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PAPER III

Business and Industrial Laws

Unit : I-VII



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I Year
Paper - III
BUSINESS AND INDUSTRIAL LAWS
Unit: I-VII
Contents

Unit I : The Indian Contract Act, 1872

1. Contract: Its Essential
2. Contingent And Quasi Contracts
3. Discharge of Contracts
4. Contracts of Indemnity guarantee and Bailment
5. Agency

Unit II : Indian Partnership Act. 1932

6. Definition. Nature of Partnership and its Formation. Relation of Partner-Implied Authority of a Partner. Dissolution of Firm

Unit III : The Sale of Goods Act. 1930

7. Contract of Sale of Goods-Sale and Agreement to Sell
Conditions and Warranties-Implied Conditions and Warranties
8. Transfer of Property-Passing of Risk
Transfer of Title by Non-owners
9. Performance of the Contract of Sale
Rights of an Unpaid Seller

Unit IV : The Negotiable Instruments Act. 1881

10. Introduction. Promissory Note, Bill of exchange, Hundi, Cheque-Crossing, Parties to Negotiable Instruments.
11. Negotiation

Unit V 12. The Payment of Wages Act. 1936

Unit VI 13. The Payment of Bouns Act. 1965

Unit VII 14. The Payment of Gratuity Act. 1972

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CONTRACT : ITS ESSENTIALS

The Indian Contract Act came into force on 1st September, 1872. It was enacted mainly with a view to ensure reasonable fulfilment of expectations created by the promises of the parties and also enforcement of obligations prescribed by an agreement between the parties. The object of the Act is also to introduce definiteness in commercial transactions. It applies to the whole of the country except that State of Jammu and Kashmir.

The Act is neither retrospective nor exhaustive. It deals mostly with the general principles embodying contracts. The Act does not cover the whole field of contract law. Besides the Contract Act, there are various other laws regulating different types of agreements, e.g., the Transfer of Property Act deals with agreements relating to transfer of immovable property; the Sale of Goods Act deals with contract of sale of goods; the Partnership Act deals with partnership agreements, etc. The present Contract Act also does not affect particular customs and usages of trade, which are not inconsistent with any of the provisions of law, for example, usages relating to Hundies as negotiable instruments. The Law of Contract is different from other branches of law in as much as that the contracting parties are at liberty to make rules and regulations about the enforcement of their rights and fulfilment of their duties.

Application of the English Law

In case, a particular matter is not covered by any section of the Contract Act or by any other law in force in India, the courts may follow the principles of English Common Law, provided they are not inconsistent with Indian conditions and circumstances.

Indian Contract Act applies only to those agreements which are valid and enforceable by law. Further, the Law of Contract is not the whole law of agreements nor is it the whole law of obligations. An agreement which does not give rise to any legal obligations will not be enforceable by law. There are various social, religious and moral obligations, e.g., marriage, conveyance of gifts, etc., which are not enforceable by law as contracts. Obligation to maintain one's wife and children does not arise out of contract. Agreements which result in the transfer or the destruction of rights are not covered by the Contract Act.

Meaning and Nature of Contract

A contract has been defined as follows: Salmond defines a contract as “an agreement creating and defining obligations between the parties”.

Sir William Anson observes, A contract is an agreement enforceable at law made between two or more persons, by which rights are acquired by one of more to acts or forbearances on the part of other or others.

According to Sir Federick Pollock, “Every agreement and promise enforceable at law is a contract”.

Sec. 2(h) of the Indian Contract Act defines a contract as “An agreement enforceable by law”.

These definitions resolve themselves into two distinct parts: *First*, there must be an agreement. *Secondly*, such an agreement must be enforceable by law and an agreement to be enforceable must be coupled with obligation and the obligation has its source in law.

Thus a contract requires:

- (i) **Two Parties** : There must be two parties to constitute a contract. A contract can only be bilateral and the same party cannot be a party from both the sides. Hence, there cannot be a contract between A on one side and A on the other. Nor can a partner be a servant of his own firm as a man cannot be his own employer. A person cannot enter into a contract with himself.

The person who makes the promise is known as the “promisor” and the person to whom the promise is made is known as the “promisee”. As a matter of fact in a contract each party is a promisor as well as promisee. For example when A promises to sell his car for a sum of Rs.20,000 to B, A is a promisor because he has promised to sell his car while he is also a “promisee” because there is a promise from B to pay a sum of Rs. 20,000 to him. The same is the position of B.

- (ii) **An Agreement** : A proposal from the side of one party to do or abstain from doing a particular act and its acceptance by the other party are the two essential elements of an agreement. An agreement is constituted by means of an offer and a binding acceptance of the offer. Thus, an agreement occurs when two minds meet for a common purpose; they agree on the same thing in the same sense at the same time. The meeting of the mind is called *consensus ad idem*, i.e., consent to the matter.

For example; if A says to B that he is willing to sell him his car for Rs.20,000 and B gives his assent to this offer, the agreement will come into being.

- (iii) **An Obligation** : An obligation is the legal duty to do or abstain from doing something. An agreement to a contract should give rise to some legal obligation i.e., obligation which is enforceable at law. Agreements which give rise only to social or domestic obligations cannot be termed as contracts. Thus, an agreement to go to a picture or attend a dinner is not a contract, as it was not intended to give rise to any legal obligation. Similarly, an agreement to agree in future is not a contract because unless all important terms of the contract are settled, there cannot be any binding obligation. Such agreements are void for want of certainty. For example, if A agrees to sell 100 bales of cotton to B at a price to be settled in future. .

All Agreements are not Contracts

Agreement is a much wider concept than a contract. Agreements in which the intention to create legal obligation is absent are not contracts. Therefore, agreements relating to social matters are not contracts. For example, an agreement between two persons to go together for a walk, or a cinema show does not create any legal obligation on their part to abide by it.

Also, agreements which the parties declare not to be binding do not constitute a contract. They may be just “honoured pledges” and expressly stated to be “outside the jurisdiction of any court”. (*Rose Frank Co. v. Crompton Bs. (19257)*). There cannot be any binding contract unless there is intention to create legal relationship.

All Obligations also do not constitute contracts

Any obligation, which arises independently of an agreement, cannot be the basis of a valid contract. A domestic arrangement with no intention to create legally binding relations will not constitute a contract, such as a promise by a father to pay pocket money to his son. In the words of Lord Atkin, “The most usual form of agreements, which do not constitute a contract, are the agreements made between husband and wife”. They are not contracts because the parties do not intend that they should be attended by legal consequences. **Leading Case-Balfour v. Balfour (1919).**

Mr. Balfour left his wife in England on medical grounds and left for Ceylon, the place of his appointment. He had promised to pay £30 P.M. to his wife until she returns. Subsequently, he stopped sending money to her and decided to live apart. The wife sued the husband for the recovery of the amount promised for, on the ground that her consent to the agreement was enough to constitute valid consideration for the contract. The court did not agree with the views of the wife and dismissed her claim. It was held that it was only a domestic arrangement and not a legal contract because domestic arrangements are outside the realm of contract altogether.

However, parties standing in a domestic or social relationship may enter into an enforceable contract if they intend their agreements to have legal consequences *Merrit V Merrit (1970)*,

Therefore, to sum up, a contract results from a combination of agreement and obligation, But it is not necessary that all agreements should create an obligation between the parties to the agreements. An agreement may exist without any legal obligation but a contract cannot. Agreements giving rise to social obligations will not constitute binding contracts. Obligations arising from a trust or a decree or from statutes do not fall within the scope of the Contract Act. Thus, an agreement is the genus of which contract is the species, and therefore, all contracts are agreements but all agreements are not contracts- Hence, “the law of contracts is not the whole law of agreements nor is it the whole law of obligations. It is the law of those agreements which create obligations, and those obligations which have their sources in agreements.”—Sir John Salmond.

