound to compensate the bailee.

4) **To Claim Increase or Profit from Goods Bailed:** In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, any increase or profit which may have accrued from the goods bailed.

Duties of Bailee:

The bailee, as the person in possession of bailor's goods has following duties:

1) **To Take Care of the Goods:** Every bailee has a duty to take a reasonable care of the goods, as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take ofhis own goods of the same bulk, quantity and value as the goods bailed (Section 51).

   If, in spite of bailee's care, goods are lost or damaged, bailee shall not be liable; but the parties may increase (but not decrease) the level of care expected from bailee through a special term in the contract (Sectionl 52).

   Even when parties increase the expected level ofbailee's duty for care of goods, he will not be liable for losses caused by reasons beyond his control, such as losses caused by an act of God, like floods, or by acts of enemies of State or by communal riots. In case of loss of goods by theft, bailee must take necessary steps to recover the goods, like reporting to police; otherwise he shall be liable to the bailor.

2) **Not to Make Unauthorized Use:** Bailee is under duty to handle the bailed goods strictly according to the terms of the contract. Any deviation in this respect will be an unauthorized use of the goods; e.g., a drycleaner putting on the suit received from the customer, a lender allowing his wife to use the jewellery

received as a security for the loan. Bailee should also not do anything which is contrary to the title of bailor over the goods.

In case of an unauthorized use of the goods, the bailee shall be liable for any damage, whatsoever arising to the goods from or during such use of them (Section 154).

In addition to this, the bailor would have a right to terminate bailment in case of unauthorized use (Section 153).

3) **Not to Mix Goods with his Own:** Bailee must keep bailor's goods separate from his own or from those of others and should not mix them without bailor's consent. If bailee mixes bailor's goods and his own goods with bailor's consent, then, as per section 155, "the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced."

However, if bailee mixes bailor's goods and his own goods without bailor's consent, then following consequences shall follow:

i) **When the Goods can be Separated:** If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expense of separation or division and any damage arising from the mixture (Section 156).

ii) **When the Goods cannot be Separated:** If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods (Section157). In this case, bailor cannot be compelled to accept a share in the mixture.

The problem of mixing may arise in case of similar looking but intrinsically different goods, such as bales of cotton, or bags of wheat or rice, or quantities ofliquid, etc.

4) **To Return the Goods:** The bailee has a basic duty to return or deliver according to the bailor's directions the goods bailed to him without demand at the proper time, i.e., as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished (Section160).

If bailee fails to return the goods at proper time, his liability for loss or damage to goods increases; he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time (Section161).

The increase in bailee's liability for loss is so substantial that loss of goods during the period of delay even, by an act of God or an inevitable accident also falls upon the bailee.

Bailee's failure to return in time is a breach of contract in its own way and entitles the bailor to recover damages also for breach from the bailee.

Return of Goods to Joint-Bailors: When goods have been bailed by several joint-owners, the bailee may deliver them back to, or according to the directions of, one joint owner without the consent of all in the absence of any agreement to the contrary (Section165).

5) **To return any Accretion to the Goods:** 'Accretion' means increase or growth. Such an increase or growth or profits may take place in connection with the goods as

NOTES

a natural process when they are in bailee's possession. The bailee has a duty to restore or deliver any such accretion to the bailor or according to his directions (Section 163).

Rights of Bailee

1) **Enforcement of Bailor's Duties:** The duties of the bailor are the rights of the bailee. As such, the bailee can, by suit, enforce the duties of the bailor. To recapitulate, the bailee has the following rights against the bailor (based on the bailor's duties discussed above):

   a) Right to claim damages for loss arising from the undisclosed faults in the goods bailed (Section 150).

   b) Right to claim reimbursement for extraordinary expenses incurred in relation to the thing bailed (Section 158).

   c) Right to indemnity for any loss suffered by him by reason of defective title of the bailor to the goods bailed (Section 164).

   d) Right to claim compensation for expenses incurred for the safe custody of the goods if the bailor has wrongfully refused to take delivery of them after the term of bailment is over.

2) **Right to Deliver Goods to One of Several Joint Bailors:** Where goods have been bailed by several joint owners, the bailee has a right to deliver them to, or according to the directions of, one joint owner without the consent of all, in the absence of any agreement to the contrary (Section 165).

3) **Right to Deliver Goods, in Good Faith, to Bailor without Title:** The bailee has a right to delivet the goods, in good faith, to the bailor without title, without incurring any liability towards the true owner (Section 166).

4) **Right of Lien:** The right to retain possession of the property or goods belonging to another until some debt or claim is paid, is called the right of lien. The right depends on possession and is lost as soon as possession of the goods is lost. As such it is also called as 'possessory lien'. Liens may be of two types - 'particular' and 'general.'

'Particular lien' means the right to retain only that particular property in respect of which the charge is due. 'General lien' means the right to retain all the goods of the other party until all the claims of the holder against the party are satisfied. In other words, this is a right to retain the goods of another as a security for a general balance of account.

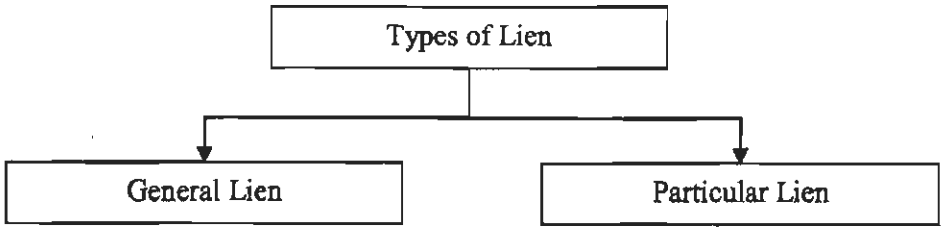
Bailee's Lien

'Lien' is a right of a person to retain the possession of goods of another person so long as some claim upon that person is not satisfied by him.

According to Halsbury, "Lien is thus a right in one man to retain that which is in his possession belonging to another until certain demands of the person in possession are satisfied".

'Lien' is a lawful mode of putting pressure upon a person so that he takes steps to satisfy claims of possessor of his goods.

Types of Lien:



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1) **Bailee's Particular Lien:** 'Particular lien' means the right granted by law to a person to detain only a particular property or goods of the owner againsr a particular claim upon the owner. To be more specific, 'particular lien' means the right to detain goods of another person until a claim upon the owner in relation to the detained goods is satisfied.

Requirements for 'Particular Lien'

Section 170 lays down the requirements for bailee's particular lien:

Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labor or skill in respect of the goods bailed he has in the absence of a contract to the contrary, a right ro retain such goods until he receives due remuneration for the services he has rendered in respect of them.

The bailee shall have particular lien on the goods if following conditions are satisfied:

i) The bailee had rendered some service in relation to the goods involving the exercise of labor or skill. This condition rules our lien where bailee's claim is for safe custody of goods which did not involve exercise of labor or skill.

ii) The service rendered by bailee must have been such as would lead to value-addition to the goods or improve them. This condition rules out lien where bailee's claim related to maintenance of goods, because mere maintenance does not add to the value of goods.

In Hutton *versus* Car Maintenance Co, H gave his car for maintenance to C under his three-year maintenance contract with the company. An amount became overdue from H. The company claimed lien on the car. It was not allowed as company's work had only maintained the value of car and not increased it.

Similarly, a person feeding and keeping a horse would only be maintaining it whereas a trainer would be adding value to it. Repair of a damaged car will also add value to it.

iii) Bailee must have rendered his services in accordance with the terms of bailment. If there is any deviation by bailee from the agreed terms, e.g., work is incomplete or is delayed or is of inferior quality, then, lien cannot be exercised while other rights may be intact.

iv) Bailee must have kept the possession of goods. Lien is a possessory right. It is rooted in possession of goods belonging to another person. If possession is lost even once, lien is lost altogether. So, to claim his lien, bailee must

NOTES

have kept the possession of the particular goods in relation to which his claim is due against bailor.

Example: X purchased an old machine from Y. Y agreed to repair it for a charge. The machine was delivered to X after a part payment. Later, there was a problem in the machine and X brought it to Y again. Having obtained the machine, Y claimed lien on the machine for the unpaid amount. Court disallowed lien on the ground that earlier delivery of the machine marked an end of the lien and repossession was for a fresh repair only for which no amounr was agreed to be paid.

v) Bailee should not have agreed to provide services on credit. Section 170 stated that lien shall be available if there is no contract to the contrary. The bailee might agree to grant credit to the bailor. In such a case, lien shall be lost.

If all these conditions are satisfied, bailee shall have particular lien over the goods. It may be added that lien under section 170 is available only to recover charges for services rendered by bailee. Bailee has the additional right of filing a suit against bailor for such a claim and for all other claims. Expenses on maintenance of goods during the exercise of lien shall not be paid to bailee.

2) **Bailee's General Lien:** A general lien is a right to retain the goods of another as a security for a general balance of account. In simple words, this right entitles a person to retain possession of any goods belonging to another for any amount due to him whether in respect of those goods or any other goods. For example, if two loans have been taken against two securities from a banker and the borrower repays one of these loans, the banker may detain both securities until his other loan is paid.

Requirements for 'General Lien'

When would general lien be available to a bailee? According to section.171, general lien is available to a bailee in following cases:

i) **To any Kind of Bailee by an Express Contract to that Effect:** An express contract can be made to grant to a bailee a general lien over the goods in every case of bailment, including a case where, under law, only a particular lien is available or no lien is available to the bailee.

ii) **To Specify Categories of Bailees:** Section 171 has given a list of special type of bailees who would always have a general lien over the goods of bailors that come in their possession unless otherwise agreed. These special bailees are as follows:

a) **Bankers:** A banker is a person or an institution engaged in the business of banking. Every banker will have a general lien which attaches to all goods, securities and papers entrusted to it as a bailee by its customer against any kind of claim upon the latter.

Deposit of money does not amount to bailment with the bank; bank is like a debtor and not a bailee for the amount. So, the bank cannot have lien over the money deposited with it. But, if the customer has two accounts with the bank, a deposit account and a loan account, then, a set-off may be possible between the two.

Where goods are deposited with the banker for safe custody or for any special purpose, there is to be no general lien on such goods because the acceptance of goods by the banker for special purpose implies the exclusion of general lien.

b) **Factors:** The word 'factor' is used for such mercantile agents who are entrusted with principal's goods for selling them. Section 171 grants a general lien to a factor on all goods received by him in his capacity as factor for his balance of account against the principal. The claim of the factor may relate to his remuneration or advances.

c) **Wharfingers:** A 'wharf is a place close to a seaport where goods are temporarily placed during the loading or unloading operations to or from the ship. It is not a storehouse proper but a transit place. A 'wharfinger' is the owner of a wharf. Section 171 grants to a wharfinger a general lien over goods bailed to him in that capacity for the wharfage, i.e., his remuneration for allowing the use of his wharf.

d) **Attorneys of High Court:** An attorney or a solicitor of a High Court is granted a general lien over the client's documents and papers received by him in professional capacity from the client until his professional fee and other legal costs incurred by him for the client are paid.

If the attorney is discharged from his position by the client, the lien continues unaffected. If the attorney himself leaves his client's work, he forfeits his lien and is bound to hand over the documents to the client immediately.

e) **Policy-Brokers:** An insurance agent employed to affect a policy of marine insurance is called a policy-broker. He may detain any property or documents received from his clients for any balance on any insurance account due to him from his client.

Rights of Bailor and Bailee against Wrong-Doer

1) **Suit against Wrong-Doer:** Sometimes a third person may wrongfully deprive the bailee of the use or possession of the goods bailed or may cause injury to the goods. In such a case, the bailee may use such remedies as the owner might have used and either the bailor or the bailee may bring a suit against the third person for such deprivation or injury (Section 180).

2) **Apportionment of Relief:** Whatever is obtained by way of relief or compensation in any such suit in the above case shall, as between the bailor and the bailee, be dealt with according to their respective interests (Section 181).

TERMINATION OF BAILMENT

Termination of Every Contract of Bailment (Whether Gratuitous or Not)

Every contract of bailment comes to an end under the following circumstances:

1) **On the Expiry of Fixed Period:** A bailment is terminated on the expiry of fixed period if the goods are bailed for a fixed period.

2) **On Fulfillment of the Purpose:** A bailment is terminated on the fulfillment of the purpose if the goods are bailed for a specific purpose.

NOTES

3) **Inconsistent Use of Goods:** A bailment may be terminated if the bailee does not use the goods according to the conditions of the bailment.

4) **Destruction of the Subject Matter of Bailment:** A bailment is terminated if the subject matter of the bailment:

   i) Is destroyed, or

   ii) Becomes incapable of being used for bailment because of some change in the nature of goods.

Termination of Gratuitous Bailment

A contract of gratuitous bailment is terminated in the following circumstances:

1) **Before the Expiry of a Fixed Period:** A gratuitous bailment may be terminated by the bailor at any time even though the baihnent was for a fixed period. However, the bailor is required to indemnify the bailee in case the loss due to premature termination exceeds the benefit actually derived by the bailee.

2) **On Death of Bailor7Bailee:** A gratuitous bailment is terminated by the death of either the bailor or bailee.

MEANING OF PLEDGE (OR PAWN) [Section 172]

Pledge is special kind of bailment, where delivery of goods is for purpose of security for payment of a debt or performance of a promise. Pledge is bailment for security. According to section 172, "The bailment of goods as a security for payment of debts or performance of promise is called pledge. The bailer is called pledger or pawner and the bailee is called Pawnee". The transaction is called the pledge or pawn. The goods must be delivered as security. Delivery may be actual or constructive delivery. Pledge can be made of movable goods only. Transfer of possession of goods is essential. Common example is keeping gold with bank/money lender to obtain loan. Since pledge is bailment, all provisions applicable to bailment apply to pledge also. In addition, some specific provisions apply to pledge.

Pledge is a form of security to assure that a person will repay a debt or perform an act under contract. In a pledge one person temporarily gives possession of property to another party. Pledges are typically used in securing loans, pawning property for cash, and guaranteeing that contracted work will be done. Pledges are different from sales. In a sale both possession and ownership of property are permanently transferred to the buyer. In pledge only possession transferred to second party. The first party retains ownership of the property, while the second party takes possession of the property until the terms of the contract are satisfied.

The bailment of goods as security for payment of a debt or performance of a promise is called pledge (or pawn).

Example: X borrows Rs. 1,00,000 from Citi Bank and keeps his shares as security for payment of a debt. It is a contract of pledge.

MEANING OF A PAWNOR (OR PLEDGOR) [SECTION 172]

The person who delivers the goods as security for payment of a debt or performance of a promise is called the Pawnor or Pledgor. In the above example, X is the pawnor.

Meaning of Pawnee (or Pledgee) [Section 172]

The person to whom the goods are delivered as security for payment of a debt or performance of a promise is called the Pawnee or Pledgee. In the above example, Citi Bank is the pawnee.

NOTES

Distinction between Pledge and Bailment

Basis of Distinction	Pledge	Bailment
1) Purpose	Pledge is bailment of goods for a specific purpose, i.e., repayment of a debt or performance of a duty.	Bailment is for a purpose of any kind.
2) Right of Use	Pawnee cannot use the goods pledged.	Bailee can use the goods as per terms of baibnent.
3) Right to Seli	Pawnee can sell the goods pledged after giving notice to the pawnor in case of default by the pawnor.	Bailee can either retain the goods or sue the bailor for his dues.
4) Property	In the case of pledge, the pawnee acquires a special property in the goods bailed the general property or ownership remaining with the pawnor. The special property is a right to possession coupled with the power of sale on default.	In the case of bailment, the bailee gets only the possession of the goods bailed, ownership remaining with the bailor.

ESSENTIALS OF PLEDGE

1) The goods must be delivered as security for payment of a debt or for performance of a promise.
2) There must be actually or constructive delivery of goods pledged. When a third person having possession of the goods agrees to hold them on pledgee's behalf it will constitute sufficient delivery. Delivery of documents of title to the goods which would enable the pawnee to obtain possession thereof, like delivery of railway receipt would constitute the same thing as delivery of goods and would therefore be a pledge.
3) The pledge can be made of movable goods only. Movable goods include documents, shares, or valuable things. Government promissory notes may be pledged by endorsement and delivery. Money cannot be pledged.
4) Transfer of possession is essential. Agreement to transfer possession of goods when ready or in future does not create a pledge.

Distinction between 'Pledge' and 'Lien'

Basis	Pledge	Lien
1) **Creation of Right**	In a pledge, goods are bailed 'as a security for payment of debt or for performance of a promise.	There is no bailment of goods as security. It is only a creation of a right to possession in the bands of the bailee. It is a mere right of retainer.
2) **Right to Sell**	It gives a right to sell.	It gives no right to sell.

Check Your Progress

3. Explain meaning of a Pawnor?
4. What is a Wharf?

3) **Possession**	It creates a right of security, i.e., pledge of goods is not lost by return of goods to the owner or by loss of possession.	Lien is lost by loss of possession.
4) **Origin**	Pledge is created by contract between the parties.	Lien is created by law or by express or implied contract.

WHO MAY PLEDGE ?

The following persons may make a valid pledge or pawn:

1) **Owners of the Goods:**

The general rule is that it is the owner of the goods who can ordinarily create pledge. An authorized agent of the owner also comes in this category. It may be noted that if there are several co-owners (i.e., joint owners) and the goods are in possession of one of them, then that one co-owner who is in possession of the goods can create a valid pledge of such goods with the consent of the other co-owners.

2) **Pledge by Non-Owners:**

Under certain circumstances, even non-owners can make a valid pledge as follows:

i) **Mercantile Agent:**

A mercantile agent who is in possession of the goods or the 'documents of title' can create a valid pledge with the consent of the real owner.

ii) **Person who is in Possession of Goods:**

A person who is in possession of goods under a voidable contract can create a valid pledge before such contract is rescinded.

iii) **Seller who is in Possession of the Goods:**

A seller who is in possession of the goods even after sale can make a valid pledge of them.

iv) **Buyer who has Obtained Possession of Goods:**

A buyer who has obtained possession of goods before sale can create a valid pledge.

v) **Person who has a Limited Interest in the Goods:**

A person who has a limited interest in the goods can create a valid pledge of such goods but only to the extent of his own interest.

It should be noted that in cases of pledge by non-owners, a valid pledge is created provided the pawnor or pawnee acts and takes the goods in good faith and without the notice of any reverse fact against the non-owner pawnor or the goods itself.

RIGHTS AND DUTIES OF PAWNOR AND PAWNEE

NOTES

Rights of Pawnee

1) **Right of Retainer (Section 173):**

The pawnee has the right to retain the goods pledged until his dues are paid. He has the right to retain the goods pledged, not only for payment of the debt or performance of the promise, but for the interest due on the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged. Thus this right may be termed as the pawnee's right of 'particular lien.'

2) **Right of Retainer for Subsequent Advances (Section 174):**

When the pawnee lends money to the same debtor after the date of the pledge without any further security, it shall be presumed that the right of retainer over the pledged goods extends even to subsequent advances. This presumption can be denied only by a contract to the contrary. It will be noticed that although a pawnee has a 'particular lien' only, but this section allows him to track his subsequent advances to the original debt in the absence of ahy agreement to the contrary.

3) **Right to Extraordinary Expenses (Section 175):**

The pawnee also has the right to recover from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged. But he cannot retain the goods, if such expenses are not paid. He has only a right to sue the pawnor for recovery of such extraordinary expenses.

4) **Right to Sue the Pawnor or Sell the Goods on Default of the Pawnor (Section 176):**

Where a pawnor makes default in the payment of the debtor performance of the promise, the pawnee may exercise either of the following rights:

i) He may bring a suit against the pawnor for the recover>' of the amounr due to him and retain the goods pledged as a collateral security; or

ii) He may himself sell the thing pledged, after giving to the pawnor a reasonable notice ofhis intention to sell.

In connection with the alternative right of sale, the following points must be noted:

a) The requirement of a 'reasonable notice' is a statutory obligation and cannot be waived by agreement. A sale without notice is void, notwithstanding any contract ro the contrary.

b) The pawnee cannot sell the goods to himself and ifhe does so then such a sale is void as against the pawnor and the pawnor can recover the goods on paying the amount due.

c) If the proceeds of such sale are insufficient to meet the full claim of the pawnee, he may recover the balance from the pawnor, but if there is surplus, he must pay it over to the pawnor.

NOTES

a) **Duties of the Pawnee**

The duties of the pawnee are almost similar to those of a bailee which have already been discussed. However, the following are some additional duties of the pawnee:

1) **Duty not to Use the Pledged Goods:** The pawnee must not use the goods pledged by the pawnor. If the pawnee uses such goods, he may be held liable for damages for any loss caused to the goods by such use.

2) **Duty to Return the Pledged Goods:** It is the duty of the pawnee to return the goods to the pawnor when the amount of debt has been paid by the pawnor.

Rights of Pawnor

1) **Enforcement of Pawnee's Duties:**

The duties of the pawnee are the rights of the pawnor. The pawnor can, therefore, enforce by suit all the duties of the pawnee as his rights. For example, if the pawnee makes an unauthorized sale (without giving the notice as required under section 176)the pawnor can file a suit for redemption of goods, treating the sale as void (of course after depositing with the Court the full amount due), or for damages for conversion. Similarly, the pawnor has a right to receive the pledged goods back along with accretion, if any, on making the payment on stipulated date, and so forth.

2) **Defaulting Pawnor's Right to Redeem [Section 177]:**

A pawnor, who defaults in payment of the debt amount at the stipulated date, has aright to redeem the debt at any subsequent time before the actual sale of goods pledged. Thus an agreement that the pledge should become irredeemable, if it is not redeemed within a certain time, would be invalid. Of course, the pawnor redeeming after the expiry of 'the specified time must pay to the pawnee, in addition, any expenses which have arisen from his default.

Duties of Pawnor

The duties of the pledgor are almost similar to those of the bailor as already discussed. However, the following are some additional duties of the pledgor:

1) **Duty to Repay the Loan:**

It is the duty of the pledgor to comply with the terms of pledge and repay the debt on the fixed date or to perform the promise at the fixed time.

2) **To Pay Extraordinary Expenses Incurred by the Pawnee:**

If the pawnee has incurred extraordinary expenses for the preservation of the pledged goods, then it is the duty of the pawnor to pay such expenses to the pawnee.

PLEDGE BY NON-OWNERS

Generally the goods can be pledged by the owner or by any person with owner's authority. This rule is based on the principle that no one can pass a better title than

he himself has. This principle is necessary to protect the individual interest in the ownership of goods. But in the following cases pledge made by non-owners will also be valid.

NOTES

1) **Pledge by Mercantile Agents:**

Mercantile agent means an agent having the customary course of business such authority to sell or buy goods or raise money on the security of goods. A pledge by mercantile agent will be valid if the following conditions are satisfied:

i) The mercantile agent is in possession of goods or the documents of title to goods;

ii) Such possession must be with the consent of the owner of goods;

iii) The mercantile agent must be acting in the ordinary course of business;

iv) The pawnee acts in good faith; and

v) The pawnee has no notice of the pawnor's defective title.

If all the above conditions are fulfilled then a pledge by mercantile agent shall be valid. Thus a servant who is in possession of goods of his master cannot pledge them.

2) **Pledge by Person in Possession under Voidable Contract:**

When the pawnor has obtained possession of the goods pledged by him under a voidable contract, he can make a valid contract of pledge provided the contract is not rescinded at the time of pledge and the pawnee has received the goods in good faith.

The case of Phillips ***versus*** Brooks is relevant in this connection. In this case a person obtained a costly ring from a jeweller pretending him to be a man of credit. Before the fraud could be detected, he pledged the ring. The pledge was held valid.

But if a person is in possession of goods under a void contract, he cannot make a valid contract of pledge, e.g., a pledge by a thief will not be valid.

Pledge by a Person having Interest:

When a person who has limited interest in the goods, pledges them, the pledge is valid to the extent of his interest.

Example:

A finds a watch and spends Rs. 20 on its repair. He pledges the watch for Rs. 50. The true owner can recover his watch from the pawnee by paying Rs. 20.

Pledge by Co-owner in Possession:

When there are several owners of the goods but the goods are in the possession of one of the co-owner with the consent of other co-owners, then a pledge made by such a co-owner shall be valid provided the pawnee accepts the goods in good faith.

NOTES

Pledge by Seller in Possession of Goods after Sale:

If a seller who has sold the goods is in possession of the goods, pledges them and the pawnee accepts them in good faith, then it is a valid pledge. The buyer of goods cannot recover the goods from pawnee.