Essential Elements of a Valid Contract

An agreement to be enforceable at law must satisfy the essentials of a valid contract According to *Section 10* of the Act. “All agreements are contracts, if they are made by the free consent of parties, competent to contract, for a lawful consideration and with a lawful object, and not hereby expressly declared to be void.”

Thus, the following are the essential elements of a valid contract-

- (i) Agreement, i.e., Proposal and Acceptance.
- (ii) Intention to create legal relationship
- (iii) Lawful Consideration
- (iv) Competent Parties
- (v) Free Consent
- (vii) Not expressly declared void by law.
- (viii) Certainty and possibility of performance ‘
- (ix) Compliance with legal formalities.

- (i) *Agreement*: An offer or proposal by one party and an acceptance of that offer by another party is called an agreement. An agreement has been defined by the Act as “every promise or every set of promises forming considerations for each other.” The acceptance of the offer must be according to the mode prescribed and must be communicated to the proposer. Further, the intention of the agreement must be to create legal relationship between the parties. Agreement must be capable of performance with terms which are clear and certain. It should not be suffering from either a fundamental mistake or impossibility of performance.
- (ii) *Intention to create legal relationship*: Whenever parties make an agreement, their must be an intention to create a legal relationship between them. If such intention is not present, there is no contract between the parties. In case of social or domestic agreements, parties do not contemplate legal relationship, as such these are not contracts. [Balfour Vs. Balfour (1919)2 K.B. 571]

But in case of business agreements or commercial agreements, the usual presumption is that the parties have intention to create legal relationship. But this presumption is rebuttable with the help of evidence.

[Rose and Frank co. Vs. Crompton Bros. (1925) A.C. 445] [Jones Vs. Vernon’s Pools. Ltd. (1938) 2 All.R. 626]

- (iii) *Free Consent*: Two or more persons are said to have consented when they agree upon the same thing in the same sense. Thus, if two persons enter into an apparent contract concerning a particular person or thing and it turns out that each of them was misled, by a similarity of name and actually each had a different person or thing in mind, no contract would exist between them. For example, A has two cars, one blue and the other red. He wants to sell his blue car. B, who knows of only A’s red car, offer to purchase A’s car for Rs.20.000. A accepts the offer thinking that it is for his blue car. There is no consent because both the parties are not understanding the same thing in the same sense. Besides, to make a contract valid not only consent is necessary but the consent must also be free. According to Sec. 14, consent is said to be free when it is not caused by coercion, undue influence, fraud, misrepresentation or mistake. A clear distinction must be made between ‘no consent’ and ‘no free consent’. In the case or ‘no consent,’ there is no identity of mind and therefore, in the absence of consent the agreement is void abinitio—from the very beginning. In the later case of ‘no free consent’, consent is there but it is not free, the agreement is voidable at the option of the party whose consent is not free.

A thief who deprives a person of his goods without his consent cannot claim any title whatsoever in the goods. But a dacoit who obtains goods from the other person by obtaining his consent at the point of pistol (coercion) can retain the goods until the real owner claims them back. The possession of the thief is void for want of consent but the possession of the dacoit is voidable at the option of the real owner, i.e., valid unless challenged by the real owner because it has been obtained with the consent of the real owner though the consent had not been free.

- (iv) *Competent Parties*: At least two parties are essential for every valid contract. A person cannot enter into a contract with himself except in a different capacity, e.g., a partner may purchase goods from his own firm. In order that an arrangement may be a binding contract, the parties must have the legal capacity of entering into the contract.

According to Sec. 11 of the Act “Every person is competent to contract who is of the age of majority according to the law to which he is subject and who is of sound mind and is not disqualified from contracting by any law to which he is subject.” Thus, a contract entered into by a minor or by a lunatic is void. In India, a person who has not completed his 18th year of age is considered to be a minor. However, a lunatic can enter into binding contracts during his lucid intervals.

The legal presumption is that every party to a contract has the capacity to contract unless contrary is proved and the presumption is rebutted.

- (v) *Lawful Consideration:* Consideration is an essential element of a valid contract. An agreement without consideration is a bare promise and is not binding on the parties.

Contracts result only when a promise is made in-exchange for in something in return. This something in return is termed as “consideration”. Consideration is the price paid by the **promisee for the obligation of the promisor. Consideration need not be a benefit to the promisor.** If the promisee has suffered some loss or detriment, it will be taken as a sufficient consideration for the promisor to fulfill his promise.

Example: A agrees to sell his car to B for a sum of Rs. 10,000. For A a promise the consideration is a sum of 10,000 while for B’s promise consideration is the car.

Consideration is also the necessary evidence required by law about the intention of the parties to establish legal relationship.

Consideration must be real, and not illusory or illegal. Consideration may be past, present or future. It may move from the promisee or any other person but it should always be furnished at the desire of the promisor. Consideration must be valuable in the eyes of law, i.e., it must result in some gain to one party and detriment to the other.

- (vi) *Legal object:* The agreement must not relate to a thing which is contrary to the provisions of any law or has expressly been forbidden by any law or which is opposed to public policy or immoral. All agreements which are not lawful cannot be enforced by law. This is because courts will not allow polluted hands to touch the pure fountains of justice. No agreement can be allowed to defeat the provisions of any law or to cause injury to the person or property of any person or to achieve fraudulent objects.

Example: A agrees to sell certain goods to B. A knows that the goods are to be smuggled out of the country. The contract is unlawful and not enforceable.

A person who knowingly lets out his house for prostitution cannot recover the rent thereof because the purpose of the agreement has been immoral.

- (vii) *Not expressly declared void:* The agreement must have not been expressly declared void by any law in force in the country. In India agreements in restraint of trade, in restraint of marriage, or to do things which are impossible or are in the nature of illegal or immoral agreements, etc. are expressly declared void by the Indian Contract Act.

Example: A and B are competitors in o business. B agreed to pay A a sum of money if he would close his business. A did so but B refused to pay him the money. Held, the agreement was void because it was in the nature of restraint of trade and therefore, money could not be recovered.

- (viii) *Certainty and possibility of performance.* The agreement between the parties must be certain. It should not be vague or indefinite. If it is vague and the determination of its meaning is not possible, it is not a contract and can not be enforced.

In addition to this, the terms of the contract must be such .which can be performed. An agreement to do an impossible act can not be enforced. For example, A agrees with B to put life into B's dead child, the agreement is void as it is impossible of performance. [Sec 56 (1)]

- (ix) *Compliance with Legal Formalities:* If any legal formalities of writing, registration, etc. are necessary by law, these must be satisfied. In the absence of these legal formalities, agreements will not be enforceable in courts of law. **Contracts which must be registered**
- (i) A promise made without consideration on account of natural love and affection between parties standing in near relation to each other.
- (ii) Documents of which registration is compulsory under Sec. 17 of the Registration Act, 1908.
- (iii) Contracts relating to the transfer of immovable properties under the Transfer of Property Act 1882.
- (iv) Memorandum and Articles of Association, debentures, mortgages and charges under the Companies Act, 1956.

Kinds of Contracts

Contracts may be classified as follows:

1. *On the basis of enforceability*
 - (a) Valid Contracts.
 - (b) Void Contracts.
 - (c) Voidable Contracts.
 - (d) Illegal Contracts.
 - (e) Unenforceable Contracts.
2. *On the basis of mode of creation*
 - (a) Express Contracts.
 - (b) Implied Contracts.
3. *On the basis of the extent of execution.*
 - (a) Executed Contracts.
 - (b) Executory Contracts.
4. *On the basis of the form of the Contract*
 - (a) Formal Contracts. (b) Simple Contracts.

1. Classification on the basis of enforceability.

- (a) *Valid Contracts:* Contracts which satisfy all the essentials of a valid contract as laid down in Sec. 10, are termed as valid contracts. Only valid contracts are enforceable in a court of law.

- (b) *Void Contracts:* An agreement may be enforceable at the time when it was entered into but later on, due to certain reasons, for example impossibility or illegality of the contract, it may become void and unenforceable. Such contracts are called void contracts. Technically the words “void contracts” are a contradiction in terms. Such contracts can appropriately be termed as “contracts which have become void” in place of “void contracts”.

Example: X, by exercising coercion over Y, makes him agree to sell his house worth Rs.50,000 for a mere sum of Rs. 1,000. The agreement is voidable at the option of Y. In case Y decides to rescind the contract, it becomes void between X and Y.

Void Agreement: A void agreement is one which is deficient in essentials and is, therefore, destitute of legal effect. Sec.2 (g) defines it as, “an agreement not enforceable by law, is said to be void.’ A void agreement is non-existent in the eyes of law. So, it cannot be enforced and confers no rights on either party. All illegal or immoral agreements are void. An agreement with a minor is void.

Example: A agrees with B to draw two parallel lines in such a way so that they cross each other for consideration of Rs.500. The agreement is impossible to perform and hence void.

Void Agreement and Void Contract

Thus, a void agreement is void from the very beginning i.e., void abinitio, while a void contract was valid at the time when it was made but becomes void later on because of certain reasons

An agreement void ab initio or which becomes-void subsequently will have these effects:

- (i) The agreement shall be unenforceable.
- (ii) Money paid or property transferred is recoverable subject to the condition that both the parties were ignorant about the illegal or void nature of the agreement when it was made.
- (iii) Collateral transactions shall not become void unless the agreement has also been illegal.
- (iv) All lawful promises shall remain valid in case they are severable and can be enforced.
- (c) *Voidable Contract:* As per Sec. 2(i) “An agreement, which is enforceable by law at the option of one or more of the parties thereto, but not at the option of other or others, is a voidable contract”. Agreements induced by coercion, undue influence, fraud or misrepresentation are voidable at the option ,of the party whose consent has been so obtained. The contract shall remain valid so long as it is not repudiated by the aggrieved party entitled to do so. The aggrieved party is entitled to get damages for any loss suffered by him. Similarly, if he has received some benefit under the contract, he must restore such benefits to.the persons from whom it was received.
- (d) *Illegal Agreements :* An agreement is illegal when it is in contravention of a statutory provision. An illegal agreement is destitute of legal effects abinitio—from the very beginning. All the transactions collateral to illegal agreements become tainted with illegality and are, therefore, not enforceable. For example, if A promises to pay a sum of Rs. 100 to B if he (B) gives a good beating to C. B gives a good beating to C and A, in order to pay B borrows from D a sum of Rs. 100. D knows the purpose of borrowing. The agreement between A and B being illegal, the collateral transaction

between A and D will be void, D cannot recover his debt of Rs. 100 from A. Parties to an unlawful agreement cannot get any help from a Court of law, for courts expect a person to come to them with clean hands. Law does not permit a guilty man to take advantages of his guilt.

- (c) *Unenforceable contracts* : Certain contracts become void because they cannot be enforced due to certain technical defects, i.e., non-observance of legal formalities of writing, registration, etc. These contracts are valid in the eyes of law but since they are incapable of proof, law courts will not enforce them. Many of the contracts, in the absence of writing, are quite good but cannot be enforced in a court of law until the written evidence is furnished. Some of them can be enforced if the technical defect is removed.

Difference between void agreements, illegal agreements and voidable contracts

1. The term “illegal agreement” has wider conception than void agreement. All illegal agreements are void but all void agreements are not necessarily illegal, e.g., a wagering agreement is void but not illegal or an agreement with a minor is void but not illegal. Illegal agreements are prohibited by law. Void agreements are declared non-enforceable in a court of law. If the parties wish to perform, they can perform void agreements.
2. Though the legal effects of both are the same, i.e. void ab initio. But a void agreement does not affect the performance of collateral transaction but illegality of the original contract will make even the collateral transactions tainted with illegality.
3. For entering into a void agreement, there is no penalty on the parties. But for an illegal agreement the parties may be punished.

Classification of contracts on the basis of mode of creation

- (a) *Express Contracts*: Contracts entered into between the parties by words spoken or written, are termed as express contracts. In such contracts, parties make oral or written declaration of their intentions and of the terms of the transaction.
- (b) *Implied Contracts*: Contracts which come into existence on account of the conduct and acts of the parties are termed as implied contracts. For example, if a person takes a seat in a bus. His act shows that he has entered into an implied contract that he will pay the specified fare to the bus owner for taking him to his destination.

Classification of contracts on the basis of the extent of execution

- (a) *Executed contracts*: When both the parties to the contract have fulfilled their respective obligations, contract is said to be executed.
- (b) *Executory contract*: When one or both the parties to the contract have still to perform certain things in future, the contract is termed as an executory contract. For Example: A agrees to sell a radio set to B for Rs.200, B pays the price in advance. The contract is executed as regards B, but executory as regards A, for he is yet to deliver the radio set to B.

On to the basis of execution, contracts may also be divided as :

- (a) Unilateral contracts.
- (b) Bilateral contracts.

- (a) *Unilateral contracts:* A contract is said to be unilateral where one party has performed his obligation either before or at the time when the contract comes into existence, whereas the other party is yet to perform his obligation.

Example: A, a coolie, puts B's luggage in the carriage. A has performed his obligation. It is now for B to perform his obligation by paying the charges to the coolie.

- (b) *Bilateral contracts:* A contract is bilateral if the obligations of both the parties are outstanding at the time of the formation of the contract. They are executory or bilateral contracts.

Example: A agrees to sell his car to B after a month. B promises to pay the price on the delivery of the car. The contract is bilateral.

It is to be noted that the contract comes into existence on the date on which it is entered into between the parties and not from the time its performance is due.

Classification of contracts on the basis of form

- (a) *Formal Contracts:* (i) Contracts under seal and (ii) contracts of record have been recognised as formal contracts under English Law. Their validity depends upon their form alone. Consideration is not necessary for such contracts. They are required to satisfy certain legal formalities in order to be valid and binding.
- (b) *Simple Contracts:* All contracts other than formal contracts are known as simple contracts. They will be valid only when they are supported by consideration. The Indian Law does not recognise formal contracts. It recognises only simple contracts which must be supported by consideration except in circumstances specifically laid down in the Act.

Essential elements of a contract

1. Agreement—offer and acceptance

An offer is a promise to do or abstain from doing something with the object of getting another person's assent thereto. Examples :- A offers to sell his dog to B for Rs.200; A offers not to open a shop in a particular area if B gives him Rs.50,000.

One party makes a definite offer to the other party and that the other party accepts it in its entirety. In simple words, it means: an offer or proposal is a statement by the offerer of what he will give in return for some act or promise of the offeree. Section 2(a) of the Act defines an offer or proposal as follows: "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 the proposal." Thus an offer is a proposal by one person, whereby he expresses his willingness to enter into a contractual obligation in return for a promise, or act, or forbearance. Thus, offer consists of two parts: one, a promise by the offerer, together with, second, a request addressed to the offeree for something in return.

Rules regarding offer:

1. An offer must intend to create legal relationship.
2. The offer must not be vague or uncertain.
3. A mere quotation, or statement of a future offer, or an invitation to offer, is not an offer.