Pledge by a Buyer in Possession of Goods under an "Agreement to Sell":

Quite often a person is given possession of goods under an agreement to sell, i.e., the buyer has not yet become the owner of goods but he is possessing them, if such a person pledges the goods and the pawnee accepts the goods in good faith, it is a valid pledge.

Example:

A buys a radio set from B on hire purchase system. A has not yet become the owner because he has not paid the full price. If A pledges that radio set with C, it is a valid pledge provided C has no knowledge about the defective title of A.

Example:

A gives cloth to B, a tailor, to make inro 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. Bailee's General Lien Section 171 provides that bailees coming within the following categories have a general lien: bankers, facrors, wharfingers; attorneys of High Court, and policy brokers. Such bailees can retain all goods of the bailor so long as anything is due to them. The general lien in all these cases may not exist if there is a contract to the contrary. Bailees failing in categories other than those mentioned above may have a general lien if there is an express agreement to that effect.

CASE STUDY:

Mr. Shankar, a barber and beautician occupied a suite of three rooms, a back rooms used as a barbershop, a middle room where the beauty shop was operated and facing a reception room, whose interior was visible from the outside through the glass door. Outsiders could not see into the operating room, nor persons in the operating room to the reception room. A conspicuous sign in the shop read.

Anna fur coat was stolen while she was getting a permanent wave Mr. Shankar did not know that she had it with heron that day.

So here the question is Shankar has to pay for it or not. There can be no delivery unless there is a change of possession of an article from one person to another. When property is stolen the loss will lie where it falls unless the owner can prove that it was due to his negligent act of another who had a duty of care with regard to it. The duty of care falls upon the bailer because he possesses the articles and has the power of custody or control over it. This situation will not arise unless the owner parts with control over the articles as a result of bailee because he possesses the articles and power of custody and control over it.

For example if we takes off our ornaments and deposits in to our presence then the possession changes and burden of caring too and in any damage bailee will have to

pay but in case of restaurant, the person (bailer) will retain the power of surveillance and control in himself and the operator or restaurant has not receive the exclusive possession and dominion over it. In this case Anna may not have had an adequate opportunity for surveillance, nevertheless, she had not transferred control of it to Shankar by a delivery and they were unaware that a valuable fur coat had been left in the reception room.

SUMMARY

- Sec. 148 defines 'bailment' as the delivery of goods by one person to another from some purpose, when the purpose is accomplished, the goods is returned to or otherwise disposed off according to the direction of the person delivering them.
- Essential Elements of Bailment: Agreement, Delivery of Goods, Movable Property, Definite Purpose, Return to specific goods, Essentials of a valid contract, Ownership not transferred.
- A gratuitous bailment is that in which neither the bailor nor the bailee is entitled to any remuneration.
- A non-gratuitous bailment is that in which either the bailee or the bailor is entitled to some remuneration.
- Lien is the right of a person to retain the possession of goods of another person so long as some claim upon that person is not satisfied by him.
- Particular lien means the right granted by law to a person to detain only a particular property or goods of the owner against a particular claim upon the owner.
- A general lien is a right to retain the goods of another as a security for a general balance of account.
- Pledge is special kind of bailment, where delivery of goods is for purpose of security for payment of a debt or performance of a promise.
- The person who delivers the goods as security for payment of a debt or performance of a promise is called Pawnor or Pledgor. The person to whom the goods are delivered as security for payment of a debt or performance of a promise is called Pawnee or Pledgee.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. According to Section 148 of the Act "Bailment is the delivery of goods by one person to another for some purpose upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them".
2. According to Halsbury, "Lien is thus a right in one man to retain that which is in his possession belonging to another until certain demands of the person in possession are satisfied".

NOTES

3. The person who delivers the goods as security for payment of a debt or performance of a promise is called the Pawnor or Pledgor.
4. A 'wharf is a place close to a seaport where goods are temporarily placed during the loading or unloading operations to or from the ship.
5. "goods" means every kind of movable property other than actionable claims (i.e., claims to be settled by the Court) and money.

TEST YOURSELF

1. Explain the term 'Bailment'. What are the essentials elements of a bailment?
2. What are the different kinds of Bailment?
3. What are the right and duties of Bailer?
4. Briefly describe the types of Lien.
5. Explain Pledge. What are the essential elements of Pledge?
6. Explain rights and duties of Pawnor and Pawnee.

FURTHER READING

- *Mercantile Law:Sharma, Sareen, Gupta and Chawla*

6 Contract of Agency

NOTES

The Chapter Covers :

- Meaning of Contract of Agency
- Relationship between Principal and Agent
- Duties of Principal
- Creation of Agency
- Agent's Authority
- Personal Liability of an Agent
- Termination or Determination of Agency
- [Sections 201 - 210]
- Irrevocable Agency

INTRODUCTION

Agency is different from Company. It has Agent that works for it. Formation of an agency is different from company's formation, so as its principles and duties.

MEANING OF CONTRACT OF AGENCY

By a contract of agency, a person employs another person to do any act for him or to represent him in dealing with third persons so as to bind himself by the acts of such another person.

The law of agency is based on the following general rules:

1) Whatever the principal can do by himself, he may get the same done through an agent, except when the act involved is of personal nature, e.g., the principal cannot ask his agent to become insolvent on his behalf or to marry on his behalf.

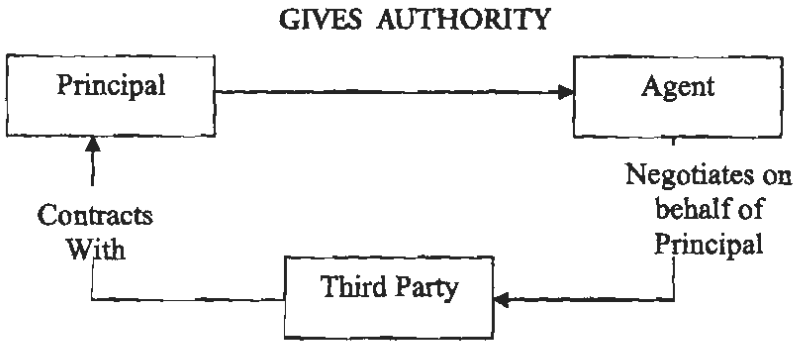
2) What a person does by another, he does by himself. Thus, the acts of the agent are the acts of the principal.

Agency is a special type of contract. The concept of agency was developed as one man cannot do every transaction himself. Hence, he should have opportunity or facility to transact business through others like an agent. Agency is the relationship that exists when one person or party (the principal) engages another (the agent) to act

NOTES

for him, e.g. to do his work, to sell his goods, to manage his business. The law of agency thus governs the legal relationship in which the agent deals with a third party on behalf of the principal. Since agency is a contract, all usual requirements of a valid contract are applicable to agency contract also. No consideration is necessary to create an agency.

In general terms, Agency refers to the relationship which exists between two persons, the Principal and the Agent in which the Agent has to perform different duties/ functions as per instructions of the principal and also enters into contract with the third party / parties on behalf of the principal. The relationship of agency plays an important role in business and commercial dealings. This relationship is legal created by virtue of agreement between Principal and Agent.



Meaning of an Agent [Section 182]

An agent is person employed to do any act for another or to represent another in dealings with third persons. Thus, an agent establishes a contract between such another person and third person.

Who may be an Agent?

Any person who is authorized to act as such may be an agent. As the agent does not make contracts on his own behalf, it is not necessary that he should have contractual capacity. Even a minor may be an agent. If person who is not competent to contract is appointed an agent, the principal is liable to the third party for the acts of the agent. Thus as between the principal and a third person any person may become an agent. But no person who is not of the age of majority and of sound mind is responsible to his principal (Section 184). It is therefore in the interest of the principal that the agent should have contractual capacity.

Distinction between an Agent and Servant

An agent differs from servant in the following respects:

Basis of Distinction	An Agent	Servant
1) Authority to Create contractual Relationship	He has the authority to create contractual relationship between the principal and a third party.	He ordinarily has no such authority.
2) Work of Several Persons	He may work for several principals at a time.	He ordinarily works only for one master.
3) Remuneration	He usually gets commission.	He usually gets salary or wages.

Distinction between an Agent and Independent Contractor

An agent differs from an independent contractor in the following respects:

Basis of Distinction	An Agent	Independent Contractor
1) Control and Supervision	He works under the control and supervision of the principal.	He works independently of the control of the person for whom he does the work.
2) Personal Liability	He is not personally liable for all acts done by him within the scope of his authority.	He is personally liable for all acts done by him.
3) Remuneration	He usually gets commission.	He usually gets the fixed contracted amount or amount at a fixed contracted rate.

Meaning of Principal [Section 182]

The person for whom act is done by an agent or who is represented in dealings with third persons by an agent is called the principal.

Who can employ Agent?

Any person who is of the age of majority according to the law to which he is subject and who is of sound mind, may employ agent (section 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 organization, must act through agent, e.g., a company, which is an artificial person and thus can transact business only through agent.

Essentials for Agency:

1) **Principle Should be Competent to Contract:** 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 (section 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 organization, must act through agent', e.g., a company, which is an artificial person and thus can transact business only through agent.

2) **Agent Need not be Competent:** Any person who is authorized to act as such may be an agent. As the agent does not make contracts on his own behalf, it is not necessary that he should have contractual capacity. Even a minor may be an agent. If a person who is not competent to contract is appointed an agent, the principal is liable to the third party for the acts of the agent. Thus as between the principal and a third person any person may become an agent. But no person

NOTES

who is not of the age of majority and of sound mind is responsible to his principal (Section 184). It is therefore in the interest of the principal that the agent should have contractual capacity.

3) **Consideration Not Necessary in Agency:** Section 185 states, "No consideration is necessary to create an agency".

This means that if a person promises to act as an agent of another without any remuneration, this would remain a valid agency relationship even if without consideration. This does not, however, mean that this is a valid contract also. If the agent in this case refuses to actually act as promised, he will not be guilty of breach of contract because the agreement is void for want of consideration. The rule contained in Section 185 implies that for the creation of the relationship of agency between two persons, consideration is not required. Thus, if the agent without remuneration actually acts as the agent, he would be acting as the valid agent authorized to bind the principal by his acts; and he would himself be bound by the duties laid down in law for an agent.

It may be added that the utility of the rule on consideration contained in Section 185 would be particularly visible in situations of implied agency which are created by the demand of circumstances, because, in such cases, a person would act as an agent without any question 'of remuneration being paid to him.

Kinds of Agent

Agents are found under different names in the business world. These various kinds of agents may be described from two viewpoints:

1) **From the Point of View of Extent of Authority**

   i) **General Agent:** An agent granted authority to do everything necessary for a particular business or venture would be called a general agent. Such an agent, e.g., a managing director of a company, would wield wide authority, actual as well as perceived, to perform his work.

   ii) **Universal Agent:** An agent granted nearly unlimited power to do things on behalf of the principal in all fields would be called a universal agent. Such agents would be found rarely.

   iii) **Special Agent:** An agent appointed to do a particular act would be a special agent. **For example,** a lawyer appointed to handle a case in court, a broker to purchase a property.

2) **From the Point of View of Nature of Work**

   Mercantile Agent: The term has been defined by Section 2(9) of The Sale of Goods Act as follows: "mercantile agent" 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 purposes of sale, or to buy goods, or to raise money on the security of goods.

   Thus, "mercantile agent" is a wide term and comprises of many activities, all involving goods of the principal. There are several kinds of mercantile agents as mentioned below:

   a) **Factor:** A factor is an agent whose primary duty is to sell principal's goods entrusted to him. A factor usually sells goods of his principal in his own name. He can exercise general lien over principal's goods for his claims upon the latter (Section171).

b) **Commission Agent:** A commission agent is one who buys or sells goods for a distant or foreign principal and performs his duty in his own name. Even if the fact of agency is known to the third party, there is no privity of contract between the principal and the third party unless otherwise agreed. Such an agent is personally liable to the third party and also to his principal. Similarly, the principal of such commission agent would be liable to his agent but not to the third party.

Example: D of India orders K of England to buy some goods for him. K buys the right goods at the right price from a person R in England and ships them for D. There is no privity of contract between D and R but both have rights and duties in relation to K only.

c) **Broker:** A broker is any kind of middleman who brings two persons or sides together and arranges for an agreement between them, be it a commercial deal or a peace agreement between two warring nations or groups. In business deals, a broker generally helps the parties in the making of an agreement. His job as broker is over with the making of agreement and he need not look after the fulfillment of terms of the contract.

d) **Auctioneer:** An auctioneer is a person who conducts an auction for the sale of goods of another person. He starts his work as agent of only the seller but aftet the highest bid has been accepted, he becomes the agent of the purchaser also.

e) **Del-Credere Agent:** The term 'del credere' literally means 'of entrusting'. Normally, the duties of an agent are confined to the making of the agreement for his principal. He does not become personally liable to his principal for any improper performance by the third person. However, a factor, entrusted with principal's goods to find customer for them, may give a personal guarantee to the principal that the buyer shall pay the price for goods and if he defaults, the agent himself would make payment to principal. Such an agent is called a del credere agent. For the risk that he undertakes, the agent takes some extra remuneration also which is called del credere commission.

f) A del credere agent's position has been held to be partly of an insurer and partly of surety to the principal. However, this agency is not a contract of guarantee. So, if a del credere agent is made to pay an amount to his principal on default by the buyer, he cannot recover this amount from the buyer later. His compensation would be the extra commission that he was getting.

ii) **Non-Mercantile Agents:** There would be numerous types of agents performing non-Mercantile duties for their principals. These may include legal duties by lawyers, financial duties by bankers, technical duties by engineers or architects, etc.

RELATIONSHIP BETWEEN PRINCIPAL AND AGENT

Duties of Agent

1) To conduct Principal's Business [Section 211)]: An agent is bound to conduct the business of his principal according to the directions given by the principal. In the absence of any such directions, the agent must conduct the business according to the custom which prevails in doing business of the same kind at the place where the agent conducts such business. When the agent acts otherwise,

NOTES

if any loss be sustained, he must make it good to his principal, and, if any profit accrues, he must account for it.

2) **Conduct the Business with Skill and Diligence [Section 212]:** An agent is bound to conduct the business of agency with as much skill as is generally possessed by persons engaged in similar business, unless the principal has notice of his want of skill. The agent is always bound to act with reasonable diligence, to use such skill as he possesses. He is to make compensation to his principal in respect of the direct consequences of his own neglect, want of skill or misconduct, but not in respect of loss or damage which is indirectly or remotely caused by such neglect, want of skill or misconduct.

3) **To Render Proper Accounts [Section 213]:** An agent is bound to render proper accounts to his principal on demand. An agent is under an obligation to keep his own accounts, property, etc., separate from those of his principal and others. He shall maintain proper accounts of his principal and of the dealings and transactions effected by him on behalf of his principal. It is the obligation of the agent not only ro tender the accounts but also to explain them ro the principal.

4) **To Pay Sums Received for Principal [Section217 and 218]:** The agent is bound to pay to his principal all sums received on his account after deducting there from all monies 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.

5) **To Communicate with Principal [Section 214]:** In cases of difficulty, it is the duty of an agent to use all reasonable diligence in communicating with his principal and in seeking to obtain his instructions.

   However, in emergency, where an agent cannot communicate with his principal he has authority to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence (Section 189).

6) **On Principal's Death or Insanity [Section 209]:** In case the principal dying or becoming of an unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him.

7) **Not to Deal on his own Account [Section 215]:**The agent shall not deal on his own account in the business of the agency, without first obtaining the consent of the principal and acquainting him with all material circumstances which have come to his own knowledge on the subject.

8) **Use of Information:** The agent shall not use information obtained in the course of his agency against the principal.

9) **Secret Profits [Section 216]:** The agent shall not make secret profits from agency, beyond the agreed commission or remuneration. Secret profit is an advantage obtained by an agent over and above his agreed remuneration or commission.

10) **Adverse Title:** The agent must not set up an adverse title, i.e., he must not set up his own title or the title of the third parties to the goods received by him from his principal.

11) **Not to Delegate [Section 190]:** An agent cannot delegate his authority or employ another to perform acts which he has expressly or impliedly undertaken to perform personally.

12) **Naming an Agent for Principal [Section 195]:** In selecting an agent for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case.

NOTES

Rights of the Agent

1) **Right of Lien on Principal's Property [Section 221]:** An agent is entitled to retain goods, papers and other property, whether movable or immovable, of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or accounted for to him.

2) **Right to be Indemnified against Consequences of Lawful Acts [Section 222]:** The employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him. For instance, B at Singapore, under instructions from A of Calcutta contracts with C to deliver certain goods to him, A does not send the goods to B and C sues B for breach of contract. B informs A of the suit, andA authorizes him to defend the suit. B defends the suit and is compelled to pay damages and costs and incurs expenses. In the circumstances, A is liable to B for such damages, costs and expenses.

3) **Right to be indemnified against Consequences of Acts in Good Faith [Section 223]:** Where one person employs another to do an act and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it causes an injury to the rights of third persons. For instance, B at the request of A sells goods in the possession of A but A had no right to dispose of the same, B does not know this and hands over the proceeds of the sale to A. Afterwards, C, the true owner of the goods, sues B and recovers the value of goods and costs. A is liable to indemnify B for what he has been compelled to pay C and for B's expenses,

   However, notwithstanding any express or implied promise in this regard, an agent cannot claim to be indemnified against the consequences of an act which he does but which is prohibited under the penal law of the country [Section 224]. So, if A employs B to beat C and agrees to indemnify him against all consequences of the act, and B thereupon beats C, and has to pay damages to C for doing so, A is not liable to indemnify B for those damages.

4) **Compensation for Injury caused by Principal [Section 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. For instance, A employs B as a brick-layer in building a house and puts up the scaffolding himself. The scaffolding is unskillfully put up land B in consequence is hurt. A must make compensation to B.

5) **Rights of Retainer [Section 217]:** An agent may retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advance made or expenses properly incurred by him in conducting such business and also such remuneration as may be payable to him for acting as an agent Therefore, what an agent has to account for to his principal is the balance of money received by him as agent after the deduction of moneys due to himself from the principal.

6) **Right to Remuneration:** An agent is entitled to remuneration agreed upon for the performance of any act in the business of the agency. Where no specific remuneration has been fixed, then the agent is entitled to be paid what is usual and

NOTES

customary in the business in which he has been employed. Yet in the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act; but an agent may detain moneys received by him on account of goods sold, although the whole of the goods consigned to him for sale may not have been sold or although the sale may not be actually complete (Section 219). But an agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of that part of the business of the agency which he has miscounted (Section 220).

Duties of Principal

1) **To Indemnify the Agent**

   i) **Against Consequences of Lawful Act [Section 222]:** The employer is bound to indemnify his agent against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him. It must be noted that principal is liable only for such damages as are direct and immediate and naturally flow from the execution of the agency. When the agent acts unauthorizedly or in breach of his duty, he is not entitled to be indemnified. However, the principal may ratify agent's default.

   ii) **Against Consequences of the Acts done in Good Faith [Section 223]:** Where one person employs another to do an act, and the agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it causes an injury to the right of third persons.

   The principal is therefore liable to indemnify the agent not only against the lawful acts (Section 222), but also against the unlawful acts of an agent done in good faith (Section 223). An agent, therefore, cannot claim indemnity for acts which he knows to be unlawful.

   When is the Agent not entitled to be indemnified [Section 224]: Where one person employs another to do an act which is criminal, the employer is not liable either upon an express or an implied promise, to indemnify him against the consequences of that act. This establishes the principle that an agent can refuse to carry out the instructions of the principal to do a criminal act.

2) **Compensate the Agent for Injury Caused: [Section 225]:** The principal must make compensation to his agent in respect of injury caused to the agent by the principal's neglect or want of skill.

3) **To Pay Remuneration and Dues [Section 217]:** It is the principal's duty to pay his agent such remuneration as may be payable to him for acting as agent, and also all monies due to the agent in respect of advances made or expenses properly incurred by the agent in conducting principal's business.

4) **Misrepresentation or Fraud by Agent [Section 238]:** Misrepresentations made, or frauds committed, by an agent acting in the course of business for his principal, has the same effect on agreements made by such agent as if such misrepresentations or fraud had been made or committed by the principal. Therefore, in case of misrepresentations made or frauds committed by an agent in the course of the business, the principal is liable..However, misrepresentations made or frauds committed, by an agent in matters which do not fall within his authority, do not affect his principal.

5) **On Contracts Entered by Agent with Third Persons [Section 226]:** Principal is liable for the contracts entered into through an agent and obligations arising

Check Your Progress

1. What is an Agency?
2. What is the meaning of a Principal?

from acts done by an agent. Contracts entered into through an agent and an obligation arising from acts done by an agent, may be enforced in the same manner and will have the same legal consequences, as if the contracts had been entered into and the acts done by the principal in person. Principal is bound by the acts of his agent with all its results.

6) **On Notice given to Agent [Section 229[:** Principal is bound upon any notice given to or information obtained by the agent, provided it be given or obtained in the course of the business transacted by him for the principal. Notice so given or information so obtained shall have the same legal consequences as between the principal and third parties, as if it had been given to or obtained by the principal.

7) **Where Principal Induces Third Persons to Believe that Agent's Un-authorized Acts were Authorized [Section 237]:** When an agent has without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has by words or conduct induced such third persons to believe that such acts and obligations, were within the scope of the agent's authority. This is where principal is estopped from denying agent's authority.

Rights of Principal

1) **To Repudiate Contract [Section 215[:** If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances which have come to his own knowledge on the subject, the principal may repudiate the transaction, if the case shows either that any material fact has been dishonestly concealed from him by the agent or that the dealings of the agent have been disadvantageous to him.

   As a rule, an agent cannot deal on his account. Only after obtaining the consent of the principal and full disclosure of all material facts, agent may act on his own account. However, where agent's personal interest, is to conflict with principal's interest, he cannot act on his own account. Where the agent acts on his own account, principal has following rights:

   i) He may repudiate the transaction;

   ii) He may affirm the transaction and claim the benefits;

   iii) He may claim damages for loss caused to him.

2) **To Claim Benefit: [Section 216]** :If an agent without the knowledge of the principal, deals in the business of the agency on his own account instead of on account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction. The principal must show that a material fact has been dishonestly concealed or the dealing of an agent has been disadvantageous to him. All profits and advantages made by the agent in the business conducted by him for his principal must be paid over to the principal. Agent cannot make any secret profits or receive bribes. Principal is entitled to receive all such sums and also interest on them. The position of an agent being fiduciary in character, he cannot conflict his personal interest with his duty to the principal.

3) **To Ratify or Disown Agent's Acts [Section 196]:** Where acts are done by one person on behalf of another but without his knowledge or authority, he may elect to ratify or disown such acts.

NOTES

4) **To Revoke Agent's Authority [Section 203]:** The principal may revoke the authority given to his agent by giving a reasonable notice of revocation at any time before the authority has been exercised so as to bind the principal.

5) **To Claim Loss or Profit [Section 211 and 212]:** The principal is entitled to compensation for any loss sustained by him or to any profits accrued:

   i) Where the agent acts contrary to the directions given by the principal; or

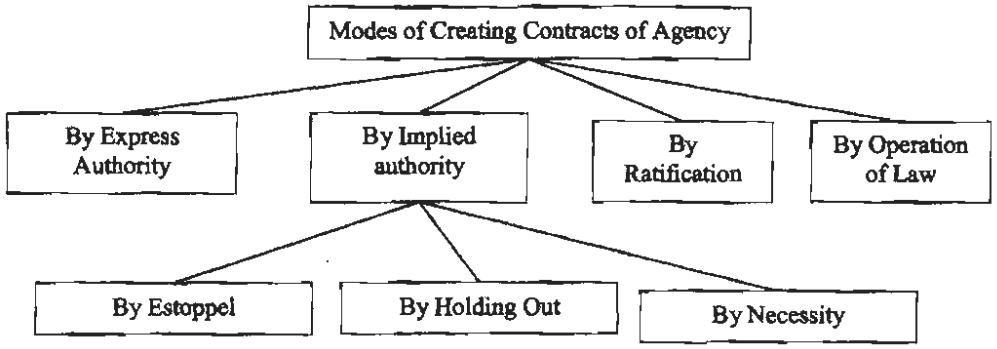
   ii) Where loss is caused due to agent's neglect, want of skill, or misconduct.

6) **To Demand Accounts [Section 213]:** Principal is entitled to demand proper accounts from the agent.

7) **To Refuse Remuneration when Agent is Guilty of Misconduct [Section 220]:** The principal has a right to refuse remuneration to the agent who is guilty of misconduct in the business of the agency.