4. An offer may be specific (made to a particular person) or general (made to the world at large).
5. An offer must be communicated to the offeree.

An offer may be communicated by word of mouth, by writing or by conduct. A written offer may be contained in a letter, telegram, circular or advertisement.

Termination of offer :..An offer may come to an end under the following circumstances:

1. When the offerer prescribes a time within which the offer must be accepted, the offer lapses as soon as the time expires.
In case offerer does not prescribe time, offer terminates after the expiry of reasonable time.
2. An offer lapses by not being accepted in the mode prescribed, or if no mode is prescribed in some usual and reasonable manner.
3. An offer lapses by the death or insanity of the offerer or of the offeree before acceptance.
4. An offer lapses by revocation. The offerer may withdraw the offer at any time before it has been accepted.
5. Standing Offers: A standing offer is in the nature of a continuing offer. A tender or offer for the supply of such goods as may be required, no quantity being specified, is a continuing standing offer. Such an offer is accepted from time to time whenever an order is given for any of the goods specified in tender.

ACCEPTANCE

All contracts are made by the process of a lawful offer by one party and its lawful acceptance by the other party. Acceptance is the manifestation by the offeree of his assent to the terms of the offer. Mathematically stated, offer + acceptance = agreement Agreement + enforceability = Contract.

Who can accept? An offer made to a particular person can only be accepted by him as he is the person with whom the contract is intended to be entered into.

An offer made to a class of persons can be accepted by any member of that class.

Rules Regarding Acceptance: The acceptance of an offer, to be legally effective, must satisfy the following requirements.

1. It must be an absolute and unqualified acceptance of the offer. If there is a variation, even on an unimportant point, between the terms of the acceptance, there is no contract.
2. The acceptance must be expressed in some usual or reasonable manner. The offeree may express his acceptance by word of mouth or by post or telegram.
3. An acceptance of an offer may be by conduct. If the offeree does what the offerer wants him to do, there is acceptance of the offer by conduct. A offers a reward of Rs.100 to anyone who finds his lost dog. B finds the dog. The offer has been accepted by conduct.
4. There may be acceptance by taking benefit. The DTC offers to carry passengers from the University to the Central Secretariat for Rs.10. A gets into the bus at the University and is taken to the Central Secretariat. A has taken the benefit and must pay the contract price of Rs. 10,

5. Where the offerer prescribes a particular mode of acceptance, the offeree must follow that mode of acceptance. Thus, if the offer says, 'Wire reply', and the reply is sent by post, this is not a compliance with the offer.

Note: If the acceptance is not made in a reasonable mode or in the mode prescribed by the proposer, the offerer may insist (within reasonable time of communication of acceptance to him) that the proposal be accepted in the prescribed manner and not otherwise. If he fails to do so, the acceptance is binding on the proposer.

6. An acceptance must be made before the offer lapses or before it is terminated.
7. Acceptance must be communicated to the offerer or shown by conduct. Mental acceptance or uncommunicated assent does not result in a contract. An acceptance cannot be implied by silence of offeree.

An offer is complete when it comes to the knowledge of the offeree. Acceptance of an offer is complete when it comes to the knowledge of offerer. Offer can be revoked by the offerer before it is accepted by the offeree. Revocation of the offer will be complete when it comes to the knowledge of the offeree. Acceptance, once given, cannot be revoked. The position is different with regard to contracts through Post Office. Acceptance given by a person who is not authorised to give acceptance is not effective in law. It must be given by the party to whom it is made.

Contract through the Post Office

An offer and its acceptance may be made by post. Under Indian Law, an offer is made when the letter containing the offer is delivered to the offeree.

An acceptance is complete against the proposer or offerer when it is posted to him. Acceptance binds the acceptor only when it reaches the offerer.

An offer can be revoked if the letter of revocation reaches the offeree before he posts the letter of acceptance.

An acceptance can be revoked as against the offerer if the letter of revocation reaches the offerer before he receives the letter of acceptance.

2. Intention to create legal relationship

When the parties enter into an agreement, at that time their intention must be to create legal relationship. The words 'legal relationship' mean that if a party does not carry out its promise, it will have to face legal consequences. Therefore, creation and existence of legal relationship between the parties is must for making a contract. On the other hand if there is no intention to create legal relationship on the part of parties, there is no contract between the parties. If the agreements are social or domestic, these are not contracts as they do not contemplate legal relationship.

Example: A promise was made by a husband to pay his wife a monthly household allowance of £30. He paid the amount for a few months but later failed to pay as the parties had separated. The husband was sued by his wife. It was held that such agreements do not come under the category of contracts as such. [Balfour v. Balfour, (1919) 2 K.B. 571]

Example: Under an agreement between R. Company and C. Company the former was appointed as the agent of the latter. There was a clause in the agreement which, stated ; "This agreement is not entered into ... as a formal or legal agreement, and shall not be subject to legal

jurisdiction in the law courts.” It was held that there was no binding contract as there was no intention to create legal relationship [Rose & Frank co. Vs. Crompton Bros., (1925) A.c. 445]

3. Consideration -Necessity of consideration

Contracts result only when one promise is made in exchange for something in return. The *something in return* is consideration. Its necessity arises because law aims at enforcing the mutual promises of the parties. The need of consideration limits the enforcement of promises to those in which each of the parties has bargained to give or surrender something. The fact that each party has agreed to give or surrender something, suggests that the parties have devoted some reflection to the matter and that they seriously desire the promises to have legal consequences.

Definition of consideration

Pollock defines it as :- “An act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable.” Consideration must be an act or forbearance of some value in the eye of law. The promisee must suffer a legal detriment. The detriment need not be real, it need not involve actual loss to the promisee. This means legal detriment as different from detriment in fact. It is giving up by the promisee of a legal right, the refraining from doing what he has the legal right to do, or the doing of what he has the legal right not to do. So, a benefit to the promisor or a detriment to the promisee is sufficient consideration for a contract.

In the English case, *Currie Vs. Misa* (1875) 10 Ex. 153, consideration was defined as a “some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other.”

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

Example

- (1) A agrees to sell his motor car to B for Rs.70,000. For the promise of A, the consideration is Rs.70,000. For B’s promise, the consideration is the motor car.
- (2) A employs B as a manager of his factory at a salary of Rs. 4,000 a month. The monthly salary is the consideration by B, and the services rendered by B constitute the consideration received by A.
- (3) A agrees not to file a suit against B if B pays him Rs. 500 by a fixed date. The forbearance of A is the consideration for B’s payment.

Rules regarding consideration

Consideration is essential to support a contract. A promise without consideration is void. The following are the legal rules of the consideration.

1. *Consideration must move at the desire of the promisor:* The act constituting consideration must have been done at the desire or request of the promisor. If it is done at the instance of third party or without the desire of the promisor, it is not consideration.
2. *Consideration may move from the promisee or any other person:* Under the English law, consideration must move from the promisee. This means that a person can enforce

a promise only if he himself did or abstained from doing or promised to do or abstain from doing, something in return for the other's promise. He can not sue if the consideration for the promise moved from a third party. Simply stated, this means a stranger to consideration cannot sue on a contract, i.e., if the consideration moves from a person other than the promisee, the promisee cannot enforce the agreement (Tweedle V. Atkinson).

But under the Indian Law, consideration may move from the promisee or any other person. This means a person can sue on a contract even if the consideration for the promise moved from a third party. In other words, a stranger to consideration, in a contract, may maintain suit.

A stranger to consideration under the English Law cannot sue on a contract. But under the Indian Law, he can do so provided he is a party to the contract. It is a general rule of law that a person who is not a party to a contract can sue if the contract is for his benefit. This means that unless there is a privity of contract, a party cannot sue on a contract. Privity of contract means the relationship subsisting between the parties who have entered into contractual obligations. It implies a mutuality of will and creates a legal bond or tie. A contract cannot confer rights or impose obligations arising under it on any person unless there is privity of contract (Chinnaya V. Ramayya).

3. *Consideration may be past, present or future:* The definition of consideration, when analysed, clearly lays down that the consideration may be past, present or future. The words used in Section 2 (d) are : “_____. has done or abstained from doing (past), or does or abstains from doing (present), or promises to do or abstain from doing (future), something_____”
 1. Past consideration: When the consideration by one party for a present promise was given in the past, it is said to be past consideration.
 2. Present consideration: When the consideration is given simultaneously with the promise, i.e., at the time of the promise, it is said to be present consideration.
 3. Future consideration: When the consideration from one party to the other is to move at some future date, it is future consideration.
4. *Consideration need not be adequate :* Consideration means something in return. The something in return need not necessarily be commensurate in value with something given. The law simply provides that a contract should be supported by consideration. It ordinarily does not take into account adequacy of consideration for enforcing a contract. The parties are free to make their own bargains and it is up to them to consider the pros and cons of every promise. Consideration, however, must be something to which the law attaches value though it need not be equivalent in value to the promise made.
5. *Consideration must be real and not illusory :* Consideration although it need not be adequate, must be real, competent and of some value. The mere fact that promisor has some sentimental motive for making the promise will not make it binding. Also consideration must not be illegal, impossible, or illusory or sham. Where consideration is legally or physically impossible or uncertain or ambiguous, it shall not be enforceable in the Court of law.

6. *Consideration must be something which the promisor is not already bound to do performance of a pre-existing obligation:* A promise to do what one is already bound to do, either by general law or by a contract, is not a good consideration for a new promise, since it adds nothing to the pre-existing legal obligation. In *Collins V. Godefroy*, D. promised to pay P who had received summons to appear at a trial in a civil suit, a certain sum being a compensation for the loss of time during his attendance. It was held that the promise was without consideration because P was in any case bound to appear and give evidence.
7. *Consideration must be lawful :* The consideration given for an agreement must be lawful. Where the consideration is unlawful, the Courts do not allow an action on the contract. The consideration of an agreement is unlawful, if :
 - (i) It is forbidden by law or
 - (ii) it is of such a nature that, if permitted, it would defeat the provisions of any law or
 - (iii) it is fraudulent or
 - (iv) it involves or implies injuring to the person or property of another or
 - (v) the court regards it as immoral or opposed to public policy.

Every, agreement of which the consideration is unlawful is void.

Types of consideration : Consideration may be of the following types :

- (i) Executory or future, which means that it will move at a future date. A promise to - pay the price at a future date for goods delivered to-day is executory or future consideration.
- (ii) Executed or present, which moves simultaneously with the promise. Example : A buys a watch and pays for it there and then.
- (iii) Past, which means a past act or forbearance. In this case, the consideration of one party was given before the date of promise. Example: A found B's watch in July and gave it to him. In August B promises to give Rs.50 to A as a reward. (Under English law, past consideration is no consideration.)

Stranger to contract

It is a general rule of law that a person who is-not a party to a contract cannot sue upon it even though the contract is for his benefit. This means that unless there is privity of contract, a party cannot sue on a contract. This means a contract cannot confer right or impose obligations arising under it on any person other than parties to it.

Exceptions

- (1) A person in whose favour a charge or other interest'in some specific immovable property has been created may enforce it even though he is not a party to the contract.
- (2) Marriage settlement, partition or other family arrangements. Where an agreement is made in connection with marriage, partition or other family arrangements and a provision is made for the benefit of a person, he may sue although he is not a party to the contract.
- (3) Acknowledgement or estoppel. Where the promisor, by his conduct, acknowledges or otherwise constitutes himself as an agent of the third party, a binding obligation is thereby incurred towards him,

- (4) Assignment of a contract. The assignee of rights and benefits under a contract not involving personal skill can enforce the contract subject to the equities between the original parties.

No consideration necessary: The general rule is that an agreement without consideration is void. But Section 25 of the Contract Act lays down three exceptions which make a promise without consideration valid and binding.

An agreement without consideration is Valid

- (1) if it is expressed in writing and registered if so required by the law relating to registration of documents and is made out of natural love and affection between ‘ parties standing in a near relation to each other;- or
- (2) if it is made to compensate a person who has already done something voluntarily for the promisor, or done something which the promisor was legally compellable to do; or
- (3) if it is a promise by a debtor in writing to pay a time barred debt and signed by the debtor, or by his agent authorised to do so. The promise may be to pay whole or part of debt.

Also in case of a completed gift consideration is not required.

Further, consideration is also not required to create an agency.

Example 1. A saves B’s sons from drowning. B promises to pay him ten thousand as reward. This is a contract.

2. B owes A, Rs.5,000 for the last 5 years. The debt is barred by the law of limitation. B promises to pay Rs.2,500. This is a contract provided it-is in writing and signed.

4. Capacity of Parties

One of the essential elements of a valid contract is that all the parties to it must have capacity to enter into contracts. Section 11 of the Contract Act provides that “every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject”.

Negatively stated, a person is incapable of entering into contracts, if :

- (i) he is a minor;
- (ii) he is not of sound mind, i.e., he is a lunatic, an idiot or a drunkard;
- (iii) he is disqualified from contracting by any law to which he is subject; e.g., if he is a foreign sovereign ambassador, alien enemy, convict.

A *minor* is one who has not completed his or her age of 18 years. But, if a guardian has been appointed for the minor and his property has been taken over by the Court of Wards for management, minority continues upto the completion of the 21st year.

Subject to two exceptions, an agreement by a minor is absolutely void and inoperative against him.

Since the contract is void *ab initio* it cannot be ratified or adopted by the minor on attaining majority.

If a minor has obtained any benefit under a contract he cannot be asked to compensate. A minor can always plead infancy, even where he had entered into a contract by falsely representing that he was of full age, when in reality he was a minor.

The *exceptions* referred to above are :

- (i) A minor can always derive a benefit under a contract. He can be a promisee although he cannot be a promisor.
- (ii) The minor's property is liable for the payment of a reasonable price for 'necessaries' supplied to him or to anyone whom he is legally bound to support according to his station in life in which he is placed. (Section 68)

A loan taken by a minor to obtain necessaries binds him and is recoverable by the lender as if he had himself supplied these necessaries. It is only the property of minor which is liable for such loans but a minor can never be held personally liable for such loans.

Contracts by idiots, lunatics and drunken persons are also void. But an insane person may make valid contracts during lucid intervals.

These persons are incapacitated because they cannot understand the nature of the contract and they cannot know how their interests will be affected by entering into such a contract.

Contract by Persons Incompetent by Statute

An *alien* is a citizen of a foreign state. An alien may be a friend or an enemy. Contracts with alien friends are valid. But contracts with alien enemies are void. An alien enemy is one whose country is at war with India. Foreign Sovereigns and Ambassadors cannot be sued in Indian Courts unless they voluntarily submit to our courts.

A *convict* is incapable of entering into contracts while undergoing sentence.

Corporations: A corporation is an artificial person created by law and has no physical existence. There are some contracts into which it cannot enter, e.g., a contract to marry. Further, the powers of a corporation to contract are limited by its Statute, Charter or Memorandum of Association. Any contract beyond such powers is void.