Creation of Agency

The various modes to create the contract of agency are shown below in figure.



Modes of Creating Contract of Agency

1) **Agency by Express Authority [Sections 186 and 187]:** The authority of an agent may be expressed or implied (Section 186).

   Normally, the authority given by a principal to his agent is an express authority which enables the agent to bind the principal by acts done within the scope of his authority. The agent may, in such a case, be appointed either by word of mouth or by an agreement in writing (Section 187). The usual form of a written contract of agency is the power of attorney (a formal instrument, by which one person empowers another to represent him, or act in his stead, for certain purposes) on a stamped paper.

2) **Agency By implied Authority [Section 187]:** An agency which has to be understood from the conduct and behavior of the parties is called implied agency. It is to be inferred from the circumstances of the case and things spoken or written, or the ordinary course of dealing may be accounted as circumstances of the case.

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

   Implied Agency include the following:

   i) **Agency by Estoppel:** An agency may emerge by the application of'doctrine of estoppel'. This doctrine in the present context would mean that when a

person has led another person to believe by his words or conduct that a certain person is his agent, then he is precluded or stopped from denying the truth of this fact even if it is wrong and is bound by the acts of the agent (Section 237).

Example: A tells B that he is Cs agent. This he does in the presence of C and within his hearing. C does not object to the statement of A although A is actually not his agent. Later, B makes a deal with A as agent of C C shall be bound by this deal.

ii) **Agency by Holding out:** To 'hold out' means to present or to show up. 'Agency by holding out' means creation of agency by presenting a person as agent without actual words to that effect. This is also a form of 'agency by estoppel, but here, a person's positive action rather than silence leads another to believe in the existence of agency.

Example: A child purchases goods from a shop and desires the shopkeeper to collect payment from his parents later. The parents, though not bound to pay, make the payment. After a few days, the child again makes purchases from the shop on the credit of the parents. The parents would be bound this time because, by making payment earlier without raising any objection, they had held their child out as their agent for making such purchases.

iii) **Agency by Necessity:** Under certain circumstances, a person may be compelled to act as an agent to the other without requiring the consent of the principal. Such an agency is called the agency by necessity. For example, a master of the ship can borrow money at a port where the owner of the ship has no agent, to carry out necessary repairs to the ship in order to complete the voyage. In such a case of necessity, person acting as an agent need not necessarily have the authority of the principal. However, the agent must act under pressing conditions and for the benefit of the principal. To constitute a valid agency of necessity, following condition must be satisfied:

a) Agent should not be in a position or have any opportunity to communicate with his principal within the time available.

b) There should have been actual and definite commercial necessity for the agent to act promptly.

c) The agent should have acted bonafide and for the benefit of the principal.

d) The agent should have adopted the most reasonable and practicable course under the circumstances, and

e) The agent must have been in possession of the goods belonging to his principal and which are the subject of contract.

3) **Agency by Ratification:** A person may choose to act as an agent of another person without possessing any authority for this purpose. In such a situation the person so represented as principal has the option to disown that act or to approve it. This approval or ratification granted to the unauthorized act makes it an authorized act. According to Section196, the subsequent ratification of the unauthorized act by the person so represented as principal brings about an 'agency by ratification' between the two. This agency, of course, is restricted to the already performed act only and would not permit a fresh act by the agent.

NOTES

Example: K got goods of N insured without his knowledge or authority. N may ratify the policy taken by K. In that case, the insurance policy shall be valid as if K had been authorized to do the act.

If the declared principal refuses to own the act, the unauthorized agent becomes liable to compensate the third party for any loss caused to him by this fraud.

Ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done (Section 197). For example, if A, without authority, buys goods for B and later, B sells them to C on his own account, B's conduct implies a ratification of the purchase made for him by A.

4) **Agency by Operation of Law** [section 18 and 19]: Sometimes an agency arises by operation of law. When a company is formed, its promoters are its agents by operation of law. A partner is the agent of the firm for the purposes' of the business of the firm, and 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 (Section 18 and 19 of the Indian Partnership Act, 1932). In all these cases, agency is implied by operation of law.

AGENT'S AUTHORITY

Meaning of Agent's Authority

An agent's authority means the capacity of the agent to bind his principal.

Meaning of Extent of Agent's Authority

Extent of agent's authority means the scope of authority of an agent. In other words, it means what a person can do as an agent on behalf of his principal.

An agent's authority may be classified as; actual or real, ostensible or apparent, and authority in emergency.

1) **Actual or Real Authority:** This is the authority that the principal has actually delegated to the agent. This will include the task expressly or impliedly entrusted to the agent and also those acts which would be necessary to accomplish the entrusted task. Thus, the actual authority of the agent would consist of the authority obtained from principal and all the acts necessarily linked with it even if unspoken. Section 188 states that an agent, having an authority to do an act, has authority do every lawful thing which is necessary in order to do such act.

   Example: An agent may be entrusted the job of getting a machine repaired. This will require not only a con-tract with a technician for repairs but also possibly a contract with a carrier to take it.to the technician's wotkshop.

2) **Ostensible or Apparent Authority:** An agent can also bind the principal to third parties by acts done within his apparent authority; (although the act is in excess of his actual authority); provided the third party acts ***bona fide*** and without knowledge of the limitation of the agent's apparent authority. Thus 'actual' and 'apparent' authority stands on the same footing.

   Ostensible authority means an authority which the third parties dealing with the agent can presume to be with the agent in relation to a particular business ordinarily. In other words, such an authority implies authority to do an act usually necessary in the course of conducting similar business in accordance with the customs and usages of the particular place, trade or market. Thus if it is the usual practice of hotel managers to purchase liquors and cigarettes, then purchases of this nature shall be deemed within the scope of the manager's apparent

authority and the principal will be bound by such purchases, notwithstanding limitations, as between the principal and agent, put upon that authority.

Section 188 which deals with the extent of agent's authority lays down the scope of an agent's apparent authority in these words; "An agent having an authority to do an act or to carry on a business has authority to do every lawful thing which is necessary in order to do such act, or which is usually done in the course of conducting such business." The following examples are appended to the Section:

Examples

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

ii) A constitutes B, his agent, to carry on his business of a ship-builder. B may purchase timber and other materials, and hire workmen, for the purpose of carrying on the business.

3) **Agent's Authority in Emergency:** An agent would always have some authority in an emergency to do all such* acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances, to meet emergency situations (Section 189).

To conclude, the total authority of the agent consists of the actual authority granted expressly or impliedly by the principal, the ostensible or apparent authority interpreted from circumstances and the authority to meet emergency conditions. Every act within this limit is binding upon the principal. An act beyond this limit would require principal's ratification to bind him.

Delegation of Agents Authority

Section 190 provides that "an agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally, unless by the ordinary custom of trade a sub-agent may, or from the nature of agency, a sub-agent must, be employed." Accordingly an agent cannot delegate his powers or duties to another without the express authority of the principal, except in certain cases. An agent, being himself a delegate of his principal, cannot pass on that delegated authority to someone else. As a rule, he must not depute another person to do that which he has undertaken to do personally. The reason for this rule is that confidence in the integrity and competence of a particular person is at the root of a contract of agency.

But there are exceptions to this general rule. In the following cases the agent can delegate his authority to another (i.e., can appoint a sub-agent) and bind the principal:

1) Where the principal has expressly permitted delegation of such power.

2) Where the principal has impliedly, by his conduct, allowed such delegation of authority, e.g., where the principal knows that the agent intends to delegate his authority but does not object to it.

3) Where by the ordinary custom of trade a sub-agent may be employed. Thus stock exchange member brokers generally appoint clerks to transact business on behalf of their clients.

NOTES

4) Where the very nature of agency makes it necessary to appoint a sub-agent. For example, a manager of a shop may employ sales assistant.

5) Where the acts to be done are purely ministerial and do not involve the exercise of discretion, e.g., clerical or routine work.

6) Where unforeseen emergencies arise rendering appointment of the sub-agent necessary.

If a sub-agent is appointed in any of the above circumstances, then he is called as "properly appointed sub-agent."

Sub-Agent [Section191]

A 'sub-agent' is a person employed by, and acting under the control of, the original agent in the business of the agency.

In general, agency is a personal relationship based on mutual trust and confidence between the principal and the agent. Therefore, an agent cannot appoint a sub-agent by delegating to him the authority that was given to him by the principal. He is only a delegate of the principal and not the original source of authority. This rule is based on a well-known maxim of law "Delegatus non potest delegare" (A delegate cannot further delegate).

There are exceptions to this rule wherein the delegation of authority shall be held to be proper. The consequences of appointment of sub-agent shall depend upon whether the appointment was proper or improper.

Section 190 lays down the following in the matter:

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

Co-Agent or Substituted Agent

A co-agent or a substituted agent is a person who is named by the agent, on an express or implied authority from the principal, to act for the principal. He is not a sub-agent but an agent of the principal for such part of the business of the agency as is entrusted to him. He is the agent of the principal, though he is named, at the request of the principal, by the agent (Section 194).

Examples

1) P directs A, his solicitor, to sell his estate by auction and to employ an auctioneer for the purpose. A, names Ai, an auctioneer, to conduct the sale. Aj is not a sub-agent, but is P's agent for the conduct of the sale.

2) P authorizes A, a merchant in Calcutta, to recover moneys due to P from T. A instructs Ai, a solicitor, to take legal proceedings against T for the recovery of the money. A] is not a sub-agent, but is a solicitor for P.

In selecting a co-agent for his principal an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and ifhe does this he is not responsible to the principal for the acts or negligence of the co-agent (Section 195).

Difference between Sub-Agent and Substituted Agent

NOTES

1) A sub-agent does his work under the control of the agent whereas a substituted agent works under the instructions of the principal.

2) There is no privity of contract between a sub-agent and the principal. The principal cannot sue the sub-agent directly for any amounts or money. Similarly, a sub-agent cannot sue the principal for his remuneration. He is also not directly answerable to the principal. Both the principal and the sub-agent can sue the agent. In the case of a substituted agent, there is a privity of contract between him and the principal and both can sue each other.

3) The agent is responsible to the principal for the acts of the sub-agent. But he is not responsible to the principal for any act or negligence of the substituted agent.

Relations of Principal with Third Parties

The 'Basic premises of agency', is the acts of agent bind the principal towards third parties. The discussion below will explain the total relationship between the principal and the third parties, i.e., the circumstances when the principal would be liable to the third party:

1) **When Agent acted within his Authority:** If an agent has acted within the scope of his authority, whether it is actual or ostensible or emergency, principal is bound by its consequences towards third parties.

2) **When Agent acted beyond Authority:** When an agent has done an act which does not fall within any type of authority available to him, the principal shall be liable for such an unauthorized act to the third party if he ratifies it.

   Partial Violation of Authority: Sometimes, an authorized agent may do an act which includes an unauthorized part also. If the authorized part is separable from the unauthorized part and the principal does not ratify the unauthorized part, then he remains liable only for the authorized part (Section 227). If the two parts are inseparable, then the principal is free from liability for the entire act (Section 228).

   Example (for Section 227): A, being owner of a ship and cargo, authorizes B to procure an insurance for 4,000 rupees on the ship alone. B procures a policy for 4,000 rupees on the ship and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

   Example (for Section 228): A authorizes B to buy 500 sheep for him. B buys 500 sheep and 200 lambs for a sum of 6,000 rupees. A may repudiate the whole transaction.

3) **When Agent Committed Fraud or Misrepresentation:** An agent, while acting in course of agency, i.e., while pursuing the business entrusted to him by his principal, commits a fraud or makes a misrepresentation against the third party, the principal shall be liable to that party as if the wrong act was done by the principal himself (Section 238). The rule will apply even when the, principal had not authorized the wrong act. But misrepresentations made, or frauds committed, by agents, in matters which do not fall within their authority, do not affect their principals.

   Examples

Check Your Progress

3. Define the term Del-Credere Agent?
4. What is Agency by Holding Out?
5. What is Agent's Authority?

NOTES

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

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

If the agent does something which was outside his employment, i.e., for which he was not appointed, then a wrongful act by him will not bind the principal. Thus, fraud against a third party by an agent while purchasing cloth from him does not bind the principal if the agent was appointed to purchase furniture.

A few things may be noted in the context of this rule:

i) Although Section 238 talks only of fraud, etc., in an agreement, the rule shall apply in all cases of a fraud, etc., committed by agent in course of agency whether through agreement or otherwise. Moreover, the rule also covers a tort (a civil wrong causing damage to a person) by the agent, which may bind the principal; e.g., where an agent hit a boy from a moving tram, his principal was held liable for assault.

ii) If the principal conceals some vital facts from his agent and because of this a false statement gets made by the agent before third parties innocently, this would also be such a case of misrepresentation by the agent where the principal shall be liable to third parties.

iii) If a person without any authority whatsoever presents himself as agent of another person and makes a fraud against a third person, the principal shall not be liable for this even if he ratifies this transaction later with or without knowledge of fraud. The reason is that Section 238 requires that the act should have been done in course of agency.

iv) It is not necessary that the wrongful act was done by the agent for the benefit of the principal. The agent may have derived a personal benefit out of it. Still, the principal shall be liable.

4) **Principal Bound by Notice given to Agent:** The knowledge of agent acquired during his work as agent is believed to be available to the principal also. This rule is based on the idea that the agent maintains communication with his principal on a regular basis. Thus, any notice given to or information obtained by the agent, provided it be given or obtained in the course of the business transacted by him for the principal, shall, as between the principal and third parties, have the same legal consequences as if it had been given to or obtained by the principal (Section 229).

Examples

i) A is employed by B to buy from C certain goods, of which C is the apparent owner. A buys them accordingly. In the course of the discussions for the sale, A learns that the goods really belonged to D, but B is ignorant of that fact. B had to recover a certain amount from C under an old transaction. B is not entitled to set-off a debt owing to him from C against the price of goods since he is deemed to know that the goods belonged to D.

ii) Suppose, in the above example, there is one change in the situation and all other details remain the same. Before A was so employed as agent, he had been an employee of C, and then learnt that the goods really belonged to

D. B may set-off against the price of the goods the debt owing to him from C since in this case A's knowledge is not deemed to be the knowledge of B.

The requirements for the application of this rule are that the agent should have received the information in course of agency and the information should be on a matter of such significance that agent was bound to communicate to the principal.

NOTES

Another common example of this rule is the position of a client who is bound by the information or notice available to his lawyer during legal proceedings.

PERSONAL LIABILITY OF AN AGENT

General Rule [Section 230]

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

When the Agent becomes Personally Liable

The circumstances under which an agent becomes personally liable are as follows:

1) **In Case of Foreign Principal [Section 230]:** Where the contract is made by an agent for the sale or purchase of goods for a merchant residing abroad, in the absence of any contract to the contrary, it is presumed that the agent is personally liable for such contracts.

2) **In Case of Undisclosed Principal [Section 230]:** Where the contract is made by an agent for an undisclosed principal, in the absence of any contract to the contrary, it is presumed that the agent is personally liable.

3) **In Case of Incompetent Principal [Section 230]:** Where a contract is made by an agent fot a person who cannot be sued (e.g., minor, lunatic, foreign ambassador), in the absence of any contract to the contrary, it is presumed that the agent is personally liable.

4) **In Case of Principal not in Existence:** Where a contract is made by the promoter for a company not yet incorporated, the promoters are personally liable.

5) **In Case of Acts not Ratified [Section 235]:** A person untruly representing himself to be the authorized agent of another, and thereby inducing a third person to deal with him as such agent, is liable, if his alleged employet does not ratify his acts, to make compensation to the other in respect of any loss or damage which he has incurred by so dealing.

6) **In Case of Acts in his Own Name:** Where a contract is made by an agent without disclosing that he is contracting as an agent, the agent is personally liable.

   Example: X took a loan from Y by executing a hundi in Y's favor. X did not sign the hundi as agent of the firm nor did he disclose to Y the name ofhis principal. The agent was held personally liable.

7) **In Case of Express Agreement:** Where a contract made by an agent specifically provides for the personal liability of the agent, the agent will be personally liable.

8) **In Case of Custom or usage of Trade:** Where there is a custom or usage of trade making the agent personally liable, in the absence of any contract to the contrary, the agent is personally liable.

NOTES

Example: X, a share broker purchased 100 shares @ Rs. 100 per share and sold the same shares @ Rs. 90 per share on behalf of Y who refused to give the difference. X is personally liable because it is a custom that a share broker is personally liable for the contracts entered into by him.

TERMINATION OR DETERMINATION OF AGENCY
[Sections 201 - 210]

Meaning of Termination of Agency

Termination of agency implies the end of the relationship of principal and agent.

Modes of Termination of Agency

Agency may be terminated in any of the following ways:

1) **By Act of Parties** [Section 201]: Agency may be terminated by act of the parties in any of the following ways:

   i) **By Agreement:** Agency may be terminated by the parties by an agreement at any time by mutual consent.

   ii) **By Revocation and Renunciation:** An agency is terminated by principal revoking agent's authority by notice or by renunciation by an agent by notice.

   iii) **By Renouncing:** When the agent renounces the business of the agency, the agency is terminated.

   iv) **By Completion or Performance:** When the business for which the agency was constituted is completed or performed, the agency is terminated. For example, when an agent is appointed to sell a house, agency is completed when the house is sold.

2) **By Operation of Law [Section 201]:** Agency is terminated by operation of law in any of the following ways:

   i) **By Death or Insanity:** When the principal or agent dies or, becomes of unsound mind, the agency is terminated. In case of corporation, the agency is terminated on its being wound up. In India, mere death of the principal cannot terminate the agency until the agent has heard of it. In England, death of principal determines the agency at once.

   Agent's Duty: When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to undertake, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interest entrusted to him (Section 209). It is, therefore, the duty of the agent to protect the interest of legal representatives.

   ii) **By Insolvency of the Principal:** On principal being adjudicated an insolvent under the provisions of any Act for the time being in force for the relief of insolvent debtors, the agency is terminated.

3) **Other Modes of Termination or Agency**

   a) By Efflux of Time: Where an agency is for a fixed period of time, it is terminated on the expiry of time whether the purpose for which the agency is constituted is accomplished or not.

   b) By Destruction of the Subject-Matter: When the subject-matter of the agency is destroyed, the agency is terminated.

c) By Incapacity of Principal or Agent: Where a principal or an agent possesses any disqualification essential to a contract, agency is terminated.

d) Principal or Agent Becoming an Alien Enemy: Where the principal or the agent belongs to different countries and they become alien enemies, the agency is terminated.

e) By Object of Agency Becoming Unlawful: When by the happening of an event which renders agency or its object unlawful, the agency is terminated.

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 [Section 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 [Section 208].

3) The termination of the authority of agent causes the termination of authority of all sub-agents appointed by him.

IRREVOCABLE AGENCY

Meaning of Irrevocable Agency

The term 'Irrevocable Agency' means an agency which cannot be revoked or terminated by the principal.

Circumstances when the Agency is Irrevocable [Sections 202 and 204]

The circumstances when the agency is irrevocable are as follows:

1) **Where the Agency is coupled with Interest [Section 202]**

Meaning of Agency Coupled with Interest: An agency is said to be coupled with interest when the object of creating the agency is to secure some benefit to the agent in addition to his remuneration as agent. It may be noted that an agency cannot be said to be agency coupled with interest in the following cases:

i) Where the interest of the agent arises after the creation of agency;

ii) Where the agency secures a benefit to the agent incidentally though the agency was not created for this object.

No Termination of Agency Coupled with Interest [Section 202]: Where the agent has himself an interest in the property which forms the subject matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

Example 1: X consigned 100 bags of wheat to Y who has advanced Rs. 10,000 to X. X authorized Y to sell the wheat and to pay himself Rs. 10,000 out of the proceeds of wheat. Later on, X directed Y not to sell the wheat, ignoring X's direction, Y sold the wheat to recover Rs. 10,000. X could not revoke his authority because the agency was coupled with interest. Hence, Y could sell the wheat.

Example 2: X consigned 100 bags of wheat to Y and authorized Y to sell the wheat. Later on Y advanced Rs. 10,000 to X which X failed to pay. X directed Y not to sell the wheat. Ignoring X's directions, Y sold the wheat to recover Rs. 10,000. X could revoke his authority because the agency was not coupled with interest. Hence Y could not sell the wheat.

2) **Where the Agent has partly exercised his Authority [Section 204]:** The principal cannot revoke the authority given to his agent after the authority has been partly exercised; so far as regards such acts and obligations as arise from acts already done in the agency. Thus, the principal cannot revoke the agent's authority for the acts already done.

   Example: A authorizes 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 A's name, and so as not to render himself personally liable for the price, A cannot revoke B's authority to pay for the cotton.

3) **Where the Agent has incurred a Personal Liability:** The principal cannot revoke the agent's authority for the authorized acts in respect of which the agent has already incurred a personal liability.

   Example: A authorizes 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, and A cannot revoke B's authority so far as regards payment for the cotton.

When Revocation takes Effect?

Revocation of authority terminates the agent's authority. The termination of the authority takes effect as regards the agent, after it becomes known to him. As regards tiiird persons, termination of authority takes effect after it becomes known to them (Section 208).

Where agent is allowed to remain in possession of the premises for purpose of carrying on agency business of a company, on termination of agency, agent has no right to remain in possession of premises. Agent is not entitled to interfere with company's business.

Examples

1) A directs B to sell goods for him and agrees to give B 5 per cent commission on the price fetched by the goods. A afterwards, by letter, revokes B's authority. B, after the letter is sent, but before he receives it, sells the goods for Rs. 100. The sale is binding on A, and B is entitled to five rupees as his commission.

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

3) 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 ofit, pays the money to C The payment is good as against D, the executor.

The termination of the authority of an agent causes the termination of the authority of all sub-agents appointed by him (Section 210).

SUMMARY

- Agency refers to the relationship which exists between two persons, the principal and the agent in which agent has to perform different duties and

functions as per the instructions of the principal and also enters into contract with the third party/ parties on behalf of the principal.

- An agent is a person employed to do an act for another or to represent another in dealings with third persons.
- The person for whom such act is done, or who is so represented, is called the "principal".
- Essentials of Agency: Principal should be competent to contract, Agent need not be competent, Consideration not necessary in Agency.
- A mercantile agent having in the customary course of business as such agent, authority either to sell, consign goods for the purpose of sale or to buy goods or to raise money on the security of goods."
- Del credere Agent is an agent who, in consideration of extra commission, guarantees his principal that the person with whom he enters into contract on behalf shall perform their obligation. He occupies the position of both a guarantor and an agent.
- An auctioneers is a mercantile agent who is appointed to sell goods on behalf of the principal i.e., seller and for this function, an auctioneer get a reward in the form of a commission.
- Methods of Creation of Agency: The agency can be created from the following five ways:
  1. By Express Agreement,
  2. By Implied Agreement,
  3. By operation of law,
  4. By Ratification
- An agent's authority means the capacity of the agent to bind his principal.
- Ostensible Authority means an authority which the third parties dealing with the agent can presume to be with the agent in relation to a particular business ordinarily.
- A sub-agent is a person employed by and acting under the control of the original agent in the business of the agency.
- A co-agent or the substituted agent is a person who is named by the agent, or an express or implied authority from the principal, to act for the principal.
- The term 'Irrevocable Agency' means an agency which cannot be revoked or terminated by the principal.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. Agency refers to the relationship which exists between two persons, the Principal and the Agent in which the Agent has to perform different duties/ functions as per instructions of the principal and also enters into contract with the third party / parties on behalf of the principal.
2. The person for whom act is done by an agent or who is represented in dealings with third persons by an agent is called the principal.
3. The term 'del credere' literally means 'of entrusting'.
4. To 'hold out' means to present or to show up. 'Agency by holding out' means creation of agency by presenting a person as agent without actual words to that effect.
5. An agent's authority means the capacity of the agent to bind his principal.

NOTES

TEST YOURSELF

1) Define Agency. Explain different kinds of Agent.
2) What are the duties and rights of an Agent?
3) Explain the methods of creation of Agency.
4) What do you mean by Agent's Authority?
5) How Agency is terminated?
6) Write a short note on Irrevocable Agency.