5. Lack of Free Consent

A contract is valid only when it is the result of the free consent of the parties to it. The consent is said to be free when the parties agree upon the same thing in the same sense and voluntarily do so.

When the consent is absent the contract will turn out to be void. Where there is no real consent, as in the case of a mistake on the part of the parties the contract is void. It is voidable when consent has been influenced by coercion, undue influence, fraud, misrepresentation or mistake.

Coercion: When a person is compelled to enter into a contract by the use of force by the other party or under a threat, coercion is said to be exercised. 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 whatsoever, with the intention of causing any person to enter into an agreement. It is immaterial whether the Indian Penal code is or is not in force in the place where the coercion is employed (Sec. 15).

Example: A young girl of 13 years was forced to adopt a boy whose husband just died, by the relatives of the husband who prevented the removal of his body for cremation until she

consented. Consequently the adoption was set aside. Held, the consent was not free but induced by coercion.

The onus of proving that the consent of a party to a contract was caused by coercion and that he would not have entered into it had coercion not been employed, lies on the party who wants to relieve himself of the consequences of coercion.

Undue Influence: A contract is said to be induced by undue influence where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other (Section 16(1)). A person is deemed to be in a position to dominate the will of another :

- (a) where he holds a real or apparent authority over the other or where he stands in a fiduciary relation to the other or,
- (b) where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress.

Where a person, who is in a position to dominate the will of another, enters into a contract with him, and the transaction appears, on the face of it or on the evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall lie upon the person in a position to dominate the will of the other [Sec. 16(3)].

The following relationships usually raise a presumption of undue influence :

- (i) Parent and child,
- (ii) Guardian and ward,
- (iii) Trustee and beneficiary,
- (iv) Religious adviser and disciple,
- (v) Doctor and patient,
- (vi) Solicitor and client,

The presumption of undue influence can be rebutted by proving that :

- (i) Full disclosure of facts was made at the time of entering into contract.
- (ii) The price paid was adequate. The inadequacy of consideration should be too extreme for the reason, inadequacy of consideration is only an evidence of undue influence, it is not a conclusive evidence.
- (iii) The weaker party was in receipt of independent advice before making the promise. Mere getting the advice is not sufficient, it must be shown that the advice was competent and based on relevant facts.

MISREPRESENTATION

A representation means a statement or assertion of a fact made by one party to the other, either before or at the time of the contract, relating to some matter or thing essential to the formation of the contract. It may be expressed by words spoken or written or implied from the acts and conduct of the parties. A representation when wrongly made innocently is a misrepresentation. Wrong representation may be:

- (i) innocent representation but made wrongly.
- (ii) intentional, deliberate or willful wrong representation with an intent to deceive or defraud the other party.

The former, in legal terminology, is called misrepresentation and the latter fraud.

It is a misstatement made innocently and with an honest belief in its truth. The effect of innocent misrepresentation of material fact is that the party misled by it can avoid the contract. But in order to avoid a contract on the ground of misrepresentation, it is necessary to prove that (i) there was a representation or assertion, (ii) such assertion induced the party aggrieved to enter into contract, (iii) the assertion related to a matter of fact, and not mere opinion which has become untrue. Such innocent misrepresentation must be a positive assertion of a fact, and must not be mere opinion or heresy.

A representation is fraudulent if :

- (i) it is known to be false or
- (ii) is made without belief in its truth or
- (iii) is made recklessly, not caring whether it is true or false and
- (iv) the maker intended the other party to act upon it.

The intention of the party making fraudulent misrepresentation must be to deceive the other party to the contract or to induce him to enter into the contract.

Fraud: According to Section 17, fraud means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent :

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

In order to construe a misrepresentation as fraud, the following points should be proved:

- (i) There must be a representation or assertion and it must be false.
- (ii) The misrepresentation must relate to a fact.
- (iii) The misrepresentation or statement must be made with a knowledge of its falsity or without belief in its truth or recklessly, not caring whether it is true or false.
- (iv) The other party must have been induced to act upon the representation or assertion,
- (v) The other party must have been deceived.
- (vi) The other party, acting on the representation or assertion and actually deceived by it, must have suffered some loss.

Examples :- The prospectus of a company did not disclose about liabilities of the company. This gave the impression that the company was healthy. If these liabilities had been disclosed, the impression would have been quite adverse. Held, non disclosure amounted to fraud and any body who purchased shares on the faith of this prospectus could avoid the contract.

But any one who purchases shares of this company from open market cannot avoid contract on the basis of this prospectus because he has not been induced to act upon the misrepresentation. He can not said to have relied upon the representations in the prospectus.

B purchased some shares on the basis of some fraudulent representation. When he discovered the fraudulent assertions, the market price of shares was much higher than the purchase price. Held, these representations do not amount to fraud since the buyer has not suffered any loss. It is a common rule of law that there is no fraud without damage.

Distinction between Misrepresentation and Fraud

1. **Intention:** Misrepresentation is innocent. Fraud is deliberate.
2. **Belief:** When the person making the representation, knows it to be false, it is fraud, while in case of misrepresentation, he believes it to be true.
3. **Consequences:** In misrepresentation, the aggrieved party can rescind the contract. But it can not claim damages. In a fraud the aggrieved party can not only rescind the contract but also file suit for damages.

MISTAKE

Mistake may be defined as an erroneous belief concerning something. The parties do not agree on the same thing in the same sense.

Mistake may be of two kinds: (i) Mistake of law and (ii) Mistake of fact. Mistake of law in India and mistake as to a law not in force in India, e.g., foreign law.

Mistake of Indian law does not affect the contract. Ignorance of law is no excuse. But mistake of foreign law is treated a mistake of fact.

“Where both the parties, to an agreement are under a mistake as to a matter of fact essential to agreement, the agreement is void”. To make a contract void on the ground of mistake of fact, the mistake must be on the part of both parties and it must be as a matter of fact essential to the agreement. A offers to sell his house to B. B agrees to buy A’s house. A meant to sell his house in Delhi while B meant to buy A’s house in Calcutta. There is a mistake of fact and there is no agreement. A mere error or mistake of judgment, though on a material point, will not be sufficient to avoid the contract. For example, if A buys an article thinking that it is worth Rs 100/-, while it is actually worth Rs.50/- the contract is not void on the basis of mistake.

Thus, when one or more of the parties to an agreement suffer from a fundamental error and the consent, apparently given, is not really there, the agreement is void. Mistake as to the nature of the contract or mistake as to the identity of the person contracted does not result in a contract. A represents falsely that he is the Maharaja of Kapurthala and thus buys goods from B. There is no contract.

Mutual mistake as to subject matter of contract will make it void. Such mistake may relate to the existence of the subject matter, its identity, price or quantity.

Contracts Uberrimae Fidei

Uberrimae Fidei Contract: Contracts requiring utmost good faith are contracts where the law imposes upon the parties the duty of making a full disclosure of all material facts. In such contracts where one of the parties has any information concerning the subject matter of the contract, which is likely to affect the willingness of the other party to enter into the contract, he is bound to disclose the information.

The contracts which fall within this category are :

1. *Contracts of Insurance:* The insured must disclose to the insurer all material facts known to him concerning the risk to be undertaken.

2. *Contracts in which parties stand in a fiduciary relation to other*, e.g., contracts between solicitor and client, principal and agent, etc.
3. *Contracts for the sale of immovable property*: The seller must disclose any material defect in the property or in the seller's title to it, of which the seller is aware and the buyer is not, and which the buyer could not, with ordinary care discover.
4. *Issue of company prospectus*: Persons who issue the prospectus of a company must disclose all information regarding the company with strict accuracy.
5. *Family settlement*: When family disputes are settled by mutual agreements, each party must disclose truthfully all information possessed by him regarding family properties.
6. *Miscellaneous*: Good faith between partners is essential, and so partnership is regarded as contract requiring utmost good faith. In a contract of guarantee, the creditor must disclose to the surety all material facts known to him about the principal debtor.

6. Lawful object

In the previous lesson while dealing with the essentials of a valid contract, we noted that the consideration for and the object of a contract must be lawful. It follows from this that an agreement will be unlawful and so void and unenforceable if its object or the consideration is unlawful. The expression "object of an agreement" means its 'purpose' or 'design'. Consideration means something for something.

Illustration

- (a) A and B enter into an agreement for the division between them of gains acquired by them by fraud. The agreement is void as its object is unlawful.
- (b) A promises to obtain for B an employment in Government service and B promises to pay Rs. 1,000 to A. The agreement is void, as the consideration for it is unlawful.

According to Section 23 of the Contract Act the consideration or object of an agreement is unlawful in the following cases :

1. *If it is forbidden by law*. An act or an undertaking is forbidden by law when it is punishable by the criminal law of the country (Indian Penal Code) or when it is prohibited by special legislation or regulations made by a competent authority. If the consideration or object is forbidden by law (i.e. illegal) the agreement is void and will not be enforced by the Court. For example, a loan granted to the guardian of a minor to enable him to celebrate the minor's marriage in contravention of the Child Marriage Restraint Act is illegal and cannot be recovered back.
2. *If it is of such a nature that, if permitted, it would defeat the provisions of any law*. For example, an agreement by the debtor not to raise the plea of limitation, if a suit has to be filed is void as it tends to limit the provisions of the Limitation Act.
3. *If it is fraudulent*. An agreement whose object is to defraud others is void. For example, where A, a debtor transfers his property to B with the object of defeating his creditors, the transfer is invalid and will be set aside at the instance of the creditors affected.
4. *If it involves or implies injury to the person or property of another*. Thus, if the object of an agreement is to injure the person or property of another, it is void.
5. *If the Court regards it as immoral*. An agreement whose object is immoral or where the consideration is immoral is void. For example. A who is B's Mukhtiyar, Promises

B to, exercise his influence in favour of C and C promises to pay Rs. 1,000 to A. The agreement is void because it is immoral. A knowingly lets his house to B, a prostitute, for prostitution. The agreement is immoral and A cannot recover the rent.

6. *If the Court regards it as opposed to public Policy.* An agreement which is injurious to the public or is against the interests of the society is said to be opposed to public policy.

AGREEMENTS AGAINST PUBLIC POLICY

The following agreements have been held by courts of law to be against public policy, and so void.

1. *Trading with the enemy.* An Indian national cannot trade with an alien enemy without a license from the Government. An agreement with an alien enemy is illegal, void and inoperative.
2. *Agreement interfering with, the course of justice.* An agreement for stifling prosecution is unlawful and void. When an offence has been committed by a person; he must be prosecuted. Any agreement which seeks to prevent the prosecution of such a person is opposed to public policy and is unlawful. Similarly, an agreement to vary the statutory period of limitation is void. Also, an agreement for the purpose of using improper influence of any kind with judges or officers of justice are void.
3. *Agreements for sale of public offices and titles.* Transfer of public offices and titles is against public policy and invalid. Agreement to transfer office from one person to another or to secure an office of honour or title for monetary consideration is totally bad and unlawful.
4. *Agreements tending to create monopolies.* These are void as opposed to public policy. Also, agreements not to bid at an auction sale will be unlawful if made with the object of defrauding a third party.
5. *Agreements creating an interest opposed to duty are void.* For example, an agreement by an agent whereby he would be enabled to make secret profits is void. An agreement by a newspaper proprietor not to comment on the conduct of a particular person is void as opposed to public policy.
6. *Agreements restraining personal freedom.* An agreement which unduly restrains personal liberty is void, as against public policy. An agreement by a debtor to do manual work for the creditor so long as the debt is not paid is full is void.
7. *Agreement restraining parental rights.* According to law, the father is the natural guardian of his minor child and in the absence of the father, the mother is the guardian. This right cannot be deprived away by any agreement. A agreed to transfer guardianship of his two minor sons to B and agreed not to revoke this transfer. But later, he changed his mind and wanted his sons back. It was held by the Court that he could get back his sons as the agreement was void as being against public policy. Similarly an agreement to receive money for giving a daughter in marriage is void.
8. *Agreement interfering with marital duties.* An agreement which interferes with the performance of marital duties is void as being against public policy. Thus, an agreement to lend money to a woman in consideration of her getting a divorce and marrying the money lender is void.

9. *Marriage brokerage or marriage brokerage agreement.* An agreement to procure marriage for reward is void as being opposed to public policy. An agreement to pay money to parents or guardian in consideration of his giving his daughter in marriage is void.

The entire position regarding unlawful agreement may be summed up as: An agreement will be unlawful and so void if it is illegal or immoral or is opposed to public policy.

7. Void Agreement

An agreement may be void for the following reasons, namely:

1. there being no lawful consideration;
2. contracts by minor or a person of unsound mind;
3. contracts made under a mistake of fact on the part of both parties; and
4. agreements of which the consideration or objects are unlawful.

In addition to these four cases, the Contract Act expressly declares certain types of agreements to be void vide Section 26 to 30. Such contracts are :

1. *Agreements in restraint of marriage.* The law regards marriage and the married status as the ordinary right of every individual, and therefore, every agreement in restraint of marriage of an adult person is void. Thus, no restriction or limitation on a person's right to marry any person is valid (S. 26).
2. *Agreement in restraint of trade.* Every man is at liberty to work for himself and carry on any lawful business, trade or profession and is not at liberty to deprive himself of this right. Accordingly, Section 27 of the Act lays down that an agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind is void. In English law, however, contracts which impose reasonable restraints are valid. But in India, all agreements in restraint of trade, whether general or partial, qualified or unqualified, are void. Therefore, an agreement between an employee and his employer that the latter shall not carry on any similar business after the terms of employment is over is void.

Cases in which restraint of trade is valid in India. There are certain statutory exceptions to the above rule of Section 27. An agreement of trade is valid in the following cases:

- (a) *Sale of Goodwill.* A seller of a goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified limits as to territory and time so long as the buyer carries on a like business, and the restraint is reasonable.
- (b) A partner of a firm may be restrained from carrying on a similar business, so long as he remains a partner. [S. 11(2) of the Indian Partnership Act.]
- (c) Section 36(2) of the same Act provides that a partner may agree with the other partners that on ceasing to be a partner he will not carry on any business similar to that of the firm within specified local limits and time; and the agreement shall be valid if the restrictions are reasonable.
- (d) Section 54 of the same Act provides that partners may, upon or in anticipation of the dissolution of the firm, agree that all or some of them shall not carry on similar business within a specified period within specified local limits.

Similarly, negative stipulations in service contracts are not considered to be in restraint of trade and are, therefore, valid. Thus, a doctor employed in a hospital may be debarred from private practice.

3. *Agreement in restraint of legal proceedings.* A person cannot by agreement alter his personal law or the statutory law. Thus an agreement which prohibits a person from taking judicial proceedings in respect of any right arising from a contract, is void. But arbitration is valid.
4. *Uncertain agreements.* Agreements, the meaning of which is not certain, or capable of being made certain, are void [S 29]. For example, where A agrees to sell to B, “a hundred tons oil,” the agreement is void for uncertainty, for there is nothing to show what kind of oil was intended.
5. *Agreements by way of wagers.* Agreements, by way of wager are void. A wager is an agreement by which money is payable by one person to another on the happening or non-happening of a future uncertain event. The essence of gambling and wagering is that one party is to win and the other to lose upon a future event, which at the time of the contract is of an uncertain nature that is to say, if the event turns out one way. A will lose but if it turns out the other way he will win. For example, A agrees with B that if it rains on a certain day A will pay Rs.50. This is a Wagering agreement and void.