FURTHER READING

- *Mercantile Law:Sharma, Sareen, Gupta and Chawla*

7 Indian Partnership Act

NOTES

The Chapter Covers :

- Definition of Partnership (Section 4j
- Partnership Distinguished From Other Forms of Organization
- Kinds /Types of Partners
- Partners, Firm, Firm Name
- Registration of Firms
- Minor's Status In A Partnership Firm
- Relations of Partners
- Relation of Partners To Third Parties
- Changes In A Firm/Reconstitution of A Firm
- Dissolution of Firm
- Rights And Liabilities of Partners On Dissolution
- Settlement Of Accounts [Sections 48,49 And 55]

INTRODUCTION

Partnership is a word that is very common in business practices. Those who cannot do business alone make a partnership with one or more than person and share profits, risks and liabilities of business. Partnership has many forms in India and abroad.

DEFINITION OF PARTNERSHIP (SECTION 4J)

According to Section 4 of the Indian Partnership Act, 1932, "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."

NOTES

ESSENTIAL ELEMENTS OF PARTNERSHIP

This definition contains five elements, which constitute a partnership, namely:

i) There must be a contract;

ii) Between two or more persons;.

iii) Who agree to carry on a business;

iv) With the" object of sharing profits; and

v) The business must be carried on by all or any of them action for all (i.e., there must be mutual agency).

All the above elements must coexist in order to constitute a partnership. If any of these is not present, there cannot be a partnership. We now discuss these elements one by one:

1) **Contract:** Partnership is the result of a contract. It does not arise from status, operation of law or inheritance. Thus at the death of father, who was a partner in a firm, the son can claim share in the partnership property but cannot become a partner unless he enters into a contract for the same with other persons concerned. Similarly, the members of Joint Hindu Family carrying on a family business cannot be called partners for their relation arises not from any contract but from status.

2) **Association of Two or More Persons:** Since partnership is the result of a contract, ar least two persons are necessary to constitute a partnership. The Partnership Act does not mention any thing about the maximum number of persons who can be partners in a partnership firm but Section 11 of the Companies Act, 1956, lays down thar a partnership consisting of more than 10 persons for banking business and 20 persons for any other business would be illegal. Hence these should be regarded as the maximum limits to the number of partners in a partnership firm.

3) **Carrying on Business:** The third essential element of a partnership is that the parties must have agreed to carry on a business. The term 'business' is used in its widest sense and includes every trade, occupation or profession [Section 2 (b)]. If the purpose is to carry on some charitable work, it will not be a partnership. Similarly, if a number of persons agree to share the income of a certain property or to divide the goods purchased in bulk amongst them, there is no partnership and such persons cannot be called partners because in neither case they are carrying on a business. Thus, where A and B jointly purchased a tea shop and incurred additional expenses for purchasing pottery and utensils for the job, contributing the necessary money half and half and then leased out the shop on rent which was shared equally by them, it was held that they are only co-owners and not partners as they never carried on any business.

4) **Sharing of Profits:** This essential element provides that the agreement to carry on business must be with the object of sharing profits amongst all the partners, impliedly the partnership must aim to make profits because then only profits may be divided amongst the partners. Thus, there would be no partnership where the business is carried on with a philanthropic motive and not for making a profit or where only one of the partners is entitled to the whole of the profits of the business. The partners may, however, agree to share profits in any ratio they like.

5) **Mutual Agency:** The fifth element in the definition of a partnership provides that the business must be carried on by all the partners or any (one or more) of them acting for all, that is, there must be mutual agency. Thus every partner is both an agent and principal for himself and other partners, i.e., he can bind by 'his acts the other partners and can be bound by the acts of other partners in the ordinary course of business.

PARTNERSHIP DISTINGUISHED FROM OTHER FORMS OF ORGANIZATION

Distinction between Partnership and Company

Basis	Partnership	Company
i) Regulating Act	A partnership firm is governed by the provisions of the Indian Partnership Act, 1932.	A company is governed by the provisions of the Companies Act, 1956.
ii) Legal Entity	A firm does not enjoy separate legal existence. Partners are collectively termed as a firm and individually as partners.	It has a separate legal existence. A company is separate from its members.
iii) Agency	Every partner is an agent of the other partners, as well as of the firm.	A member is not an agent of the other members or of the company; his actions do not bind either.
iv) Liability	Each partner has unlimited liability and is personally liable for all the debts of the firm.	Liability of its members is limited to the extent of the value of shares held by them.
v) Number of membership	In the case of firms carrying on business other than banking, the number must not exceed 20 and in the case of banks such number must not exceed 10.	A private company may have as many as 50 members but not less than two and a public company may have any number of members but not less than seven.
vi) Transfer of shares	A share in a partnership cannot be transferred without the consent of all the partners.	A shareholder may transfer his shares, subject to the provisions contained in its Articles. In case of public company, a shareholder can transfer his shares freely without restriction.
vii) Distribution of profits	Profits are distributable among partners as per the partnership deed.	There is no such compulsion that profits must be distributed. Only when dividends are declared that the members get a share of profits.

Basis	Partnership	Company
viii) Management	All the partners of a firm are entitled to take part in the management of the business.	The right to control and manage the business is vested in the Board of Directors elected by the shareholders.
ix) Registration	A partnership firm may or may not be registered.	A company registration is essential.
x) Winding up	A partnership firm can be wound up at any time by any partner, if it is 'at will', without legal formalities.	No one member can require it to be wound up at will and winding up involves legal formalities.

Distinction between Partnership and Hindu Undivided Family

Points of Distinction	Partnership	Hindu Undivided Family
i) Regulating law	A partnership is governed by the provisions of the Partnership Act, 1932.	A joint Hindu family business is governed by the principles of Hindu law.
ii) Creation	It arises from an agreement.	It arises by status or operation of law.
iii) Name of the persons involved	The persons who form part nership are called 'partners'.	The persons who are the members of the HUF are called 'Coparceners'.
iv) Admission of new members	No new partners are admit ted without the consent of all the partners.	A new member is admitted just by birth.
v) Death	Death of a partner ordinarily leads to the dissolution of partnership.	Death of a member in the HUF does not give rise to the dissolution of the family business.
vi) Management	All the partners are equally entitled to take part in the partnership business.	The right of management of joint family business generally vests in the Karta, the governing male member of the family.
vii) Number of members	In a partnership the maximum limit of partners is 10 for banking business and 20 for any other business.	There is no maximum limit of members in the case of joint Hindu family business.
viii) Right of members to share in profits	In a partnership each partner is entitled to claim his separate share of profits.	A member of a joint Hindu family business has no such right. His only remedy lies in a suit for partition.
ix) Authoriry to bind the firm	Every partner can, by his act, bind the firm.	The karta or the manager has the authority to contract for the family business.
x) Female members	A female can become a full-fledged partner.	A female does not become member merely by her birth.

Points of Distinction	Partnership	Hindu Undivided Family
xi) Liability	The liability of a partner is unlimited.	The liability of the Karta is unlimited, and the other coparceners are liable only to the extent of their share in the profits of the family business, unless they take part in the act performed or transactions entered into by the Karta.
xii) Minor's capacity	A minor cannot become a partner, though he can be benefits of partnership, only with the consents of all the partners.	A minor becomes a member of the ancestral business by the incidence of birth. He does not have to wait for attaining majority.
xiii) Continuity	A firm subject to a contract between the partners gets dissolved by death or insolvency of a partner.	A HUF has the continuity till it is divided. The status of HUF is not thereby affected by the death of a member.

Distinction between Partnership and Joint Stock Company

Basis	Partnership	Joint Stock Company
i) RegulatingAct	A partnership firm is governed by the provisions of the Indian Partnership Act, 1932.	A company is governed by the provisions of the Companies Act, 1956.
ii) Legal Entity	A firm does not enjoy separate legal existence. Partners are collectively termed as a firm and individually as partners.	It has a separate legal existence. A company is separate from its members.
iii) Agency	Every partner is an agent of the other partners, as well as of the firm.	A member is not an agent of the other members or of the company; his actions do not bind either.
iv) Liability	Each partner has unlimited liability and is personally liable for all the debts of the firm.	Liability of its members is limited to the extent of the value of shares held by them.
v) Numberof membership	In the case of firms carrying on business other than banking, the number must not exceed 20 and in the case of banks such number must not exceed 10.	A private company may have as many as 50 members but not less than two and a public company may have any number of members but not less than seven.
vi) Transfer of shares	A share in a partnership cannot be transferred without the consent of all the partners.	A shareholder may transfer his shares, subject to the provisions contained in its Articles. In case of public company, a shareholder can transfer his shares freely without restriction.
vii) Distribution of profits	Profits are distributable among partners as per the partnership deed.	There is no such compulsion that profits must be distributed. Only when dividends are declared that the members get a share of profits.

viii) Management	All the partners of a firm are entitled to take part in the management of the business.	The right to control and manage the business is vested in the Board of Directors elected by the shareholders.
ix) Registration	A partnership firm may or may not be registered.	A company registration is essential.
x) Winding up	A partnership firm can be wound up at any time by any partner, if it is 'at will', without legal formalities.	No one member can require it to be wound up at will and winding up involves legal formalities.

Distinction between Partnership and Club

Basis	Partnership	Club
i) Objects	It has business-oriented objects aimed at profit sharing.	It is most aimed at making profits and hence has no business interest.
ii) Number of members	Membership limited to 10 or 20 depending upon the nature of business.	There is no limit on the number of its members.
iii) Tenure	Change in membership affects its existence and therefore generally does not enjoy a long tenure.	Change in membership does not affect its existence.
iv) Agency	It is based on agency relationship among partners.	A member of a club is not agent of other members and therefore they do not bind each other with their acts.

Distinction between Partnership and Association

Partnership means and involves setting up relation of agency between two or more persons who have entered into a business for gains, with the intention to share the profits of such a business; but partnership does not exist between members of a charitable society or religious association or an improvement scheme or building corporation, etc.

Partnership does not exist between members of a mutual insurance society.

In a trade combine or protection association, the relation between the members is not that of partnership.

KINDS /TYPES OF PARTNERS

1) **Actual or Ostensible Partner:** A person who has by agreement become a partner and who takes active part in the conduct of the partnership business is an actual or ostensible partner. He is the agent of the other partners for the purpose of the business of the partnership. All his acts performed in the ordinary course of the business, so far as third parties are concerned, bind him and the other partners.

2) **Sleeping or Dormant Partner:** A sleeping partner is one who does not take an active part in the conduct of the business of the firm. He, like other partners, invests capital and shares in the profits of the business. He is equally liable along with other partners for all the debts of the firm, even though his existence is kept a secret from the outsiders dealing with the firm.

3) **Nominal Partner:** A partner who lends his name to the firm, without having any real interest in it, it is called a nominal partner. He does not invest in the

business of the firm, nor does he share in the profits or take part in the management of the business of the firm. But he, along with other partners, is liable to the outsiders for all the debts of the firm.

4) **Partners in Profits Only:** A partner may stipulate with the other partners that he will be entitled to a certain share of the profits only without being liable for the losses. Such a partner may be called a partner in profits only.

5) **Working Partner:** It may, at times, be agreed between the partners that one of them shall, because of certain special qualifications, work the business and have control over it. Such a partner is commonly known as working partnet. It may be noted that the other partners do not take any part in the management of the business does not absolve them of liability to third parties.

6) **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, Sec. 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".

7) **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.

8) **Sub-partners:** Where a member of the firm agrees to share the profits derived by him from the partnership with a stranger, there arises a sub-partnership between the contracting member and the stranger. Such stranger is said to be a **sub-partner**, although he is no sense a partner in the original firm and has no rights against it nor is he liable for its debts.

9) **Incoming Partners:** A person who is admitted as a partner into an already existing firm either with the consent of all the parties or in accordance with a previous contract between the partners permitting the introduction of a new partner or partners is called new **partner**. The incoming partner does not become liable for any act of the firm done before he became a partner, unless he agrees to be liable for obligations incurred before his admission into the firm.

10) **Retired or Outgoing Partners:** A partner who goes out of a firm in which the remaining partners continue to carry on the business is a called a **retired or outgoing partner.** A partner may retire from a firm:

   i) With the consent of the other entire partner.

   ii) In accordance with an agreement by the partners.

   iii) Where the partnership is at will by giving notice in writing ro all fhe other partners ofhis intention to retire.

   A partner, whether active or dormant, who retires from a firm does not thereby cease to be liable for partnership debts or obligations incurred before his retirement.

11) **Partnership by Estoppels or Holding Out:** A person is held liable as a partner by estoppels or holding out if the following two conditions are fulfilled:

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i) He must have represented himself ro be a partner by word spoken or written or by his conduct (such type of representation may be called as active representation), or He must have knowingly permitted himself to be represented as a partner (such type of representation may be called as tacit representation); and

ii) The other person acting on the faith of such representation must have given credit to the firm. It isimmaterial whether the person so representing to be a partner, is awafe or not that the representation has reached the other person.

12) **Duration of Partnership:** On the basis of duration, the partnership can be either Partnership at will or Particular Partnership.

i) **Partnership at Will [Section 7]:** When there is no provision in partnership agreement for duration of the partnership, the partnerships is called 'Partnership at Will'. A partnership at will may be dissolved by any partner by giving a notice in writing to all other partners of his intention to dissolve the firm.

ii) **Particular partnership [Section 8]:** When a partnership is formed for a specific venture or for a particular period, the partnership is called a 'Particular Partnership'. Such partnership comes to an end on the completion of the venture or on the expiry of the period. If such partnership is continued after the expiry of term or completion of the venture, it is deemed to be a partnership at will. A particular partnership may be dissolved before the expiry of the term or completion of the venture only by the mutual consent of all the partners.

FORMATION OF PARTNERSHIP

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:

1) The Act provides that a minor may be admitted to be benefits of partnership.

2) No consideration is required to create partnership. A partnership is an extension of agency for which no consideration is necessary.

3) 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.

4) An alien friend can enter into partnership, an alien enemy cannot.

5) A person of unsound mind is not competent to enter into a partnership.

6) A company, incorporated under the Companies Act, 1956 can enter into a contract of partnership.

7) 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.

PARTNERSHIP DEED

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The document in which the respective rights and obligations of the members of a partnership are set forth is called a 'partnership deed'. It should be drafted with care and be signed by all the partners. It must be stamped ip accordance with the Indian Stamp Act. Each partner should have a copy of the Deed should be filed at the time of registration with the Registrar of Firms because in the absence of such registration partners cannot enforce the conditions laid down in the Deed through a Court of law.

The Deed should cover the following points:

1) The name of the firm and the names and addresses of partners who compose it.
2) Nature of business and the town and place where it will be carried on.
3) Data of commencement of partnership.
4) The duration of partnership.
5) The amount of capital to be contributed by each partner and the methods of raising finance in future if so required.
6) The ratio of sharing profits and losses.
7) Interest on partners' capital, partners' loan, and interest, if any, to be charged on drawings.
8) Salaries, commissions etc.,if any, payable to partners.
9) The method of preparing accounts and arrangement for audit and safe custody of cash etc.
10) Division of task and responsibility, i.e., the duties, powers and obligations of all the partners.
11) Rules to be followed in case of retirement, death and admission of a partner.
12) Expulsion of partners in case of gross breach of duty or fraud.
13) Can a partner carry on a competing business or any other business whether competing or not. Section 11 (2) clearly provides that the Deed may provide that a partner shall not carry on any business other than that of the firm while he is a partner, notwithstanding anything contained in Section 27 of the Indian Contract Act where agreements in restraint of trade are void.
14) The circumstances under which the partnership will stand dissolved.
15) Arbitration in case of dispute among the partners.

The terms laid down in the Deed may be varied by consent of all the partners, and such consent may be expressed or may be implied by a course of dealing. [Section 11(1)]

Check Your Progress

1. Define Partnership?
2. Define the term Business according to [Section 2 (b)]?

PARTNERS, FIRM, FIRM NAME

Persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm', and the name under which the business is carried on is called the 'firm name' [Section 4, para 2]. The firm name is only a short way of expressing the names of all the partners. The, partners of a firm may carry on

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business under any name and style which they please to adopt. But this is subject to the following two limitations:

1) A firm name shall not contain any of the following words, namely, "Crown", "Emperor", "Empress", "Empire", "Imperial", "King", and 'Queen'. "Royal", or words expressing or implying the sanction, approval or patronage of the Government. The State Government may, however, signify its consent to the use of such words by a firm as part of its name by order in writing [Section 58 (3)].

2) The law safeguards the trade names and goodwill of other persons who are already in existence. The mere fact that a firm has already been doing business under a certain name does not prevent a new firm from adopting it. But if the name is used with a fraudulent intention, the law will intervene. The firm may be restrained from the adoption of such name by injunction.

Registration of Firms

The partnership Act does not provide for the compulsory registration of firms. It has left it to the option of the firms to get them registered. But indirectly, by creating certain disabilities from which an unregistered firm suffers, it has made the registration of firms compulsory. Section 69 deals with such disabilities. These disabilities are such that, sooner or later, every firm has to get itself registered. However, registration does not create partnership; it is only a reliable evidence of the existence of partnership. It also affords protection to outsiders dealing with the firm.

Procedure for Registration [Section 58 and Section 59]

The various steps involved in the registration of a firm are given below:

Step 1: Obtain a Statement in the prescribed form from the office of the Registrar of Firms of the area in which any place of business of the firm is situated or proposed to be situated.

Step 2: State the following information in the statement:

a) The name of the firm;
b) The principal place of the firm;
c) The names of other places where the firm carries on business;
d) The date when each partner joined the firm;
e) The names in full and permanent addresses of the partner;
f) The duration of the firm.

Step 3: Get the statement duly verified and signed by all the partners or by their authorized agents.

Step 4: File the Statement along with prescribed fees with the Registrar of the Firms of the area.

Step 5: Obtain a Certificate from the Registrar

Note: When the Registrar is satisfied that the provisions of Section 58 have been duly complied with, he shall record an entry of the Statement in the register called 'Register offirms' and file the statement. He shall then issue a certificate of registration [Section 59].

It may be noted that if any change is made in the particulars filed with the Registrar, the same should be duly notified to the Registrar so that he can incorporate the same in the 'Register of Firms'.

Change of Particulars [Sections 60-63]: With a view to keep the Registrar of Firms posted with up-to-date information regarding the firm, if any change takes place in any of the particulars given above, it should be notified to the Registrar, who shall thereupon incorporate the necessary change in the register of firms. Further, the Registrar should also be informed when any partner ceases to be a partner by retirement, expulsion, insolvency or death, or when a new partner is admitted or a minor, having been admitted, elects to become or not to become a partner, or when the firm if dissolved.

Penalty for False Particulars [Section 70]: If any person knowingly or without belief in its truth signs any statement, amending statement, notice or intimation containing false or incomplete information to be supplied to the Registrar, he shall be punishable with imprisonment which may extend to three months, or with fine, or with both.

Time of Registration

Registration may take place at any time during the continuance of the partnership firm. Where the firm intends to institute a suit in a Court of law to enforce rights arising from any contract, registration must be affected before the suit is instituted otherwise the Court shall not entertain the suit. Registration may also be affected even after a suit has been filed by the firm but in that case it is necessary to withdraw the suit, get the firm registered and then file a fresh suit. Registration of the firm subsequent to the institution of the suit cannot by itself cure the defect.

Effect of Non-Registration [Section 69]

1) **Suits between Partners and Firm:** A person suing as a partner of an unregistered firm cannot sue the firm or any partners of the firm to enforce a right arising from a contract or conferred by the Partnership Act. He can do so if:
   i) The firm is registered, and
   ii) The person suing is or has been shown in the register of firms as partner in the firm.
2) **Suits between Firm and Third Parties:** An unregistered firm cannot sue a third party to enforce a right arising from a contract until:
   i) The firm is registered, and
   ii) The names of the persons suing appear as partners in the register of firms.
3) **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 effected. This right of set-off, however, is not affected if the claim of set-off does not exceed Rs.100 in value [Section 69 (4) (b)].

Exceptions

Non-registration, however, does not affect:

i) The right of a firm or partners of a firm having no place of business in India.
ii) The right to any suit or claim of set-off not exceeding Rs. 100 in value.
iii) The right of a partner to sue for the dissolution of the firm, or for the accounts of the dissolved firm, or for share of the property of the dissolved firm.

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iv) It should be noted that this disability of a partner to sue disappears with the dissolution of the firm.

v) The powers of an Official Assignee, Receiver or Court to realize the property of an insolvent partner of an unregistered firm.

vi) The right of a third party to proceed against an unregistered firm or any of its partners.

vii)The right of an unregistered firm to enforce a right arising otherwise than out of a contract.

MINOR'S STATUS IN A PARTNERSHIP FIRM

According to Section 11 of the Indian Conrract Act, an agreement by or with a minor is void. As such, he is incapable of entering into a contract of partnership. But with the consent of all the partners for the time being, a minor may be admitted to the benefits of partnership [Section 30 (1)]. This provision is based on the rule that a minor cannot be a promisor, but he can be a promisee or a beneficiary. It should, however, be noted that a new partnership cannot be formed with a minor partner. Also, there cannot be partnership of minors among themselves as they' are incapable of entering into a contract.

If we analyze the above definition of Minor's partners the following point may be not out:

1) A minor can be admitted to the benefits of a partnership with the consent of all the existing partners. Consent only of the majority of partners would not be sufficient.

2) There must be a partnership in existence before a minor can be admitted to its benefits.

3) There cannot be a partnership consisting of all minors.

4) If a minor is made a full-fledged partner under the terms of a partnership deed, the deed would be invalid not only *vis-a-vis* the minor but also in regard to other partners. Since a minor cannor enter into any contract of partnership, the deed representing the contract is void *ab-initio* in total and cannot be enforced even *visa-vis* the remaining adult partners.

Rights and Liabilities of Minor Partner

1) Position before Attaining Majority Rights:

i) He has a right to such share of the property and of profits of the firm as may have been agreed upon.

ii) He has a right to have access to and inspect and copy any of the accounts, of the firm [Section 30 (2)] but not books.

iii) When he is not given his due share of profit, he has a right to file a suit for his share of the property of the firm. But he can do so only if he wants to sever his connection with the firm (Section 30 (4)].

Liabilities:

i) The liability of the minor partner is confined only to the extent of his share in the profits andproperty of the firm. Over and above this, he is neither personally liable nor is his private estate liable [Section 30 (3)].

ii) He cannot be declared insolvent, but if the firm is declared insolvent his share in the firm vests in the "Official Receiver" or "Official Assignee".

2) **Position on Attaining Majority:** On attaining majority the minor partner has to decide within six months whether he shall continue in the firm or leave it. These six months run from the date of his attaining majority or from the date when he first comes to know that he had been admitted to the benefits of partnership whichever date is later. Within this period he should give a public notice of his choice:

i) To become, or

ii) Not to become, a partner in the firm.

If he fails to give a public notice, he is deemed to have become a partner in the firm on the expiry of the said six months [Section 30 (5)]. The burden of proof that he had no knowledge of his admission until a particular date after the expiry of six months of his attaining majority lies on the person asserting that fact [Section 30 (6)].

i) **Where he elects to become a Partner**

a) He becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership.

b) His share in the property and profits of the firm is the share to which he was entitled asa minor partner [Section 30 (7)].

ii) **Where he elects not to become a Partner**

a) His rights and liabilities continue to be those of a minor up to the date of the notice.

b) His share is not liable for any acts of the firm done after the date of the public notice.

c) He is entitled to sue the partners for his share or the property and profits in the firm [Section 30 (8)].

RELATIONS OF PARTNERS

Relation of Partners to One Another

These are governed by the contract existing between them which may be express or implied by the course of dealings. The contract may be varied by the consent of all the partners; which may be expressed or implied by the course of dealings.

The contract may provide that a partner shall not carry on any business other than that of the firm while he is partner [Section 11]. Subject to a contract between the partners the mutual rights and liabilities are as follows.

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Rights of Partners

1) **Right to take Part in the Conduct of the Business** [Section 12 (a)]: Every partner, irrespective of the amount of capital contribution, has an inherent right to take part in the conduct of the business of the firm. Although one may agree not to participate in the management of the business but the right of participation should be available to each partner.

2) **Right to be consulted** [Section 12 (c)]: Every partner has a right to be consulted and heard before any matter is decided. Any difference arising as to ordinary matters connected with the business may be decided by a majority of the partners. But no change may be made in the nature of the business or the constitution of the partnership, for example, admission of a new partner, without the consent of all the partners. The partnership deed may, however, provide that in all matters consent of all the partners is necessary or that all matters shall be decided by majoriry opinion. It may be noted that majority powers should be exercised in good faith for the benefit of the firm. If the majority of the partners decide to expel a partner without sufficient cause, the expulsion would be set aside.

3) **Right of Access to Accounts:** Subject to contract between the partners, every partner has aright to have access to and inspect and copy any of the books of the firm [Section 12 (d)]. A minor partner may have access to and inspect any of the accounts of the firm [Section 30 (2)] but not 'books'.

4) **Right to Share in Profits** [Section 13 (b)]: In the absence of any agreement, the partners are entitled to share equally in the profits earned and are liable to contribute equally to the losses sustained by the firm.

5) **Right to Interest on Capital** [Section 13 (c)]: The partnership agreement may contain a clause as to the right of the partners to claim interest on capital at a certain rate. Such interest, subject to contract between the partners, is payable only out of profits. If any, earner by the firm.

6) **Rights to Interest on Advances** [Section 13 (d)]: Where a partner makes, for the purposes of the business of the firm, any advance beyond the amount of capital, he is entitled to interest on such advance at the rate of six percent per annum. Such interest is not only payable out of the profits of the business but also out of the assets of the firm.

7) **Right to the Use of Partnership Property:** Subject to contract between the partners, the property of the firm must be held and used by the partners exclusively for the purposes of the business of the firm. No partner has a right to treat it as his individual property (Section 15). If a partner uses the property of the firm directly or indirectly for his private purpose, he must account to the firm for the profits which he may haw earned by the use of that property.

8) **Right to be Indemnified** [Section 13 (e)]: Every partner has the right to be indemnified by the firm in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of the business of as well as in the performance of an act in an emergency for protecting the firm from any loss, if

the payments, liability and act are such as a prudent man would make, incur or perform in his own case, under similar circumstance.

9) **Right to Stop Admission of a New Partner** [Section 31]: Every partner has the right to prevent the introduction of a new partner in the firm without the consent of all the existing partners. Where a partner is introduced into the firm, he is not liable for any act of the firm done before he became a partner.

10) **Right to Retire** [Section 32 (1)]: Every partner has the right to retire with the consent of all the other partners and in the case of a partnetship being at will, by giving notice to that effect to all the other partners.

11) **Right not to be Expelled** [Section 33]: Every partner has the right not to be expelled from the firm by any majority of the partners.

12) **Right of Outgoing Partner to carry on Competing Business** [Section 36 (1)]: An outgoing partner may carry on business competing with that of the firm and he may advertise such business, but without using the firm name or representing himself as carrying on the business of the firm or soliciting the custom of persons who were dealing with the firm before he ceased to be a partner.

13) **Right of Outgoing Partner to Share Subsequent Profits** [Section 37]: Where any partner has died or ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, the outgoing partner or his estate has at his or his representative's option, the right to such share of the profit made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or to interest @ 6% per annum on the amount of his share in the property of the firm.

14) **Right to Dissolve the Firm** [Section 40]: A partner has the right to dissolve the partnership with the consent of all partners. But where the partnership is at will the firm may be dissolved by any partner giving notice in writing to all other partners ofhis intention to dissolve the firm.

Duties of Partners

1) **General Duties** [Section 9]: Partners are bound to carry on the business of the firm:

   a. To the greatest common advantage,

   b. To be just and faithful to each other and

   c. To render to any partner or his legal representative a true account and full information of all things affecting the firm.

2) **Duty to Indemnify for Loss Caused by Fraud** [Section 10]: Every partner is liable to indemnify the firm for any damage caused to it by reason ofhis fraud in the conduct of the business of the firm.

3) **Duty to Indemnify for Willful Neglect** [Section 13 (f)]: A partner must indemnify the firm for any loss caused to it by willful neglect in the conduct of the business of the firm.

NOTES

4) **Duty to Attend Diligently to his Duties [Section 12 (b)]:** Every partner is bound to attend diligently to his duties in the conduct of the business'.

5) **Duty to Work without Remuneration [Section 13 (a)]:** A partner is not entitled to receive remuneration for taking part in the conduct of the business.

6) **Duty to contribute to the Losses [Section 13 (b)]:** The partners are bound to contribute equally to the losses sustained by the firm, irrespective of the amount of capital contribution by each one of them.

7) **Duty to Use Firm's Property Exclusively for the Firm [Section 15]:** It is the duty of every partner to use the property of the firm exclusively for the purposes of the business. No partner should use partnership property for his personal benefit.

8) **Duty to Account for Personal Profits Derived [Section 16 (a)]:** 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 must account for that profit and pay it back tc the firm.

9) **Duty not to Compete with the Business of the Firm [Section 16 (b)]:** A partner must not carry on any business, which is similar to or likely to compete with the business of the firm. If he does that, he is bound to account for and pay to the firm all profits made by him in that business. A partner may, however, carry on a non-competing business and may retain the profits of that business to him.

10) **To act within Authority [Section 19 (1)]:** Every partner is bound to act within the scope of his actual or implied authority. Where he exceeds the authority conferred on him and the firm suffers a loss, he shall have to compensate the firm for any such loss.

11) **To be Liable Jointly and Severally [Section 25]:** Every partner is liable,jointly with all the other partners and also severally, for all the acts of the firm done while he is a partner.

12) **Not to Assign his Rights [Section 29]:** A partner cannot assign his rights and interest in the firm to an outsider so as to make him the partner of the firm. He can, however, assign his share of the profit and his share in the assets of the firm.

RELATION OF PARTNERS TO THIRD PARTIES

The relations of partners with third parties are governed by the mutual agency relationship existing among the partners. According to Section 18, "every partners is an agent of the firm for the purpose of the business of the firm" In other words, every partner has the capacity to bind other partners

1) He does the act for carrying on, in the usual way, business of the kind carried on by the firm, and

2) The act is done in the name of the firm.

Therefore, all partners are liable to third parties for the acts of every partner.

Express Authority of a Partner

When a partner is expressly authorized by an agreement of all the partners to do certain acts on behalf of the firm, it is called express authority of a partner. The firm is bound by all acts of a partner done within the scope of his express authority even if the acts are not within the scope of the partnership business.

Implied Authority of a Partner

The firm is also bound by all acts of a partner done within the scope of his implied authority. An implied authority of a partner can be inferred from the circumstances of the case. Generally speaking, such acts of a partner which are incidental to or usually done in the course of the proper conduct of the business come within the scope ofhis implied or apparent or ostensible authority.

Section 19 (1) and 22 define the scope of the implied authority of a partner. Accordingly, for an act to be covered within the implied authority it is necessary that:

1) The act should be done for carrying on the business of the kind carried on by the firm;
2) The act should be done in the usual way of such business; and
3) The act must be done in the firm name or in any other manner expressing or implying an intention to bind the firm.

Acts within the Implied Authority of a Partner

In a trading firm, i.e., a firm, which depends for its existence on the buying and selling of goods, the implied authority of a partner has been held to include:

1) Purchasing goods, on behalf of the firm, in which the firm deals of which are employed in the firm's business;
2) Selling the goods of the firm;
3) Receiving payment of the debts due to the firm and giving receipts for them;
4) Setting accounts with the persons dealing with the firm;
5) Engaging servants for the partnership business;
6) Borrowing money on the credit of the firm;
7) Drawing, accepting, indorsing bills and other negotiable instruments in the name of the firm;
8) Pledging any goods of the firm for the purpose of borrowing money; and
9) Employing a solicitor to defend an action against the firm for goods supplied.

Acts beyond Implied Authority / Restriction on Implied Authority (Section 19 & 20]

NOTES

Check Your Progress

3. What is Partnership at Will?
4. Explain Dissolution of the Firm?
5. Explain Dissolution of the Partnership?

NOTES

The act beyond or restrictions on implied authority of a partner may be discussed under the following two heads:

1) Statutory Restrictions and
2) Restrictions imposed by mutual agreement.

1) **Statutory Restrictions [Section 19(2)]:** In the absence of any usage or custom of trade to the contrary, the implied authority of a partner does not empower him to.
   i) Submit a dispute relating to the business of the firm to arbitration as it is not the ordinary basis of partnership firm to enter into a submission for arbitration;
   ii) Open a bank account on behalf of the firm in his own name;
   iii) Compromise or relinquish any claim or portion of a claim by the firm against a third party (i.e., an outsider).
   iv) With draw a suit or proceedings filed on behalf of the firm;
   v) Admit any liability in a suit or proceedings against the firm;
   vi) Acquire immovable property on behalf of the firm;
   vii) Transfer immovable property belonging to the firm; and
   viii) Enter into partnership on behalf of the firm.
2) **Restrictions Imposed by Mutual Agreement [Section 20]:** The partners of a firm by mutual agreement may extend or restrict the scope of implied authority of any partner. But a third party is not bound by any such restriction unless it has the knowledge of such restriction. In other words, the firm is liable to third party only if the third party has no knowledge of the restrictions.

Example:

X, Y and Z are partners in a trading firm. They decide that no partner shall have the right to borrow beyond Rs 20,000 without the consent of other partners. X without consulting Y and Z borrows from W Rs 25,000 in the name of the firm and utilized the same in paying of the firm's debts. The firm is liable to pay W if W is unaware of the restriction but it will not be liable to pay W if W was aware of such restriction.

Liability of Partner to Third Parties

All partners are liable to third parties for all acts of a partner which fall within the scope of his implied authority. Their liability to third parties in various cases is summarized as under:

1) **Effect of Admissions by a Partner [Section 23]:** Any admission or representation (for example, acknowledgement signed by a partner) by a partner is sufficient evidence against the firm if the following two conditions are fulfilled:
   i) Such admission or representation must relate to the affairs of the firm; and
   ii) Such admission or representation must be made in the ordinary course of business.

2) **Effect of Notice to an Acting Partner [Section 24]:** Any notice to a partner operates as a notice to the firm if the following three conditions are fulfilled:

   i) Such notice must relate to the affairs of the firm;

   ii) Such notice must be given to a working partner and not to a sleeping partner.

   iii) There must not be any fraud committed by the partners and the third party against the firm.

3) **Contractual Liability [Section 25]:** Every partner is liable jointly with other partners and also severally (i.e., individually) for all those acts of the firm which have been done while he was a partner.

   Example: X, Y and Z were partners in a firm when infringement of a trademark took place. X retired. Later on, damages arising out of the alleged infringement arose after the dissolution of the firm. It was held that all the partners who were members of the firm at the time when infringement of a trademark took place were liable.

4) **Liability of the Firm for Wrongful Acts of a Partner [Section 26]:** The firm is liable to the same extent as the partner for any loss or injury caused to any third party or any penalty by the wrongful act or omission of a partner if either of the following two conditions is fulfilled:

   i) Such wrongful act or omission must have been done by a partner while he was acting in the ordinary course of business of the firm, or

   ii) Such wrongful act or omission must have been done by a partner with the authority of the other partners.

   Example: X, Y, Z are partners in a magazine business. X allows the publication of a defamatory article about a prominent person "Sharad Pawar", without checking its validity. Sharad Pawar files a suit against the firm. The firm will be liable for this act of the editor partner on the following two grounds:

   i) Such act caused loss of goodwill to Sharad Pawar,

   ii) Such act was done in the usual course of business:

5) **Liability of Firm for Misappropriation by Partner [Section 27]:** The firm is liable to the third parties in the following two cases of misappropriation by a partner:

Case	Condition
a) Where a partner receives money or property from a third person and misapplies it.	The receipt of money or other property by a partner must be an act within the scope of his apparent authority.
b) Where a firm, in the course of its business, receives money or property from a third person and the same is misapplied by any of its partners-	The partner must have misapplied while the property was in the custody of firm.

Example: X, Y and Z are partners in a trading firm. W, a debtor of the firm,

NOTES

repays his debt of Rs 5,000 to X who does not inform Y and Z about the repayment and misuses the money, W would be discharged of the debts on account of payment made to X because whatever is done by a partner, in the ordinary course of partnership business and within the scope of his authority, is deemed to have been done by him only as an agent for the other partners and it is immaterial whether or not the other partners have notice of this act.

6) **Partner's Authority in an Emergency [Section 21]:** A partner's authority in an emergency covers those acts which fulfill the following two conditions:

   i) The act must be done to protect the firm from loss; and

   ii) The act must be such as a prudent man would undertake under similar circumstances in his own case.

   It may be noted that these acts do not form part of the implied authority of the partner but, nevertheless, they would bind the firm. A partner's authority in an emergency is similar to that of an agent in similar circumstances u/s. 189 of the Indian Contract Act.

Example: X, Y and Z are partners in a trading firm. By an agreement, they decided that no partner would have authority to sell goods of the firm above the value of Rs 50,000 without the consent of other partners. Owing to a sudden slump in the market, the prices crashed. One partner, in order to save the firm from loss, sold all the stock worth Rs 5, 00,000 without consulting any other partner. Such an act would bind the firm.

CHANGES IN A FIRM/RECONSTITUTION 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:

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.

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; [1]

   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 ofhis intention to retire. Section 32 clearly comprehends a situation where a partner may retire without dissolving the firm.

NOTES

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.

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:

i) There is an agreement made by him with such third party and the remaining partners. (This implies the principle of innovation);

ii) 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, Section 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.

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.

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, bi any case the firm is not liable for any act of the insolvent partner after the date of order of adjudication.

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. Provision to Section 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) **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.

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 tights and duties of the partners in the teconstituted firm remain the same as they were immediately before the change, as far as may be.

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.

DISSOLUTION OF FIRM

The Indian Partnership Act distinguishes between:

1. Dissolution of firm, and
2. Dissolution of partnership.

Section 39 provides that the dissolution of partnership between all the partners of a firm is called the "dissolution of the fitm".

Dissolution of Firm: It means complete breakdown or extinction of the relationship of partnership between all the partners of a firm. If this breakdown or severance of partnership relation between a few and not all the partners (and the business is carried on), this amounts dissolution of partnership and not of the firm.

Dissolution of Partnership: It involves only a change in the relation of the partners. For example, if there is a partnership between A, B and C, comes to end and partnership between A and B comes into being. The new firm with A and B as its partners are called 'reconstituted firm'. Thus retirement of a partner from a firm does not dissolve the firm. It merely severs the partnership relation between the retiring partner and the continuing partners. It leaves the partnership amongst the continuing partners unaffected and the firm continues with the changed constitution.

Difference between Dissolution of Partnership and Dissolution of Firm:

Dissolution of Partnership	Dissolution of Firm
1) Any change in the relationship of the partners is called dissolution of partnership.	The dissolution of partnership between all the partners of a firm is called the dissolution of the firm.
2) Dissolution of partnership is not the dissolution of the firm.	Dissolution of the firm is the dissolution of the partnership.
3) Business may or may not come to an end in dissolution of the partners.	Business will come to an end in the dissolution of a firm.

MODES OF DISSOLUTION OF FIRM

Dissolution without the Order of Court

It may take place in one of the following ways:

1) **Dissolution by Agreement [Section 40]:** A firm may be dissolved:
   i) With the consent of all the partners, or
   ii) In accordance with a contract between them.

   The contract for the dissolution of the firm may be express or implied.

2) **Compulsory Dissolution [Section 41]:**

   A firm is compulsorily dissolved in the following two circumstances:
   i) If all the partners or all but one partner of the firm are declared insolvent, (The reason is that there must be at least two persons to continue a firm and such persons must be competent to contract).
   ii) If some event takes place which makes it unlawful for the firm's business to be carried on.

3) **On the Happening of certain Contingencies [Section 42]:**

   Subject to contract between the partners, a firm is dissolved:
   i) If constituted for a fixed term, by the expiry of that term;
   ii) If constituted to carry out one or more adventures or undertakings, by the completion thereof;
   iii) By the death of a partner; and
   iv) By the adjudication of a partner as an insolvent.

   The partnership agreement may provide that the firm will not be dissolved in any of the aforementioned circumstances. Such a provision is valid.

NOTES

4) **Dissolution by Notice [Section 43]:**

Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all other partners of his intention to dissolve the firm. The firm is dissolved from the date of dissolution mentioned in the notice or if no date is mentioned, as from the date of the communication of the notice.

Dissolution by Court:

Under Section 44, the Court may, at the suit ofa partner, dissolve a firm on the following grounds:

1) **Insanity:** Where a partner has become of unsound mind, the Court may dissolve the firm on the petition 6f any of the other partners or by the next friend of the insane partner [Section 44 (a)].
2) **Permanent Incapacity:** Where a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as a partner, the Court may dissolve the firm [Section 44 (b)].
3) **Misconduct:** Where a partner, other than the partner suing, is guilty of misconduct and it is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business, the Court may dissolve the firm [Section 44 (c)].
4) **Transfer of Interest:** Where a partner has in any way transferred the whole of his interest in the firm to a third party or where his share has been attached under a decree, or sold in the recovery of arrears of land revenue, the Court may dissolve the firm at the instance of any other partner [Section 44 (e)].
5) **Business working at a Loss:** Where the business of the firm cannot be carried on except at a loss, the Court may dissolve the firm at the suit of a partner [Section 44 (e)].
6) **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. [Section 44 {f)].

Persistent Breach of Agreement [Section 44 (d)]:

When a partner, other than the partner suing, commits frequently breaches of the partnership agreement or otherwise so conducts himself in matters relating to the business that other partners find it impossible to carry on the business in partnership with him. Taking away the books of accounts, using firm's monies for his private debts, continuous quarrelling with other partners are good grounds for the dissolution.

RIGHTS AND LIABILITIES OF PARTNERS ON DISSOLUTION

Rights of a Partner on Dissolution

1) **Rights to Enforce winding Up [Section 46]: On** a partnership being dissolved, any partner or his representative shall have right, against the others:
   i) To have property of the firm applied in payment of the debts of the firm, and
   ii) To have the surplus distributed amongst the partners or their representatives according to their respective rights.

2) **Rights to have the Debts of the Firm Settled Out of the Property of the Firm [Section 49):** Where a firm is dissolved, the debts of the firm are settled out of the property of the firm, and if there is any surplus it is utilized towards payment of the private debts of the partners. Similarly as regards the private debts of the partners, the private estate is first applied in payment of the private debts and if there is any surplus, and if there be a need, it is utilized towards the settlement of the debts of the firm.

3) **Right to Personal Profits earned after Dissolution [Section 50]:** Where any partner has bought the goodwill of the firm on its dissolution, he has the right to use the firm name and earn profit by its use.

4) **Right to Return of Premium on Premature Dissolution [Section 51]:** According to Section 51, in the case of dissolution of partnership earlier than the period fixed for it, the partner paying the premium is entitled to the return of the premium of such part thereof as may be reasonable, regard being had to the terms of agreement and to the length of time during which he was a partner, except when the partnership is dissolved:

   i) By the death of one of the partners;

   ii) Mainly due to the misconduct of the partner paying the premium;

   iii) Pursuant to an agreement containing no provision for the return of the premium or any part thereof.

   For example,

   X and Y become partners for 10 years; X pays Y a premium of Rs. 2,000. At the end of 8 years a quarrel arises between X and Y and dissolution is declared. In such a case, X will be entitled to a return of such amount of the premium from Y as may be deemed reasonable. What is reasonable will depend upon the circumstances of each case.

5) **Right where Partnership Contract is rescinded for Fraud or Misrepresentation [Section 52]:** Where a contract creating partnership is rescinded on the ground of fraud or misrepresentation of one of the partners, the partner entitled to rescind has the fallowing rights, namely.

6) **Right of Lien on the Surplus Assets:** He has a lien on the surplus assets after the debts of the firm have been paid, for any sum paid by him for the purchase of his share in the firm and for any capital contributed by him.

7) **Right of Subrogation:** He is subrogated to the rights of the partnership creditors in respect of any payment made by him towards the debts of the firm. This means if he pays off any creditor of the firm from his own pocket, he steps into the shoes of that creditor, i.e., he becomes the creditor of the firm for that amount.

8) **Right to be indemnified:** He has also a right to be indemnified by the partner or partners guilty of fraud or misrepresentation against all the debts of the firm.

9) **Right to Impose Restrictions [Section 53]:** In the absence of an agreement to the contrary, each partner or his representative is entitled to restrain the other partners from carrying on asimilar business in the name of the firm or from using the property of the firm for their own benefit, until the affairs of the firm have been completely wound up. However, where a partner or his representative has bought the goodwill of the firm he can use the firm name

NOTES

Further, the partners in anticipation of or upon dissolution of the firm can agree that some or all or them will not carry on a business similar to that of the firm within a specified period or within a specified period or within specified local limits. Such an agreement shall be valid and not void on the ground of restraint of trade, if the restrictions imposed are reasonable [Section 54].

Example: A, B and C are three partners in a firm. Their capital contributions are A-Rs. 20,000, B-Rs. 5,000 and C-Rs. 1,000. They share profits and losses equally. Upon dissolution it is found that realizable assets are Rs. 30,000 and debts payable are Rs. 10,000. Thus after paying the debts, assets available for partners are worth only Rs. 20,000 and as such there is a capital deficiency of Rs. 6,000. Each partner must contribute Rs. 2,000 each.

Liabilities of a Partner on Dissolution

1) **Continuing Liability for Acts of Partners done After Dissolution [Section 45]:** Until a public notice is given of dissolution, the partners continue to be liable for any act done by any of them after dissolution and such act is deemed to be an act done before the dissolution.

   Example: X, Y and Z are partners in a trading firm. They executed a dissolution deed to dissolve the firm as from 1st March but did not give public notice till 31st March. On 20th March, X borrowed Rs 20,000 in the firm's name. The firm is liable.

   Exceptions: The following shall not be liable for acts done after the dissolution of the firm even though the public notice has not been given:

   i) The estate of a deceased partner;

   ii) The estate of an insolvent partner;

   iii) A sleeping or dormant partner who has retired from the firm.

2) **Continuing Authority of Partners after Dissolution [Section 47]:** After the dissolution of a firm, the authority of a partner to bind the firm and the other mutual rights and obligations of the partners continue, so far as may be necessary:

   i) To wind up the affairs of the firm, and

   ii) To complete the unfinished transactions pending at the date of dissolution.

SETTLEMENT OF ACCOUNTS [SECTIONS 48,49 AND 55]

Unless otherwise agreed by the partners, the accounts of a dissolved firm shall be settled according to the provisions of Sections 48, 49 and 55. These provisions are as follows:

1) **Treatment of Losses [Section 48(a)]:** Losses including deficiencies of capital are to be paid in the fallowing manner:

   i) First out of profits;

   ii) Then out of capital;

   iii) Lastly by partners individually in their profit-sharing ratio. [Section 48(a)]

2) **Application of Assets [Section 48(b)]:** The assets of the firm (including the sums, if any, contributed by the partners to make up the deficiencies of capital) shall be applied in the following manner and order:

   i) In paying firm's debts to the third parties;

   ii) In paying to each partner rateably what is due to him on account of advances;

iii) In paying to each partner rateably what is due to him on account of capital;

iv) The residue, if any, shall be divided among the partners in their profit-sharing ratio [Section 48(b)].

3) **Payment of Firm's Debts and Partner's Private Debts [Section 49]:** Where there are firm's debts and partner's private debts, the following provisions shall apply:

i) Firm's property shall be applied first in payment of firm's debts then the surplus, if any, shall be applied in the payment of partner's private debts to the extent to which the concerned partner is entitled to share in the surplus; and

ii) Partner's private property shall be applied first in payment of his private debts and the surplus, if any, in payment of firm's debts if firm's liabilities exceed the firm's assets. [Section 49]

4) **Sale of Goodwill [Section 55]:** Unless otherwise agreed by the partners, the goodwill shall be included in the assets and may be sold either separately or along with other property of the firm. In case of sale of goodwill of dissolved firm, the rights of buyer and seller are as under:

Rights of a buyer	**Rights of a seller**
i) To use the firm's name.	To carry on a business competing with that of the buyer.
ii) To represent himself as carrying on the business of the old firm.	To advertise such business. But subject to agreement between him and the buyer, he is not entitled (a) to use the firm's name, (b) to represent himself as carrying on business of the old firm, or (c) to solicit the old customers.
iii) To solicit the old customers	

It may be noted that any partner may enter into an agreement with the buyer of goodwill that such partner will not carry on any business similar to that of the dissolved firm within a specified period or within the specified local limits. Such agreement shall be valid if restrictions imposed are reasonable.

Examples:

A & B entered into a partnership business of manufacturing bags under the name A & B Bags'. Individually A & B are partners, together they are firm and A & B Bags' is the firm name. The relationship between A & B is partnership.

CASE STUDY:

A partnership firm was constituted by A, B and C partners, carrying on the business of shoes manufacturing. Lateron, Nick Shoe Manufacturing Co. Limited proposed to purchase the business of the firm to the Partners of the firm. The partners unanimously consented to it and agreed to dissolve the firm. Draft a Partnership Dissolution Deed in this respect.

A partner purchasing the property with the friends of the firm did not obtain the consent of the other partners as required by the Partnership deed. Will it be the property of the firm? Comment.

NOTES

SUMMARY

- Partnership the relationship between two or more persons who have agreed to share the profit of a business carried on by all or any of them acting for all.
- Essential elements of Partnership: Contract, Association of two or more persons, Carrying on business, Sharing of profits, Mutual Agency
- A person who has by agreement become a partner and who takes active part in the conduct of partnership business is an actual or ostensible partner.
- A sleeping partner is one who does not take an active part in the conduct of the business of the firm.
- A partner, who lends his name to the firm without having any real interest in it, is called a nominal partner.
- The document in which the respective rights and obligations of the members of a partnership are set forth is called a 'partnership deed'.
- Persons who have entered into partnership with one another are called individually 'partners' and collectively 'firms' and the name under which the business is carried on is called the 'firm name'.
- Dissolution of the firm means complete breakdown or extinction of the relationship of the partnership between all the partners of the firm.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. According to Section 4 of the Indian Partnership Act, 1932, "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."
2. The term 'business' is used in its widest sense and includes every trade, occupation or profession [Section 2 (b)].
3. When there is no provision in partnership agreement for duration of the partnership, the partnerships is called 'Partnership at Will'.
4. Section 39 provides that the dissolution of partnership between all the partners of a firm is called the "dissolution of the firm".
5. Any change in the relationship of the partners is called dissolution of partnership.

TEST YOURSELF

1) What do you mean by 'Partnership'? Describe essential elements of Partnership.
2) Explain difference between Partnership Firm and A Company?
3) What are the different kinds of Partners?
4) What do you mean by Partnership Deed?
5) How firms are registered?
6) What are the duties of partners?
7) Describe the liability of partner to third Parties.
8) What do you mean by Reconstitution of a Firm?
9) What are the modes of dissolution of a firm?
10) Explain briefly rights and liabilities of partners on dissolution.

FURTHER READING

- *Mercantile Law:Sharma, Sareen, Gupta and Chawla*

8 Consumer Protection Act

NOTES

The Chapter Covers :

- Introduction
- Definition of 'Defect' and 'consumer'
- Consumer Protection Councils
- Consumer Disputes Redressal Agencies
- Consumer Disputes Redressal Forum
- Procedure on admission of complaint
- Consumer Disputes Redressal Commission
- National Consumer Disputes Redressal Commission
- Jurisdiction
- District Forum
- State Commission
- National Commission

INTRODUCTION

The Consumer Protection Act, 1986 was enacted for better protection of the interests of consumers. The provisions of the Act came into force with effect from 15-4-87. The Consumer Protection Act, 1986 is one of the most beneficial legislations of recent times and it is intended to promote and protect the interest of consumers. The Consumer Protection Act is a social welfare legislation which was enacted as a result of widespread consumer protection movement. The main object of the legislature in the enactment of this act is to provide for the better protection of the interests of the consumer and to make provisions for establishment of consumer councils and other authorities for settlement of consumer disputes and matter there with connected. Consumer Protection Act imposes strict liability on a manufacturer, in case of supply of defective goods by him, and a service provider, in case of deficiency in rendering of its services.

Consumer protection laws are designed to ensure fair trade competition and the free flow of truthful information in the marketplace. The laws are designed to prevent businesses that engage in fraud or specified unfair practices from gaining an advan-

NOTES

tage over competitors and may provide additional protection for the weak and those unable to take care of themselves. Consumer Protection laws are a form of government regulation which aim to protect the interests of consumers.

The salient features of the Act are:

1) It covers all the sectors whether private, public, and cooperative. The provisions of the Act are compensatory as well as preventive and punitive in nature. This Act applies to all goods covered by sale of goods Act and services unless specifically exempted by the Central Government;

2) It enshrines the following rights of consumers:

   - Right to be protected against the marketing of goods and services which are hazardous to life and property;
   - Right to be informed about the quality, quantity, potency, purity, standard and price of goods or services so as to protect the consumers against unfair trade practices;
   - Right to be assured, wherever possible, access to a variety of goods and services at competitive prices;
   - Right to be heard and to be assured that consumers' interests will receive due consideration at the appropriate forums;
   - Right ro seek redressal against unfair trade practices or unscrupulous exploitation of consumers; and
   - Right to consumer education;

3) The Act also envisages establishment of Consumer Protection Councils at the central, state and district levels, whose main objectives are to promote and protect the rights of consumers;

DEFINITION OF 'DEFECT' AND 'CONSUMER'

Under the CPA, Consumer Forums at the District, State and National level have been specifically constituted to adjudicate claims of consumers for any "defect" in goods. A "defect" has been defined in Section 2(1) (f) of the Act as "any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to maintained by or under any law for the time being in force or under any contract, express or implied, or as is claimed by the trader (which includes the manufacturer) in any manner whatsoever in relation to any goods."

Consumer is defined as someone who acquires goods or services for direct use or ownership rather than for resale or use in production and manufacturing. In other words, Consumers are defined as individuals who purchase, use, maintain, and dispose of products and services. Consumers are users of the final product. According to the Section 2(d),

i) 'Consumer' means any person who buys any goods for any consideration which has been paid or promised or partly paid or partly promised, or under any system of deferred payment,

ii) It includes any user of such goods other than the person who actually buys goods and whose use is made with the approval of the purchaser.

It is important to know that the term consumer excludes the person who obtains the goods for resale or for any commercial purpose.

NOTES

Complaint

An aggrieved consumer seeks redressal under the Act through the instrumentality of complaint. It does not mean that the consumer can complain against his each and every problem. The Act has provided certain grounds on which complaint can be made. Similarly, relief against these complaints can be granted within the set pattern.

What constitutes a complaint [Section 2(1)(c)] - Complaint is a statement made in writing to the National Commission, the State Commission or the District Forum by a person competent to file it, containing the allegations in detail, and with a view to obtain relief provided under the Act.

Who can file a complaint [Sections 2(b) & 12] - At the outset it is clear that a person who can be termed as a consumer under the Act can make a complaint. Following persons can file a complaint under the Act:

- 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,
- one or more consumers, where there are numerous consumers having the same interest.

In addition to the above following are also considered as a consumer and hence they may file a complaint:

1) **Beneficiary of the goods/services:** The definition of consumer itself includes beneficiary of goods and services. Where a young child is taken to the hospital by his parents and the child is treated by the doctor, the parents of such a minor child can file a complaint under the Act.

2) **Legal representative of the deceased consumer:** The expression consumer includes legal representative of the deceased consumer and he can exercise his right for the purpose of enforcing the cause of action which has devolved on him.

3) **Legal heirs of the deceased consumer:** A legal heir of the deceased consumer can well maintain a complaint under the Act.

4) **Husband of the consumer:** In the Indian conditions, women may be illiterate, educated women may be unaware of their legal rights, thus a husband can file and prosecute complaint under the Consumer Protection Act on behalf of his spouse.

Check Your Progress

1. What is Consumer Protection Act?
2. Define Defect as per Section 2(1) (f)?

NOTES

5) **A relative of consumer:** When a consumer signs the original complaint, it can be initiated by his/her relative.

What a complaint must contain [Section 2(1)(c)] -

A complaint must contain any of the following allegations :

1) An unfair trade practice or a restrictive trade practice has been adopted by any trader; Example: A sold a six months old car to B representing it to be a new one. Here B can make a complaint against A for following an unfair trade practice.

2) The goods bought by him or agreed to be bought by him suffer from one or more defects;

   Example: A bought a computer from B. It was not working properly since day one. A can make a complaint against B for supplying him a defective computer.

3) The services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect. Example: A hired services of an advocate to defend himself against his landlord. The advocate did not appear every time the case was scheduled. A can make a complaint against the advocate.

4) A trader has charged for the goods excess of the price fixed by or under any law. Example: A bought a sack of cement from B who charged him Rs. 100 over and above the reserve price of the cement declared by the Government. Here A can make a complaint against B.

5) Goods which will be hazardous to life. Example: A bought a tin of disinfectant powder. It had lid which was to be opened in a specific manner. Trader did not inform to A about this. While opening the lid in ordinary way, some powder flew in the eyes of A which affected his vision. Here A can make a complaint against the trader.

Time frame within which a complaint can be filed -

Section 24A of the Act provides that a consumer dispute can be filed within two years from the date on which the cause of action arises. Since this provision was inserted in the Act in 1993.

Examples:

1. A got his eye operated by B in 1989. He got a certificate of blindness on 18th December, 1989. He was still in hope of gaining his sight and went from second operation in 1992 and was discharged on 21-1-1992. He filed a complaint against B on 11-1-1994. B opposed on the ground that more than 2 years were over after 18-12-1989, thus the complaint is not maintainable. The Commission held that here the cause of action for filing the complaint would arose after the second operation when A lost entire hope of recovery. Thus the suit is maintainable.

Relief available against complaint [Sections 14 and 22] -

A complainant can seek any one or more of the following relief under the Act:

a) to remove the defect pointed out by the appropriate laboratory from the goods in question;

b) to replace the goods with new goods of similar description which shall be free from any defect;

c) to return to the complainant the price, or, as the case may be, the charges paid by the complainant;

d) to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party;

e) to remove the defects or deficiencies in the services in question;

f) to discontinue the unfair trade practice or the restrictive trade practice or not to repeat it;

CONSUMER PROTECTION COUNCILS

Section 4,5,6,7 & 8 of the Act makes provision for the establishment of Consumer Protection Councils. The State Government is authorized by the Act to establish by notification, councils at the Central, State & District levels to be known as "Central Consumer Protection Council", Consumer Protection Council & District Consumer Protection Council respectively. It also lays down the objects of the said councils. It also makes provisions for appointment of Chairman & other official and non-official members of the said council.

Objects of the Councils [Sections 6 and 8]:

There is one basic thought that 'consumer needs to be protected'. Another thought is - how he can be protected? Definitely, there has to be some agency to work towards this protection. The Act has provided for constitution of Consumer Councils for this purpose. Now, when we say that these councils are there to protect the consumers, a question arises - consumers are protected against what? Thus the Act has detailed some rights of consumers which need to be protected by the councils. These are:

1) **Right to safety** - It is right to be protected against the marketing of goods and services which are hazardous to life and property. Unsafe goods may cause death or serious injury to the user due to defective ingredients, defective design, poor wotkmanship, or any other reason. At times safety hazards are found due to absence of proper instructions to use the product. Thus it is to be ensured that—

   Manufacturers and traders ensure that the goods are safe for the users, in case of hazardous goods, they give clear instructions as to mode of use, consumer is informed about the risk involved in improper use of goods, and vital safety information is conveyed to consumers.

2) **Right to information** - It is right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, with a view to protect the consumer against unfair trade practices. Adequate information is very important in order to make a right choice.

3) **Right to choose** - The right to choose can be made meaningful by ensuring variety of goods and services are available at competitive prices. Fair and effective competition must be encouraged so as to provide the widest range of products and services at the lowest cost to the consumers.

4) **Right to represent** - It is right to be heard and to be assured that consumer's interests will be protected. The Consumer Protection Act, 1986 has well taken care of this right by making available the instrumentality of Redressal Forums. Every consumer has a right to file complaint and be heard in that context.

5) **Right to redressal** - It is a right to seek redressal against unfair trade practices or restrictive trade practices or exploitation of consumers. The Act has ensured this right by establishing Consumer Forums and recognizing restrictive and unfair trade practices as a ground to make a complaint.

6) **Right to education** - The right to consumer education is a right which ensures that consumers are informed about the practices prevalent in the market and the remedies available to them. For spreading this education, media, or school curriculum, or cultural activities, etc. may be used as a medium.

Note that the Central Council's object is to ensure these rights of the consumers throughout the country while the State Councils look to ensure these rights to consumers within their territories.

The Central Consumer Protection Council:

Composition [Section 2 and rule 3] Members of the councils are selected from various areas of consumer interest. The Consumer Protection Act has authorized the Central Government to make rules as to the composition of the Central Council. Accordingly, the Central Government has provided that the Central Council shall consist of the following members not exceeding 150, namely:

1) the Minister in-charge of Consumer Affairs in the Central Government who shall be the Chairman of the Central Council;

2) the Minister of State (where he is not holding independent charge) or Deputy Minister in-charge of Consumer Affairs in the Central Government who shall be the Vice-Chairman of the Central Council;

3) the Secretary in-charge of Consumer Affairs in the Central Government who shall be the member-secretary of the Central Council;

4) the Minister in-charge of Consumer Affairs in States;

5) eight Members of Parliament—five from the Lok Sabha and three from the Rajya Sabha;

6) the Secretary of the National Commission for Scheduled Castes and Scheduled Tribes;

7) representatives of the Central Government Departments and autonomous organizations concerned with consumer interests—not exceeding twenty;

8) representatives of the Consumer Organizations or consumers—not less than thirty-five;

9) representatives of women—not less than ten;

10) representatives of farmers, trade and industries—not exceeding twenty;

11) persons capable of representing consumer interest not specified above—not exceeding fifteen.

Vacancy - Any member may, by writing under his hand to the Chairman of the Central Council, resign from the Council. The vacancies so caused or otherwise, are filled from the same category by the Central Government and such person shall hold office so long as the member whose place he fills would have been entitled to hold office, if the vacancy had not occurred.

Meetings of the Central Council [Section 5 and rule 4] - Central Council is required to organize at least one meeting every year. In addition, it may meet as and when necessary. Time and place of the meeting is decided by the Chairman of the council. Each meeting of the Central Council shall be called by giving, not less than ten days from the date of issue, notice in writing to every member. Every notice of a meeting of the Central Council shall specify the place and the day and hour of the meeting. The meeting of the Central Council shall be presided over by the Chairman. In the absence of the Chairman, the Vice-Chairman shall preside over the meeting of the Central Council. In the absence of the Chairman and the Vice-Chairman, the Central Council shall elect a member to preside over that meeting of the Council. The resolutions passed by the Central Council are recommendatory in nature. No proceedings of the Central Council shall be invalid merely by reasons of existence of any vacancy in or any defect in the constitution of the Council.

Objects of the Central Council: The objects of the Central Council shall be to promote and protect the rights of the consumers such as,—

a) the right to be protected against the marketing of goods and services which are hazardous to life and property;

b) the right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be so as to protect the consumer against unfair trade practices;

c) the right to be assured, wherever possible, access to a variety of goods and services at competitive prices;

d) the right to be heard and to be assured that consumer's interests will receive due consideration at appropriate forums;

e) the right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers; and

f) the right to consumer education.

The State Consumer Protection Councils: (State Councils) [Section 7]

Composition - The power to establish State Councils is with the States. The Act provides that the Minister in-charge of consumer affairs in the State Government shall be the Chairman of the State Council. The State Council shall consist of the following members, namely:—

a) the Minister in charge of consumer affairs in the State Government who shall be its Chairman;

b) such number of other official or non-official members representing such interests as may be prescribed by the State Government.

c) such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.

Meetings - The State Council meet at least twice a year. In addition, it may meet as and when necessary. The council may meet at such time and place as the Chairman may think fit. Procedure in regard to the transaction of its business is prescribed by the State Government.

Objects of the State Council: The objects of every State Council shall be to promote and protect within the State the rights of the consumers laid down in section.6.

The District Consumer Protection Council:

The State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection Council with effect from such date as it may specify in such notification. The District Consumer Protection Council shall consist of the following members, namely:—

(a) the Collector of the district (by whatever name called), who shall be its Chairman; and

(b) such number of other official and non-official members representing such interests as may be prescribed by the State Government.

Meetings: The District Council shall meet as and when necessary but not less than two meetings shall be held every year.

The District Council shall meet at such time and place within the district as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government.

Object: The objects of every District Council shall be to promote and protect within the district the rights of the consumers laid down in clauses (a) to (f) section 6.

CONSUMER DISPUTES REDRESSAL AGENCIES:

This part of the Act contains 22 sections i.e. Sections 9 to18, 18-A, 19 to 23, 24-A, 24-B, 25, 26 and 27. This part provides for establishment of consumer disputes redressal forum at district level, state level and central levels known as "District Forum", "State Commission" and "National Commission". It also makes provisions regarding the composition, jurisdiction, procedure to be followed by the District forum, State commission & National commission. Any person aggrieved by an order of the District forum may appeal to the State commission & an order of the State commission can be challenged before the National Commission. Any person aggrieved by the order of the National Commission can resort to the Supreme Court as the last remedy.

It also provides a limitation period for preferring appeals to the State Commission, National Commission and Supreme Court. District forum, State Commission or National Commission shall not consider any appeal filed after expiry of 2 years from the date on which the cause of action has arisen.

It also makes provisions regarding enforcement of the orders of the District forum, State Commission and National Commission and penalties to be levied under the Act.

Consumer Disputes Redressal Agencies: There shall be established for the purposes of this Act, the following agencies, namely:—

NOTES

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.

b) Consumer Disputes Redressal Commission to be known as the "State Commission" established by the State Government in the State by notification; and

c) National Consumer Disputes Redressal Commission established by the Central Government.

CONSUMER DISPUTES REDRESSAL FORUM

(District Forum [Section. 10]):

Composition: Each District Forum shall consist of,—

a) a person who is, or has been, or is qualified to be a District Judge, who shall be its President;

b) two other members, one of whom shall be a woman, who shall have the following qualifications, namely:

   i. not less than thirty-five years of age,

   ii. possess a bachelor's degree from a recognised university,

   iii. be persons of ability, integrity and standing, and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

Further a person shall be disqualified for appointment as a member if he—

a) has been convicted and sentenced to imprisonment for an offence which, in the opinion of the state Government involves moral turpitude; or

b) is an undercharged insolvent; or

c) is of unsound mind and competent declared by a court; or

d) has, in the opinion of the state Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member; or

e) has such other disqualifications as may be prescribed by the State Government.

Every appointment under sub-section (I) shall be made by the State Government on the recommendation of a selection committee consisting of the following, namely:—

(i) the President of the State Commission
— Chairman.

(ii) Secretary, Law Department of the State
— Member.

(iii) Secretary incharge of the Department dealing with consumer affairs in the State
— Member.

NOTES

Where the President of the State Commission is, by reason of absence or otherwise, unable to act as Chairman of the Selection Committee, the State Government may refer the matter to the Chief Justice of the High Court for nominating a sitting Judge of that High Court to act as Chairman.

Term of Office: Every member of the District Forum shall hold office for a term of five years or up to the age of sixty-five years, whichever is earlier. He shall not be eligible for the re-appointment. However, a member shall be eligible for re-appoinrment for another term of five years or up to the age of sixty-five years, whichever is earlier, subject to the condition that he fulfills the qualifications and other conditions for appointment mentioned in clause (b) of sub-section (1) and such re-appointment is also made on the basis of the recommendation of the Selection Committee.

Resignation - A member may resign his office in writing under his hand addressed to the State Government and on such resignation being accepted, his office shall become vacant. The vacancy may be filled by appointment of a person possessing any of the qualifications mentioned in sub-section (1) in relation to the category of the member who has resigned.

Salary and terms of service: The salary or honorarium and other allowances payable to, and the other terms and conditions of service of the members of the District Forum shall be prescribed by the State Government.

Manner in which complaint shall be made.—

(1) A complaint in relation to any goods sold or delivered or agreed to be sold or delivered or any service provided or agreed to be provided may be filed with a District Forum by:

(a) the consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided;

(b) any recognized consumer association whether the consumer to whom the goods sold or delivered or agreed to be sold or delivered or service provided or agreed to be provided is a member of such association or not;

(c) one or more consumers, where there are numerous consumers having the same interest, with the petmission of the District Forum, on behalf of, or for the benefit of, all consumers so interested; or

(d) the Central Government or the State Government, as the case may be, either in its individual capacity or as a representative of interests of the consumers in general.

(2) Every complaint filed under sub-section (1) shall be accompanied with such amount of fee and payable in such manner as may be prescribed.

(3) On receipt of a complaint made under sub-section (1), the District Forum may, by order, allow the complaint to be proceeded with or rejected. However a complaint shall not be rejected under this section unless an opportunity of being heard has been given to the complainant.

The admissibility of the complaint shall ordinarily be decided within twenty-one days from the date on which the complaint was received. Where a complaint is allowed to be proceeded with under sub-section (3), the District Forum may proceed with the complaint in the manner provided under this Act. However, where a complaint has been admitted by the District Forum, it shall not be transferred to any other court or tribunal or any authority set up by or under any other law for the time being in force.

PROCEDURE ON ADMISSION OF COMPLAINT

(1) The District Forum shall, on admission of a complaint, if it relates to any goods:

(a) refer a copy of the admitted complaint to the opposite party mentioned in the complaint. It shall direct the opposite party to give his version of the case within a period of thirty days. This period may be extended by a further period not exceeding fifteen days as may be granted by the District Forum.

(b) where the opposite party on receipt of a complaint referred to him under clause *(a)* denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District Forum, the District Forum shall proceed to settle the consumer dispute in the manner specified in clauses (c) to (g);

(c) where the complaint alleges a defect in the goods which cannot be determined without proper analysis or test of the goods, the District Forum shall obtain a sample of the goods from the complainant, seal it and authenticate it in the manner prescribed and refer the sample so sealed to the appropriate laboratory along with a direction that such laboratory make an analysis or test, whichever may be necessary, with a view to finding out whether such goods suffer from any defect alleged in the complaint or from any other defect and to report its findings thereon to the District Forum within a period of forty-five days of the receipt of the reference or within such extended period as may be granted by the District Forum;

(d) before any sample of the goods is referred to any appropriate laboratory under clause (c) for analysis or test, the District Forum may require the complainant to deposit to the credit of the Forum such fees as may be specified, for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question;

(e) the District Forum shall remit the amount deposited to its credit under clause (d) to the appropriate laboratory to enable it to carry out the analysis or test mentioned in clause (c) and on receipt of the report from the appropriate laboratory, the District Forum shall forward a copy of the report along with such remarks as the District Forum may feel appropriate to the opposite party;

(f) if any of the parties disputes the correctness of the findings of the appropriate laboratory, or disputes the correctness of the methods of analysis or test adopted by the appropriate laboratory, the District Forum shall require the opposite party or the complainant to submit in writing his objections in regard to the report made by the appropriate laboratory;

NOTES

(g) the District Forum shall thereafter give a reasonable opportunity to the complainant as well as the opposite party of being heard as to the correctness or otherwise of the report made by the appropriate laboratory and also as to the objection made in relation thereto. Thereafter, it shall issue an appropriate order under section 14.

(2) the District Forum shall, if the complaint admitted by it under section 12 relates to goods in respect of which the procedure specified in sub-section (1) cannot be followed, or if the complaint relates to any services,—

(a) refer a copy of such complaint to the opposite party directing him to give his version of the case within a period of thirty days or such extended period not exceeding fifteen days as may be granted by the District Forum;

(b) where the opposite party, on receipt of a copy of the complaint, referred to him under clause (a) denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District Forum.

The District Forum shall proceed to settle the consumer dispute,

(i) ex parte on the basis of evidence brought to its notice by the complainant and the opposite party, where the opposite party denies or disputes the allegations contained in the complaint, or

(ii) ex parte on the basis of evidence brought to its notice by the complainant where the opposite party omits or fails to take any action to represent his case within the time given by the Forum, or

(iii) where the complainant fails to appear on the date of hearing before the District Forum, the District Forum may either dismiss the complaint for default or decide it on merits.

Every complaint shall be heard as expeditiously as possible and endeavour shall be made to decide the complaint within a period of three months from the date of receipt of notice by opposite party where the complaint does not require analysis or testing of commodities and within five months, if it requires analysis or testing of commodities.

No adjournment shall be ordinarily granted by the District Forum unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by the Forum.

The District Forum shall make such orders as to the costs occasioned by the adjournment as may be provided in the regulations made under this Act.

In the event of a complaint being disposed of after the period so specified, the District Forum shall record in writing, the reasons for the same at the time of disposing of the said complaint.

Where during the presidency of any proceeding before the District Forum, it appears to it necessary, it may pass such interim order as is just and proper in the facts and circumstances of the case.

Note: Although this procedure may be followed by all - the District Forum, State Commission, and National Commission, we have used the name of 'District Forum' while describing the procedure.

What is an appropriate laboratory under the Act?

Section 2(1)(*a*) of the Act defines an "appropriate laboratory" as a laboratory or organization

NOTES

i) recognized by the Central Government;

ii) recognized by a State Government, subject to such guidelines as may be prescribed by the Central Government in this behalf; or

iii) any such laboratory or organization established by or under any law for the time being in force, which is maintained, financed or aided by the Central Government or a State Government for carrying out analysis or test of any goods with a view to determining whether such goods suffer from any defect.

Powers of the District Forum: The District Forum shall have the same powers as are vested in a civil court under Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:—

i) the summoning and enforcing the attendance of any defendant or witness and examining the witness on oath;

ii) the discovery and production of any document or other material object producible as evidence;

iii) the reception of evidence on affidavits;

iv) the requisitioning of the report of the concerned analysis or test from the appropriate laboratory or from any other relevant source;

v) issuing of any commission for the examination of any witness, and

vi) any other matter which may be prescribed.

Every proceeding before the District Forum shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 of the Indian Penal Code, 1860, and the District Forum shall be deemed to be a civil court for the purposes of section 195, and Chapter XXVI of the Code of Criminal Procedure, 1973.

Where the complainant is a consumer, the provisions of rule 8 of Order I of the First Schedule to the Code of Civil Procedure, 1908 shall apply subject to the modification that every reference therein to a suit or decree shall be construed as a reference to a complaint or the order of the District Forum thereon.

In the event of death of a complainant who is a consumer or of the opposite party against whom the complaint has been filed, the provisions of Order XXII of the First Schedule to the Code of Civil Procedure, 1908 (5 of 1908) shall apply subject to the modification that every reference therein to the plaintiff and the defendant shall be construed as reference to a complainant or the opposite party, as the case may be.

CONSUMER DISPUTES REDRESSAL COMMISSION:

(State Commission [Section 16]) –

After the District Forum, State Commission is next in the hierarchy of Consumer Rederessal Forums under the Act.

Check Your Progress

3. What is a Complaint?
4. Explain Consumer Protection Councils?
5. What do you mean Jurisdiction?

NOTES

Composition –

1) State Commission consists of a president and two members one of whom is to be a woman.

2) a person who is or has been a Judge of a High Court, appointed by the State Government, who shall be its President.

Appointing Authority –

President of a State Commission is appointed by the State Government after consultation with the Chief Justice of the High Court. Other members of the Commission are made by the State Government on the recommendation of a selection committee consisting of the following, namely—

(*i*) President of the State Commission
— Chairman.

(*ii*) Secretary of the Law Department of the State
— Member.

(*iii*) Secretary, incharge of Department dealing with consumer affairs in the State
— Member

Term of Office [Section 16(3)] - Every member of the State Commission shall hold office for five years or upto the age of 67 years whichever is earlier and he shall not be eligible for re-appointment.

Vacancy- Rules as to the vacancy related in the office of the president or any member are similar to those discussed in context of the members of the District Forum.

Salary and Terms of Service [Section 16(2)] - The salary or honorarium and other allowances payable to, and the other terms and conditions of service of, the members of the State Commission shall be such as may be prescribed by the State Government.

NATIONAL CONSUMER DISPUTES REDRESSAL COMMISSION

(National Commission [Section 20]) –

The National Commission is the top most layer in the three level hierarchy of the Consumer Forums.

Composition - The National Commission consists of a president, and four other members (one of whom is to be a woman). The president should be the one who is or has been a Judge of the Supreme Court, and the members should be the persons of ability, integrity and standing and have adequate knowledge or experience of, or have shown capacity in dealing with, problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

Appointing Authority - The President is appointed by the Central Government after consultation with the Chief Justice of India.The appointment of other members of the Commission is made by the Central Government on the recommendation of a selection committee.

This selection committee consists of, namely:—

(*a*) a person who is a Judge of the Supreme Court, to be nominated by the Chief Justice of India — Chairman.

(*b*) the Secretary in the Department of Legal Affairs in the Government of India — Member.

(*c*) Secretary of the Department dealing with consumer affairs in the Government of India
— Member.

Term of Office [Section20(3)] - Every member of the National Commission is to hold office for a term of five years or upto the age of seventy years, whichever is earlier and not eligible for re-appointment.

Vacancy- A vacancy in the office of president or a member may occur after the expiry of his term, or by his death, resignation, or removal. In terms of provision of rule 12(3), the president or a member may resign his office in writing under his hand addressed to the Central Government, or he can be removed from his office in accordance with the provisions of rule 13.

Removal of the president and members in certain circumstances: In terms of Rule 13 of the Consumer Protection Rules, 1987, the Central Government may remove from office, the President or any member, who —

- has been adjudged as an insolvent; or
- has been convicted of an offence which, in the opinion of the Central Government, involves moral turpitude; or
- has become physically or mentally incapable of acting as the President or the member; or
- has so abused his position as to render his continuance in office prejudicial to the public interest; or
- remain absent in three consecutive sittings except for reasons beyond his control.

Note:

1) A casual vacancy caused by resignation or removal of the President or any other member of the National Commission is filled by fresh appointment.

2) When the President of the National Commission is unable to discharge the functions owing to absence, illness or any other cause, the senior most member of the National Commission with judicial background, if authorized to do so by the President in writing, shall discharge the functions of the President until the day on which the President resumes the charge of his functions.

NOTES

JURISDICTION

The term jurisdiction may be defined as authority or legal power to hear and decide the cases. Thus a court may adjudicate only those matters which fall under its jurisdiction. The question of jurisdiction has to be considered with reference to the value, place, and nature of the subject matter.

Example: A and B reside in Bombay. They have some dispute. Here the dispute may be subjected to the jurisdiction of the Bombay courts (except matters pettaining to Supreme Court). Courts of Delhi, or Chennai, or any other place for that matter cannot adjudicate the issue.

The general rule is that if the court rendering the judgment suffers from want of jurisdiction, its judgment is nullity and may be ignored. Jurisdiction of Consumer Forums (*i.e.*, consumer courts) differs in terms of monetary value of claims, geographical area, and appellate powers.

DISTRICT FORUM:

Pecuniary Jurisdiction - District Forum entertains the cases where the value of claim is upto Rs. 5 Lakh. Where a claim exceeds this limit, the matter is beyond the jurisdiction of the Forum. This limit of Rs. 5 lakh is as to the value of claim filed by the party. Value of goods or services in question or value of relief granted is not relevant for this purpose.

Example: 'A' purchased a machinery for Rs. 7 lakhs. After working for some time, the machine broke down due to some manufacturing defect. A filed a claim for compensation worth Rs. 4.5 lakh. Since the value of claim is less than Rs. 5 Lakh, it will fall under the jurisdiction of District Forum. The complainant has a right to reduce value of his claim in order to bring his claim within the jurisdiction of a junior forum.

Example: A filed a complaint with a District Forum claiming Rs. 6, 00,000 as against a supplier of machinery. The complaint was rejected on the ground that it was beyond the jurisdiction of the District Forum. A revised his claim to Rs. 4, 99,999 and filed the complaint again with the same District Forum. The complaint was accepted and tried.

Territorial Jurisdiction - Every District Forum has definite geographical limits within which it can exercise its jurisdiction. A case is supposed to fall within such territory when at the time of the institution of the complaint—

a) The party against whom the claim is made actually and voluntarily resides or carries on business or has a branch office or personally works for gain in that area, or

b) Where there are more than one opposite party, each such party actually and voluntarily resides or carries on business or has a branch office or personally works for gain in that area, or

c) Where there are more than one opposite party, and any such party actually and voluntarily resides or carries on business or has a branch office or personally works for gain in that area, provided the other parties not so residing or working agrees, or the District Forum gives permission in this regard,

d) The cause of action, wholly or in part, arises in that area.

Appellate Jurisdiction - District Forum is the lowest rung of the ladder of the consumer courts. Thus this is not an appellate court, *i.e.*, no appeal lies in this court.

STATE COMMISSION

Pecuniary Jurisdiction - State Commission entertains the cases where the value of claim exceeds Rs. 5 lakh. But where value of a claim exceeds Rs. 20 lakh, the matter is beyond the jurisdiction of the Commission.

Example: A of Delhi bought a house from housing board for Rs. 4 lakh. Due to defect in the house, its wall fell down on the daughter of A and she dies. A sue the Housing Board claiming Rs. 15 lakh as compensation. This matter will lie with the State Commission of Delhi.

Territorial Jurisdiction - The Consumer Protection Act does not specifically provide for the territorial jurisdiction of the State Commission. Thus it is governed by the general principles of the law which are contained in section 20 of the Civil Procedure Code.

Broadly these principles are on the similar lines on which the territorial jurisdiction of District Forum is based. Thus a suit can be instituted in the State Commission within whose local limits—

a) the party against whom the claim is made actually and voluntarily resides or carries on business or personally works for gain, or

b) where there are more than one opposite party, each such party actually and voluntarily resides or carries on business or personally works for gain, or

c) where there are more than one opposite party, and any such party actually and voluntarily resides or carries on business or has a branch office or personally works for gain, provided the other parties not so residing or working agrees, or the State Commission gives permission in this regard, or

d) the cause of action, wholly or in part, arises.

Appellate Jurisdiction [Section 17(*a*)(*ii*)] - State Commission has power to adjudicate upon the appeals made against the order of the District Forums. Any person aggrieved by an order made by the District Forum may prefer an appeal against such order within 30 days from the date of order. However, the State Commission may entertain an appeal after the expiry of 30 days if it is satisfied that there was sufficient cause for delay.

Revisional Jurisdiction [Section 17(*b*)] - State Commission may call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the State, where State Commission is of the view that the District Forum—

- has exercised jurisdiction which it was not entitled to, or
- has failed to exercise such jurisdiction which it was entitled to, or
- has exercised its jurisdiction illegally or with material irregularity.

NOTES

Such revisional jurisdiction may be exercised by the Commission on its own or on the application of a party.

NATIONAL COMMISSION

Pecuniary Jurisdiction - Since National Commission is the highest level of Consumer Forums, it may entertain all the matters where the value of claim exceeds Rs. 20 lakh.

Territorial Jurisdiction - The territorial jurisdiction of the National Commission is whole of India except the State of Jammu & Kashmir. However, the Consumer Protection Act is applicable only if the cause of action arises in India. If the cause of action arises out of India, National Commission has no jurisdiction over the matter.

Example: The complainant alleged that they were not properly treated by the Egyptian Airlines authorities at Barcelona. It was held that the cause of action arose at Barcelona, so the complaint under the Act is not maintainable in India.

Appellate Jurisdiction- The National Commission has jurisdiction to entertain appeals against the order of any State Commission. The appeal may be made within 30 days from the date of the order of the State Commission. However the National Commission may entertain an appeal filed after the expiry of 30 days if it is satisfied that there was sufficient cause for not filing the appeal within the given time.

Revisional Jurisdiction [Section 21(*b*)] - National Commission can call for the records and pass the appropriate orders in any consumer dispute which is pending before or has been decided by any State Commission it is of the view that the State Commission—

- has exercised jurisdiction which it was not entitled to, or
- has failed to exercise such jurisdiction which it was entitled to, or
- has exercised its jurisdiction illegally or with material irregularity.

Note that the revisional jurisdiction is available to the National Commission only in the cases where there has been wrongful, illegal, and improper exercise of jurisdiction or failure to exercise jurisdiction on the part of State Commission.

SUMMARY

- The Consumer Protection Act, 1986 was enacted for better protection of the interests of consumers.
- Consumer protection laws are designed to ensure fair trade competition and the free flow of truthful information in the marketplace.
- A "defect" has been defined in Section 2(1) (f) of the Act as "any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to maintained by or under any law for the time being in force or under any contract, express or implied, or as is claimed by the trader (which includes the manufacturer) in any manner whatsoever in relation to any goods."

- Consumer is defined as someone who acquires goods or services for direct use or ownership rather than for resale or use in production and manufacturing.
- An aggrieved consumer seeks redressal under the Act through the instrumentality of complaint. Complaint is a statement made in writing to the National Commission, the State Commission or the District Forum by a person competent to file it, containing the allegations in detail, and with a view to obtain relief provided under the Act.
- The State Government is authorized by the Act to establish by notification, councils at the Central, State & District levels to be known as "Central Consumer Protection Council", Consumer Protection Council & District Consumer Protection Council respectively.
- Rights of consumers: Right to safety, Right to information, Right to choose, Right to represent, Right to redressal, Right to education.
- Consumer Disputes Redressal Forum to be known as the **"District Forum"** established by the State Government in each district of the State by notification.
- Consumer Disputes Redressal Commission to be known as the "State Commission" established by the State Government in the State by notification; and National Consumer Disputes Redressal Commission established by the Central Government.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. The Consumer Protection Act is a social welfare legislation which was enacted as a result of widespread consumer protection movement.
2. A "defect" has been defined in Section 2(1) (f) of the Act as "any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to maintained by or under any law for the time being in force or under any contract, express or implied, or as is claimed by the trader (which includes the manufacturer) in any manner whatsoever in relation to any goods."
3. Complaint is a statement made in writing to the National Commission, the State Commission or the District Forum by a person competent to file it, containing the allegations in detail, and with a view to obtain relief provided under the Act.
4. The State Government is authorized by the Act to establish by notification, councils at the Central, State & District levels to be known as "Central Consumer Protection Council",
5. The term jurisdiction may be defined as authority or legal power to hear and decide the cases.

TEST YOURSELF

1) What do you mean by Consumer Protection Act? Give salient features of this Act.

NOTES

2) What are the general rights of consumers which need to protect by the councils?

3) Briefly describe Central Protection Council.

4) What do you mean by Jurisdiction?

5) Write a short note on:

   i) District Forum

   ii) State Commission

   iii) National Commission

FURTHER READING

- *Mercantile Law:Sharma, Sareen, Gupta and Chawla*

9 Foreign Exchange Management Act, 1973 (FEMA)

The Chapter Covers :

- Definitions (Sec. 2)
- Foreign Exchange Management Act, 1999
- Regulation And Management of Foreign Exchange
- Export of Goods And Services: (Sec. 7)
- Authorised Person
- Contravention And Penalities:
- Adjudicating Authority (Sec. 16)
- Directorate of Enforcement
- Employees' Provident Fund Scheme (1952)
- The Industries (Development And Regulation) Act, 1951
- Central Advisory Council And Development Councils
- Dissolution of Development Councils
- Imposition of Cess On Scheduled Industries In Certain Cases
- Regulation of Scheduled Industries
- Revocation of Registration In Certain Cases

INTRODUCTION

An Act to consolidate and amend the law regulating certain payments, dealings in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import and export of currency, for the conservation of the foreign exchange resources of the country and the proper utilisation thereof in the interests of the economic development of the country.

(1) This Act may be called the Foreign Exchange Regulation Act, 1973.

(2) It extends to the whole of India.

(3) It applies also to all citizens of India outside India and to branches and agencies outside India of companies or bodies corporate, registered or incorporated in India.

NOTES

(4) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint in this behalf:

Provided that different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

Definitions (Sec. 2)

Sec. 2 of the Act defines a number of words and phrases used in the various provisions of the Act. Some of the important definitions given in Sec. 2 of the Act are as under:

1. **"Adjudicating Authority"** [Sec. 2 (a)] means an officer authorised under sec. 16(1).
2. **"Appellate Board"** means the Foreign Exchange Regulation Appellate Board constituted by the Central Government under sub-section (1) of section 52;
3. **"Appellate Tribunal"** means the Appellate Tribunal for foreign exchange establishes under sec. 18.
3. **"Authorised dealer"** means a person for the time being authorised under section 6 to deal in foreign exchange;
4. **"Bearer certificate"** means a certificate of title to securities by the delivery of which (with or without endorsement) the title to the securities is transferable;
5. "Certificate of title to a security" means any document used in the ordinary course of business as proof of the possession or control of the security, or authorising or purporting to authorise, either by an endorsement or by delivery, the possessor of the document to transfer or receive the security thereby represented;
6. "Coupon" means a coupon representing dividends or interest on a security;
7. "currency" includes all coins, currency notes, banks notes, postal notes, postal orders, money orders, cheques, drafts, traveller's cheques, letters of credit, bills of exchange and promissory notes;
8. **"Foreign currency"** means any currency other than Indian currency;
9. **"Foreign exchange"** means foreign currency and includes -
   (i) all deposits, credits and balances payable in any foreign currency, and any drafts, traveller's cheques, letters of credit and bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency;
   (ii) any instrument payable, at the option of the drawee or holder thereof or any other party thereto, either in Indian currency or in foreign currency or partly in one and partly in the other;
10. **"Foreign security"** means any security in the form of shares, stocks, bonds, debentures or any other instruments denominated or expressed in foreign currency. It also includes securities expressed in foreign currency, where redemption or any form of return such as interest or dividend is payable in Indian currency.
11. **"Indian currency"** means currency which is expressed or drawn in Indian rupees but does not include special bank notes and special one-rupee notes issued under section 28A of the Reserve Bank of India Act, 1934;
12. **"Indian custom waters"** means the waters extending into the sea to a distance of twelve nautical miles measured from the appropriate base line on the coast of India and includes any bay, gulf, harbour, creek or tidal river;.
13. **"Money-changer"** means a person for the time being authorised under section 7 to deal in foreign currency;

14. **"Overseas market"**, in relation to any goods, means the market in the country outside India and in which such goods are intended to be sold;
15. **"Owner"**, in relation to any security, includes any person who has power to sell or transfer the security;
16. **"Person"** includes-
    i) an individual,
    ii) a Hindu Undivided family,
    iii) a company,
    iv) a firm, etc.
17. **"Person resident in India"** means –
    i) a person residing in India for more than 182 days during the course of the preceding financial year but does not include-
    ii) a person who has gone out of India or who stays outside India, in either case-
        a) for or on taking up employment outside India; or
        b) for carrying on outside India a business or vocation;
        c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;
    iii) any person or body corporate registered or incorporated in India,
    iv) an office, branch or agency in India owned or controlled by a person resident outside India,
    v) an office, branch or agency outside India owned or controlled by a person resident in India.

    For Example: When any Indian citizen proceeds abroad for business visits or medical treatment or higher studies and for such other purposes as to stay with his or her spouse for some time, which do not indicate his intention to stay outside India for any indefinite or uncertain period, he will be treated as a person resident in India during his temporary absence from India.
18. **"Person resident outside India"** means a person who is not a resident in India;
19. **"Precious stone"** includes pearl and semi-precious stone and such other stone or gem as the Central Government may for the purposes of this Act, notify in this behalf in the Official Gazette;
20. **"Prescribed"** means prescribed by rules made under this Act;
21. **"Reserve Bank"** means the Reserve Bank of India constituted under Sec. 3(1) of the Reserve Bank of India Act, 1934.
22. "Security" means
    a) shares, stocks, bonds, debentures, debenture stock,
    b) Government securities as defined in the Public Debt Act, 1944,
    c) savings certificates to which the Government Savings Certificates Act, 1959 applies,
    d) deposit receipts in respect of deposits of securities, and
    e) units or sub-units of the Unit Trusts of India establishes under section 3(1) of the Unit Trust of India Act, 1963 or of any mutual fund.

Check Your Progress

1. Define Currency?
2. What is an Overseas Market?

NOTES

It also includes certificates of title to securities, but it does not include bills of exchange or promissory notes other than Government promissory notes or any other instrument which may be notified by the Reserve Bank as security for the purpose of this Act.

23. "Transfer", includes sale, purchase, exchange, mortgage, pledge, gift, loan, or any other form of transfer of right, title, possession or lien.
24. "Director of Enforcement" means the Director of Enforcement appointed under Sec. 36(1).
25. "Export" means-
    i) taking out of India to a place outside India any goods,
    ii) provisions of services from India to any person outside India.
26. "Import" means bringing into India any goods and services.

FOREIGN EXCHANGE MANAGEMENT ACT, 1999

INTRODUCTION

Foreign Exchange Management Act or in short (FEMA) is an act that provides guidelines for the free flow of foreign exchange in India. The Foreign Exchange Management Act (FEMA), 1999 has repealed the Foreign Exchange Regulation Act (FERA), 1973. It has brought a new management regime of foreign exchange consistent with the emerging frame work of the World Trade Organisation (WTO). Foreign Exchange Management Act was earlier known as FERA (Foreign Exchange Regulation Act), which has been found to be unsuccessful with the proliberalisation policies of the Government of India. The FEMA consolidates and amends the law relating to foreign exchange with the objective-

1) of facilitating external trade and payments, and

2) for promoting the orderly development and maintenance of foreign exchange market in India.

The Act was passed by Lok Sabha on 2nd December, 1999. It extends to the whole of India [Sec.1 (2)]. It shall also apply to all branches, offices and agencies located outside India owned or controlled by a person resident in India and also to any contravention thereunder committed outside India by any person to whom this Act applies [Sec.1 (3)].

Comparison between FEMA and FERA

The main aim of FERA was to control everything that was specified, relating to foreign exchange whereas FEMA lays down that 'everything other than what is expressly covered is not controlled'. The overriding objective of FERA was to regulate and minimise dealings in foreign exchange and foreign securities while FEMA on the other hand aims to aid in creation of a liberal foreign exchange market in India. This difference in terminology reflects seriousness of government towards deregulation of foreign exchange and promotion of free flow of international trade. To facilitate external trade, section 5 of the Act removes restrictions on withdrawal of foreign exchange for the purpose of current account transactions. As external trade i.e. import / export of goods & services involve transactions on current account, there is no need for seeking RBI permissions in connection with remittances involving external trade. This is a marked deviation from FERA that under section 6 restricted imports and regulated exports, despite the government commitment to push for exports. The emphasis of FEMA is on Reserve Bank of India laying down the regulations rather than granting permissions on case-to-case basis. This transition has taken away the

concept of "exchange control" and brought in the era of "exchange management". In view of this change, the title of the legislation has rightly been changed from 'Foreign Exchange Regulation Act' to 'Foreign Exchange Management Act'. The main change that has been brought is that FEMA is a civil law, whereas the FERA was a criminal law.

REGULATION AND MANAGEMENT OF FOREIGN EXCHANGE

Dealings in foreign exchange, etc (Sec.3)

Prohibitions of dealings in foreign exchange: No person shall-

a) deal in or transfer any foreign exchange or foreign security to any person not being an authorized person;

b) make any payment to or for the credit of any person resident outside India in any manner;

Meaning of 'payment': The word 'payment' has to be understood in its ordinary sense of meaning, namely, the action or act of paying. It covers the cases of the money which may be received by an agent whose duty is to pass on the money to others on the direction of the person who is the owner of the money.

c) receive otherwise through an authorised person, any payment by order or on behalf of any person resident outside India in any manner;

d) enter 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 (Sec. 4)

No person resident in India shall acquire, hold, own, posses or transfer any foreign exchange, foreign security or any immovable property situated outside India.

Current Account Transactions (Sec. 5)

Any person sells or draws foreign exchange to or from an authorised person if such sale is a current account transaction. However, the Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed.

Capital Account Transactions (Sec. 6)

Foreign exchange transaction through authorised person: Any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction. This is however, subject to the provision of Sec. 6(2) [Sec. 6(1)].

Specification of Capital Account transactions and limit: The Reserve Bank may, in consultation with the Central Government, specify-

1) any class or classes of capital account transactions which are permissible;

2) the limit upto which foreign exchange shall be admissible for such transactions [Section. 6(2)].

The Reserve Bank shall not however, impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

Prohibition of certain transactions: The Reserve Bank may, by regulations, prohibit or restrict or regulate the following:

1) transfer or issue of any foreign security by a person resident in India;

2) transfer or issue of any security by a person resident outside India;

3) transfer or issue of any security or foreign security by any branch, office, or agency in India of a person resident outside India;

4) any borrowing or lending in foreign exchange in whatever form or by whatever name called;

5) any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;

6) deposits between persons resident in India and a person outside India;

7) export, import, or holding of currency or currency notes.

EXPORT OF GOODS AND SERVICES: (SEC. 7)

Furnishing of Declaration: Evety exporter of goods shall:

a) furnish to the Reserve Bank or to such other authority a declaration in such form and in such manner as may be specified, containing:

   i) true and correct material particulars, including the amount representing the full export value, or

   ii) if the full export value of the goods is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India.

   Declaration to be true: The declaration made under Sec.7 must be a true declaration. The section also provides for the affirmation that the full export value of the goods either has been received or will be received in the prescribed period.

   Full export value of the goods: It means nothing more than the whole of the price agreed between the parties and, therefore, if the declaration of the value is less than that has been agreed, it will amount to rhe under-invoicing of rhe goods.

b) 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 by such exporter [sec.7 (1)].

   Ensuring of receipt of value of goods: The Reserve Bank may, for the purpose of ensuring that the full export value of the goods or such reduced value of the goods as the Reserve Bank determines, having regard to the prevailing market conditions, is received without any delay, direct any exporter to comply with such requirements as ir deems fit [sec.7 (2)].

   Exporter of services to furnish declaration to Reserve Bank: Every exporter of services shall furnish to the Reserve Bank or such other authorities a declaration in such form and in such manner as may be specified, containing the true and correct material particulars in relation to payment for such services [sec.7 (3)].

AUTHORISED PERSON

Authorised Person (Sec.10)

Granting authorisation on application: The Reserve Bank made an application, and authorise any person to be known as authorised person to deal in foreign exchange

or in foreign securities, as an authorised dealer, money changer or off-shore banking unit. The authorisation shall be in writing and shall be subject to the conditions laid down therein.

Revocation of Authorisation: An authorisation may be revoked by the Reserve Bank at any time if the Reserve bank is satisfied that:

a) it is in public interest so to do; or

b) the authorised person-

i) has failed to comply with the conditions subject to which the authorisation was granted; or

ii) has contravened any of the provisions of the Act.

Declaration: An authorised person, before undertaking any transaction in foreign exchange on behalf of any person, require that person to make such declaration and to give such information to him that the transaction will not involve, and is not designed for the purpose of any contravention or evasion of the provisions of this Act or of any rule, regulation, notification, direction or order made there under.

CONTRAVENTION AND PENALITIES:

Contravention: The following contraventions by any person are liable to a penalty, i.e. contravention of-

a) any provision of this Act, or

b) any rule, tegulation, notification, direction or order issued in exercise of the powers under this Act, or

c) any condition subject to which an authorisation is issued by the Reserve Bank.

The penalty shall be levied upon adjudication (i.e. after hearing and determining judicially by the Adjudicating Authority).

Amount of Penalty: Where the amount is quantifiable, the penalty may be up to thrice the sum involved in the contravention. Where the amount is not quantifiable, the penalty may be up to Rs. 2, 00,000. Where contravention is a continuing one, further penalty which may extend to Rs. 5, 000 may be levied for every day after the first day during which the contravention continues [Sec. 13(1)].

ADJUDICATING AUTHORITY (Sec. 16)

Appointment: For the purpose of adjudication, the Central Government may appoint officers of the Central Government as the Adjudicating Authorities. The appointment shall be made by an order published in the Official Gazette, for holding an inquiry in the manner prescribed against whom the complaint has been made.

Jurisdiction: The Central Government shall, while appointing the Adjudicating Authorities, also specify in the order published in the Official Gazette their respective jurisdiction [Sec.16 (2)].

Appeal to Special Director (Appeals) (Sec. 17)

Appointment: The Central Government shall, by notification, appoint one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities. It shall also specify in the said notification the matter and places in relation to which the Special Director (Appeals) may exercise jurisdiction [Sec. 17(1)].

Appeal: Any person aggrieved by an order made by the Adjudicating Authority may prefer an appeal to the Special Director. The appeal shall be filed within 45 days

NOTES

from the date on which the copy of the order made by the Adjudicating Authority is received [Sec.17(3)].

Establishment of Appellate Tribunal (Sec. 18):

The Central Government shall, by notification, establish an Appellate Tribunal to be known as the Appellate Tribunal for Foreign Exchange to hear appeals against the orders of the Adjudicating Authorities and the Special Director (Appeals) under this Act.

DIRECTORATE OF ENFORCEMENT

Establishment: The Central Government shall establish a Directorate of Enforcement. The Central Government may authorise the Director of Enforcement or an Additional Director of Enforcement or Special Director of Enforcement or a Deputy Director of Enforcement to appoint officers of Enforcement below the rank of an Assistant Director of Enforcement [Sec. 36(2)].

EMPLOYEES' PROVIDENT FUND SCHEME (1952)

Definitions

1. **Appropriate Government** [Section 2(A)]: It may be either Central Government or the State Government. In the following cases, the appropriate government is Central Government:
   - i) in relation to an establishment belonging to, or under the control of, the Central Government, or
   - ii) in relation to an establishment connected with a railway company, a major port, a mine or an oil-field, or
   - iii) a controlled industry, or
   - iv) in relation to an establishment having departments or branches in more than one State.

   In relation to any other establishment, the appropriate Government means the State Government [sec. 2(a) (ii)].
2. **Authorised officer:** It means the Central Provident Fund Commissioner, Additional Central Provident Fund Commissioner, Deputy Provident Fund Commissioner, Regional Provident Fund Commissioner or such other officer as may be authorised by the Central Government, by notification in the Official Gazette.
3. **Basic wages:** It means all emoluments which are earned by an employee while on duty or on leave or on holidays with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include-
   - (i) the cash value of any food concession;
   - (ii) any dearness allowance (that is to say, all cash payments by whatever name called paid to an employee on account of a rise in the cost of living), e.g. , house-rent allowance, overtime allowance, bonus, commission or any other similar allowance payable to the employee in respect of his employment or of work done in such employment;
   - (iii) any presents made by the employer.
4. **Contribution:** It means a contribution payable in respect of a member under a scheme or the contribution payable in respect of an employee to whom the Insurance Scheme applies.

5. **Controlled industry:** It means any industry, the control of which by the Union of India has been declared by a Central Act to be expedient in the public interest.

6. **Employer:** It may mean the owner or occupier or any authority which has the ultimate control over the affairs of the establishment.

   In relation to an establishment which is a factory, the employer means the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier. Where a person has been named as a manager of the factory under section 7(1) (f) of the Factories Act, 1948, the person so named is the employer.

   In relation to any other establishment, the employer means the person who, or the authority which, has the ultimate control over the affairs of the establishment, and where the said affairs are entrusted to a manager, managing director or managing agent, such manager, managing director or managing agent.

7. **Employee:** It means any person who is employed for wages in any kind of work, manual or otherwise, in or in connection with the work of an establishment and who gets his wages directly or indirectly from the employer, and includes any person,-
   (i) employed by or through a contractor in or in connection with the work of the establishment;
   (ii) engaged as an apprentice, not being an apprentice engaged under the Apprentices Act, 1961 (52 of 1961) or under the standing orders of the establishment.

8. **Exempted employee:** It means an employee to whom a Scheme or the Insurance Scheme, as the case may be would, but for the exemption granted under section 17, have applied.

9. **Exempted establishment:** It means an establishment in respect of which an exemption has been granted under section 17 from the operation of all or any of the provisions of any Scheme or the Insurance Scheme, as the case may be, whether such exemption has been granted to the establishment as such or to any person or class of persons employed therein.

10. **Factory:** It means any premises, including the precincts thereof, in any part of which a manufacturing process is being carried on or is ordinarily so carried on, whether with the aid of power or without the aid of power.

11. **Fund:** It means the Provident Fund established under a Scheme.

12. **Industry:** It means any industry specified in Schedule I, and includes any other industry added to the Schedule by notification under section 4.

13. **Insurance Fund:** It means the Deposit-linked Insurance Scheme framed under sub-section 2 of section 6C.

14. **Insurance Scheme:** It means the Employees' Deposit-linked Insurance Scheme framed under sub-section (i) of section 6C.

15. **Manufacture or Manufacturing Process:** It means any process for making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal.

16. **Member:** It means a member of the Fund.

17. **Occupier of a factory:** It means the person, who has ultimate control over the affairs of the factory, and, where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory.

18. **Pension Fund:** It means the Employees' Pension Fund established under sub-section 2 of section 6A;
19. **Pension Scheme:** It means the Employees' Pension Scheme framed under sub-section 1 of section 6A;
20. **Prescribed:** It means prescribed by rules made under this Act.
21. **Recovery Officer:** It means any officer of the Central Government, State Government or the Board of Trustees constituted under section 5A, who may be authorised by the Central Government, by notification in the Official Gazette, to exercise the powers of a Recovery Officer under this Act.
22. **Scheme:** It means the Employees' Provident Funds scheme framed under section 5.
24. **Tribunal:** It means the Employees' Provident Funds Appellate Tribunal constituted under section 7D.

Employees' Provident Funds Scheme –

The Central Government is empowered to frame a scheme to be called the Employees' Provident Fund Scheme for the establishment of provident funds under this Act. However, before framing any such scheme, the Central Government shall have to issue a notification in the Official Gazette. The Provident Funds may be established for employees or for any class of employees. The Notification is to specify the establishments or class of establishments to which they said Scheme shall apply.

As soon as may be after the framing of the Scheme, a Fund shall be established in accordance with the provisions of this Act and the Scheme.

The Fund shall vest in, and be administered by, the Central Board constituted under section 5A. Subject to the provisions of this Act, a Provident Fund Scheme may provide for all or any of the matters specified in Schedule II. Further, any such Scheme shall take effect either prospectively or retrospectively on such date as may be specified in this behalf in the Scheme.

Thus (sec.5) confers two powers on the Central Government:

1. to frame a Provident Fund Scheme; and
2. to specify to which establishments, the Scheme shall apply.

The above mentioned Scheme may provide that any of its provisions shall be effective either prospective and retrospectively on such date as may be specified in this behalf in the Scheme.

In exercise of the power conferred under section 5, the Central Government framed a Provident Fund Scheme, 1952. The salient features of the Scheme are as follows:

1. **Class of employees entitled are required to become members of the Scheme :** Every employee in or in connection with the work of the factory or other establishments to which this Scheme applies other than an 'excluded employee' shall be entitled and required to become a member of the Fund from the date of joining the factory or establishment. Employees drawing a pay not exceeding Rs. 5,000 per month shall be eligible to join Provident Fund Scheme.

2. **Contributions:**

   i) **Rate of Contribution (section 6) :** According to the section 6 of the Act, the contribution paid to the Fund by the employer shall be 10 % of the basic wages and the dearness allowance and the retaining allowance and the contribution payable by the employee shall be equal to the employer's contribution. Employees, if they desire may make higher contribution.

The Central Government may, by notification, specify contribution to be 12 % in certain industries.

ii) **Payment of Contribution** : The employers shall, in the first instance, pay both the contribution payable by himself and also on behalf of the members employed by him directly or through a contractor, the contribution payable by such member. In respect of employees employed or through a contractor, the contractor shall recover the member's contribution and shall pay to the principal employer the amount of the member's contribution so deducted together with an equal amount of employer's contribution and also administrative charges.

3. **Investment** : The amount received by way of Provident Fund contributions is to be invested by the Board of Trustees in accordance with the investment pattern approved by the Government of India. The members get interest on the money standing to their credit at a rate recommended by the Board of Trustees and approved by the Government of India.
4. **Advances and Withdrawals** : Advances and withdrawals upto certain limits are allowed for certain specified purposes only.

THE INDUSTRIES (DEVELOPMENT AND REGULATION) ACT, 1951

The Industries (Development and Regulation) Act provides the conceptual and legal framework for industrial development and industries in India. It is briefly known as the IDR Act. The act was enacted in 1951 and a number of amendments have been made in the Act.

Objective:

The main objective of the IDRA is to empower the Government:

- To take necessary steps for the development of industries.
- To regulate the pattern and direction of industrial development.
- To control the activities, performance and results of industrial undertakings in the public interest.

I. PRELIMINARY

1. **Short title extent and commencement**
   (1) This Act may be called the Industries (Development and Regulation) Act, 1951.
   (2) It extends to the whole of India.
   (3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.
2. **Declaration as to expediency of control by the Union**
   It is hereby declared that it is expedient in the public interest that the Union should take under its control the industries specified in Schedule I.
3. **Definitions**
   In this Act unless the context otherwise requires -
   (a) **Advisory Council:** It means the Central Advisory Council established under Section 5.
   (b) **Ancillary industrial undertaking:** It means an industrial undertaking which in accordance with the provision to sub-Section (1) of Section 11B and the

Check Your Progress
3. What is FEMA?
4. Define Appeal?

NOTES

requirements specified under that sub-Section, is entitled to be regarded as an ancillary industrial undertaking for the purposes of this Act.

(c) **Current assets:** It means bank balances and cash and includes such other assets or reserves which are expected to be realised in cash or sold or consumed within a period of not more than twelve months in the ordinary course of business. For Example: stock-in-trade, amounts due from sundry debtors for sale of goods and for services rendered, advance tax payments and bills receivable, but it does not include sums credited to a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees, maintained by a company owning an industrial undertaking.

(d) **Current liabilities:** It means liabilities which must be met on demand or within a period of twelve months from the date they are incurred; and include any current liability which is suspended under Section 18FB.

(e) **Development Council:** It means a Development Council established under Section 6.

(f) **Existing industrial undertaking:** It means -

i) in the case of an industrial undertaking pertaining to any of the industries specified in the Schedule I as originally enacted, an industrial undertaking which was in existence on the commencement of this Act or for the establishment of which effective steps had been taken before such commencement, and

ii) in the case of an industrial undertaking pertaining to any of the industries added to Schedule I by an amendment thereof an industrial undertaking which is in existence on the coming into force of such amendment or for the establishment of which effective steps had been taken before the coming into force of such amendment.

(g) **Factory:** Factory means any premises including the precincts thereof in any part of which a manufacturing process is being carried on or is ordinarily so carried on –

i) with the aid of power provided that fifty or more workers are working or were working thereon on any day of the preceding twelve months; or

ii) without the aid of power provided that one hundred or more workers are working or were working thereon on any day of the preceding twelve months and provided further that in no part of such premises any manufacturing process is being carried on with the aid of power;

(h) **High Court** means the High Court having jurisdiction in relation to the place at which the registered office of a company is situate.

(i) **Industrial undertaking** means any undertaking pertaining to a scheduled industry carried on in one or more factories by any person or authority including government.

NOTES

(j) **New article** in relation to an industrial undertaking which is registered or in respect of which a licence or permission has been issued under this Act means –

a) any article which falls under an item in the Schedule I other than the item under which articles ordinarily manufactured or produced in the industrial undertaking at the date of registration or issue of the licence or permission as the case may be fall;

b) any article which bears a mark as defined in the Trade Marks Act, 1940, or which is the subject of a patent if at the date of registration or issue of the licence or permission, as the case may be the industrial undertaking was not manufacturing or producing such article bearing that mark or which is the subject of the patent.

(k) **Notified order** means an order notified in the Official Gazette.

(l) **Owner** in relation to an industrial undertaking means the person who or the authority which has the ultimate control over the affairs of the undertaking and where the said affairs are entrusted to a manager managing director or managing agent such manager managing director or managing agent shall be deemed to be the owner of the undertaking;

(m) **"Prescribed"** means prescribed by rules made under this Act;

(n) **"Schedule"** means a Schedule to this Act;

(o) **"Scheduled industry"** means any of the industries specified in the Schedule I;

(p) **"Small scale industrial undertaking"** means an industrial undertaking which in accordance with the requirements specified under sub-Section (1) of Section 11B is entitled to be regarded as a small scale industrial undertaking for the purposes of this Act.

CENTRAL ADVISORY COUNCIL AND DEVELOPMENT COUNCILS

Establishment and constitution of Central Advisory Council and its functions

1) For the purpose of advising it on matters concerning the development and regulation of scheduled industries the Central Government may be notified order establish a Council to be called the Central Advisory Council.

2) The Advisory Council shall consist of a Chairman and such other members not exceeding thirty in number all of whom shall be appointed by the Central Government from among persons who are in its opinion capable of representing the interests of –

i) owners of industrial undertakings in scheduled industries;

ii) persons employed in industrial undertakings in scheduled industries,

iii) consumers of goods manufactured or produced by scheduled industries;

NOTES

iv) such other class of persons including primary producers as in the opinion of the Central Government ought to be represented on the Advisory Council.

3) The term of office of the procedure to be followed in the discharge of their functions by and manner of filling casual vacancies among members of the Advisory Council shall be such as may be prescribed.

4) The Central Government shall consult the Advisory Council in regard to the making of any rules other than the first rules to be made under sub-Section (3).

It may also consult the Advisory Council in regard to any other matter connected with the administration of this Act.

Establishment and constitution of Development Councils and their functions

(1) The Central Government may be notified order establish for any scheduled industry or group of scheduled industries, a body of person to be called a Development Council which shall consist of members who in the opinion of the Central Government are -

a) persons capable of representing the interests of owners of industrial undertakings in the scheduled industry or group of scheduled industries;

b) persons having special knowledge of matters relating to the technical or other aspects of the schedule industry or group of scheduled industries;

c) persons capable of representing the interests of persons employed in industrial undertakings in the scheduled industry or group of scheduled industries;

d) persons not belonging to any of the aforesaid categories who are capable of representing the interests of consumers of goods manufactured or produced by the scheduled industry or group of scheduled industries.

(2) The number and the term of office of and the procedure to be followed in the discharge of their functions by and the manner of filing casual vacancies among members of a Development Council shall be such as may be prescribed.

(3) Every Development Council shall be by virtue of this Act a body corporate by such name as may be specified in the notified order establishing it and may hold and transfer property and shall by the said name sue and be sued.

(4) A Development Council shall perform such functions of a kind specified in the Schedule II as may be assigned to it by the Central Government which is expedient to provide in order to increase the efficiency or productivity in the scheduled industry or group of scheduled industries for which the Development Council is established.

(5) A Development Council shall also perform such other functions as it may be required to perform by or under any other provision of this Act.

DISSOLUTION OF DEVELOPMENT COUNCILS

(1) The Central Government may if it is satisfied that a Development Council should cease to continue by notified order dissolve that Development Council.

NOTES

(2) On the dissolution of a Development Council under sub-Section (1), the assets of the Development Council, after its liabilities if any are met there from shall vest in the Central Government for the purposes of this Act.

IMPOSITION OF CESS ON SCHEDULED INDUSTRIES IN CERTAIN CASES

(1) There may be levied and collected as a cess for the purposes of this Act on all goods manufactured or produced in any such scheduled industry as may be specified in this behalf by the Central Government by notified order a duty of excise at such rate as may be specified in the notified order, and different rates may be specified for different goods or different classes of goods.

(2) The cess shall be payable at such intervals within such time and in such manner as may be prescribed and any rules made in this behalf may provide for the grant of a rebate for prompt payment of the cess.

(3) The said cess may be recovered in the same manner as an arrear of land revenue.

(4) The Central Government may hand over the proceeds of the cess collected under this Section in respect of the goods manufactured or produced by any scheduled industry or group of scheduled industries to the Development Council established for that industry or group of industries and where it does so the Development Council shall utilise the said proceeds -

a) to promote scientific and industrial research with reference to the scheduled industry or group of scheduled industries in respect of which the Development Council is established;

b) to promote improvements in design and quality with reference to the products of such industry or group of industries;

c) to provide for the training of technicians and labour in such industry or group of industries;

d) to meet such expenses in the exercise of it functions and its administrative expenses as may be prescribed.

REGULATION OF SCHEDULED INDUSTRIES

1) The Central Government shall cause to be registered in the same manner every existing industrial undertaking of which it is the owner.

2) Where an industrial undertaking is registered under this Section, there shall be issued to the owner of the undertaking or the Central Government, as the case may be a certificate of registration containing the productive capacity of the industrial undertaking and such other particulars as may be prescribed.

3) The owner of every industrial undertaking to whom a certificate of registration has been issued under this Section before the commencement of the Industries (Development and Regulation) Amendment Act, 1973, shall if the undertaking falls within such class of undertaking as the Central Government may by notification in the Official Gazette, specify in this behalf, produce, within

NOTES

such period as may be specified in such notification the certificate of registration for entering therein the productive capacity of the industrial undertaking and other prescribed particulars.

4) In specifying the productive capacity in any certificate of registration issued under sub-Section (3), the Central Government shall take into consideration the productive or installed capacity of the industrial undertaking as specified in the application for registration made under sub-Section (1), the level of production immediately before the date on which the application for registration was made under sub-Section (1), the level of the highest annual production during the three years immediately proceeding the introduction in Parliament of the Industries (Development and Regulation) Amendment Bill, 1973, the extent to which production during the said period was utilised for export and such other factors as the Central Government may consider relevant including the extent of under-utilisation of capacity if any during the relevant period due to any cause.

REVOCATION OF REGISTRATION IN CERTAIN CASES

If the Central Government is satisfied that the registration of any industrial undertaking has been obtained by misrepresentation as to an essential fact or that any industrial undertaking has ceased to be registered under this Act by reason of any exemption granted under this Act becoming applicable thereto or that for any other reason the registration has become useless or ineffective and therefore requires to be revoked the Central Government may after giving an opportunity to the owner of the undertaking to be heard revoke the registration.

CASE STUDY:

Reliance Infrastructure was asked to pay Rs. 125 crore as compounding fees for parking its foreign loan proceeds worth USD 300 million with its mutual fund in India for 315 days. Afterwards the money was repatriated to a joint venture company in abroad. According to RBI, this act has violated various norms of FEMA.

RBI states that, Reliance Infrastructure raised USD 360-million through External Commercial Borrowing (ECB) on July 25, 2006 for investing in infrastructure projects in India. The ECB proceeds were temporarily parked as overseas liquid assets. Reliance Infrastructure repatriated the ECB proceeds worth USD 300 million to India and the balance amount remained abroad in liquid assets.

Reliance then invested these funds in Reliance mutual fund growth option and Reliance floating rate fund growth option on April 26, 2007. On the next day, April 27, 2007, the entire money was withdrawn and invested in Reliance Fixed Horizon Fund III Annual Plan series V. On March 5, 2008, Reliance Energy repatriated USD 500 million which included the ECB proceeds repatriated on April 26, 2007, and invested in capital market instruments for investment in an overseas joint venture called Gourock Ventures in British Virgin Islands.

According to FEMA guidelines issued in 2000, a borrower can park the ECB proceeds till actual requirement in India. Further, RBI states that a borrower cannot utilize the funds for any other purpose. In a situation where ECB proceeds are

parked overseas, the exchange rate gains or losses are neutralized. In this case, the exchange gain was realized and accumulated to the company which is unlawful under FEMA. The company had made an additional income of Rs. 124 crore and it is liable to pay of Rs. 124.68 crore.

1. Why was reliance infrastructure asked to pay a compounding fee?

   (Hint: Compounding fee was asked for parking foreign loan proceeds worth USD 300 million with its mutual fund in India for 315 days)

2. How did Reliance Infrastructure use ECB proceeds?

   (Hint: ECB proceeds were temporarily parked as overseas liquid assets)

SUMMARY

- An Act to consolidate and amend the law regulating certain payments, dealings in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import and export of currency, for the conservation of the foreign exchange resources of the country and the proper utilisation thereof in the interests of the economic development of the country.
- Foreign Exchange Management Act or in short (FEMA) is an act that provides guidelines for the free flow of foreign exchange in India. The Foreign Exchange Management Act (FEMA), 1999 has repealed the Foreign Exchange Regulation Act (FERA), 1973.
- The main aim of FERA was to control everything that was specified, relating to foreign exchange whereas FEMA lies down that 'everything other than what is expressly covered is not controlled'.
- The Reserve Bank made an application, and authorise any person to be known as authorised person to deal in foreign exchange or in foreign securities, as an authorised dealer, money changer or off-shore banking unit. The authorisation shall be in writing and shall be subject to the conditions laid down therein.
- The Central Government is empowered to frame a scheme to be called the Employees' Provident Fund Scheme for the establishment of provident funds under this Act.
- The Industries (Development and Regulation) Act provides the conceptual and legal framework for industrial development and industries in India. It is briefly known as the IDR Act. The act was enacted in 1951 and a number of amendments have been made in the Act.

ANSWERS TO 'CHECK YOUR PROGRESS'

1. "Currency" includes all coins, currency notes, banks notes, postal notes, postal orders, money orders, cheques, drafts, traveller's cheques, letters of credit, bills of exchange and promissory notes.
2. "Overseas market", in relation to any goods, means the market in the country outside India and in which such goods are intended to be sold.

NOTES

3. Foreign Exchange Management Act or in short (FEMA) is an act that provides guidelines for the free flow of foreign exchange in India.
4. Appeal: Any person aggrieved by an order made by the Adjudicating Authority may prefer an appeal to the Special Director. 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 [Sec.17(3)].
5. The Industries (Development and Regulation) Act provides the conceptual and legal framework for industrial development and industries in India. It is briefly known as the IDR Act.

TEST YOURSELF

1) Explain Foreign Exchange Regulation Act, 1973 (FEMA).
2) Briefly describe Foreign Exchange Management Act, 1999.
3) What is the difference between FEMA and FERA?
4) Explain the meaning of Authorised Person.
5) Write a short note on:
    i) Employees' Provident Fund Scheme (1952)
    ii) The Industries (Development and Regulation) Act, 1951
    iii) Central Advisory Council and Development Councils
    iv) Regulation of Scheduled Industries

FURTHER READING

- *Mercantile Law: Sharma, Sareen, Gupta and Chawla*