Commercial transaction and wagers. A commercial transaction may be valid or a wager according to the intention of the parties. A share of commodity transaction in which there is no intention to give or take delivery of the shares or the commodity and the parties intend to deal only with the differences in prices is a wagering transaction. But where there is a clear intention to give and take delivery it is not a wager but a valid contract.

Lotteries. A lottery is a game of chance. Therefore, an agreement to buy a lottery ticket is a wagering agreement. But where law has specially made lottery legal transaction it is valid.

Crossword Competitions. A crossword puzzle, in which prizes depend upon correspondence of the competitors’ solution with a previously prepared solution kept with the editor of a newspaper, is a lottery and, therefore, a wagering transaction. But, if for a successful solution a good measure of skill is required, it is not a wager; e.g., picture puzzles, athletic competition.

Contracts of insurances are not wagering agreements.

Effect of wagering agreements. An agreement by way of wager is void. It will not be enforced by the Courts of law. But, in Bombay Presidency, wagering agreements are, by a local Statute, not only void but also illegal. The consequence of this difference is that in Bombay, collateral agreements to wagering agreements are also void; while in the rest of India only the wagering agreements are void and transactions collateral to such agreements are not void. Thus, in Bombay, money lent to pay a gambling debt cannot be recovered by the lender, but in the rest of India it can be recovered.

6. *Impossible Act.* According to Section 56(1) an agreement to do an act impossible in itself is void. For example, where A agrees with B, to discover treasure by magic, the agreement is void.

8. Certainty and possibility of performance :

The agreement must be definite and not vague. If it is not definite then it is not possible to know its meaning. Therefore, it cannot be enforced.

Example : A agree to sell to B “a hundred tones of oil”. There is nothing whatever to show what kind of oil was desired. The agreement is void because it is uncertain.

Example: A agreed to purchase a motor van from B “On hire purchase terms”. The hire purchase price was to be paid over a period of two years. It was held that there was no contract as the terms were not certain about the rate of interest and mode of payment. In addition no particular meaning could be given to the words c’On hire purchase” Since there was a wide variety of hire purchase terms. [Scammel Vs. Ouston, (1941) A.C. 251]

The requirement of the law is also to see that the contract is such that it is capable of performance. If there is an agreement to perform an impossible act, it cannot be enforced. For Example, if A agrees with B to put life into B’s sister, the agreement is void as it is not possible to perform.

9. Legal formalities :

There are certain legal formalities in connection with some kinds of contracts which have to be satisfied. These legal formalities are of writing, registration, etc.

Although an agreement can be made by words spoken or written but in case if it is the requirement of the law that it must be in writing, it should be in writing otherwise the agreement will not be enforced by the court on the ground that the contract is not in writing. For example, if there is a contract to transfer immoveable property from A to B, the agreement must be in writing, it must be registered and it must be properly stamped. If such an agreement lacks any of the above mentioned legal formalities, the contract will not be enforceable. Therefore, the compliance of the statutory formalities must be ensured to make the agreement legally enforceable.

CONTINGENT AND QUASI CONTRACT

A contract may be absolute or contingent. A contract is said to be absolute when the promisor undertakes to perform it in any event. There is no condition attached to it; it is unconditional. A agrees to sell his horse to B for Rs.1,000; the contract is absolute or unconditional.

A contingent contract is a contract to do or not to do something, if some event, collateral to such contract does or does not happen (Section 31). An insurer contracts to pay B Rs.50,000, if B's house is burnt. This is a contingent contract. The contract relates to the payment of Rs.50,000, and the uncertain event collateral to the contract is the burning of the house. The promise of A to pay B Rs.50,000 is not absolute, but conditional on B's house getting burnt. If the house is not burnt, no payment is to be made.

Meaning of collateral event: It is important to clearly understand the meaning of 'collateral event' for the expression appears to resemble 'consideration'. A collateral event is an event which is neither a performance directly promised as a part of the contract, nor the whole of the consideration for a promise. This explanation shows that the following contracts are not contingent contracts:

- (a) A promises to pay B Rs. 1,000 if he marries C.'
- (b) A promises to pay Rs.100 to any person who recovers some property lost by A.

In example (a) there is an offer by A which becomes a binding promise when B marries C. The marrying of C by B is the consideration for A's promise to pay Rs. 1,000 to B. This may be conditional contract but it is not a contingent contract. In (b) there is no contract until and unless somebody finds the lost property. Nobody can claim the reward unless he recovers the goods; but the recovery of the goods is the consideration for the promise by A. It is not an event collateral to the contract.

But a contract whereby A promises to pay B Rs.50,000 if B's house is burnt, is a contingent contract because the liability of A arises only when B's house is burnt. This is an event collateral to the main contract because the burning of B's house is not the performance required for B under the contract; nor is it the consideration obtained from B. It is an independent event. (*Note:* The consideration given by B in the case is the premium paid to A for insuring his house against fire). Thus contracts of insurance, indemnity and guarantee are contingent contracts.

It follows that a contingent contract has two essential characteristics; ‘

- (a) the performance of the contracts depends on a contingency,
- (b) the contingency is “uncertain (if the contingency is bound to happen, the contract is due to be performed in any case and is not, therefore a contingent contract).

A contract may be contingent on some act of a party to the contract or of a third party. But if the performance of a promise is contingent upon the mere will and pleasure of the promisee, there is no contract at all. For example, where A promises to pay B what a third party C will determine, there is a valid contract contingent on C fixing the amount. But A promises to pay B for his services whatever A, the promisor, thinks reasonable it is not a promise.

Rules Regarding Contingent Contracts

1. Contracts contingent upon the happening of a future uncertain event, cannot be enforced by law unless and until that event has happened. If the event becomes impossible such contract becomes void.

A makes a contract with B to buy B's house if A survives C. This contract cannot be enforced unless and until C dies in A's lifetime. If the horse dies before the death of C, the contract becomes void on account of impossibility of performance.

2. Contract contingent upon the non-happening of an uncertain future event can be enforced when the happening of that event becomes impossible, and not before. For example A agrees to pay B a sum of money if a certain ship does not return, The ship is sunk. The contract can be enforced when the ship sinks.
3. If a contract is contingent upon how a person will act at an unspecified time, the event shall be considered to have become impossible when such person does anything which renders it impossible that he should so act within any definite time or otherwise than under further contingencies.
4. A agrees to pay B a sum of money if B marries C. C marries D. The marriage of B to C must now be considered impossible although it is possible that D may die and that C may afterward marry B.
5. A contract contingent upon the happening of an event within a fixed time, becomes void if, at the expiration of the fixed time, such event has not happened or if, before the time fixed, such event becomes impossible.

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

6. Contracts contingent upon the non-happening of an event within a fixed time may be enforced by law when the time fixed has expired or if it becomes certain that such event will not happen. .

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

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

A agrees to pay B Rs. 1,000 if B marries A's daughter C. C was dead at the time of the agreement. The agreement is void.

QUASI CONTRACTS

Or

Certain Relations Resembling those of Contracts

In a contract the promisor is under an obligation to the promisee and this obligation is undertaken voluntarily. The contract has all the essential elements of a valid contract, namely offer and acceptance, free consent, legal object and consideration and intention to enter into the contract. But sometimes an obligation may be imposed by law upon a person for the benefit of another person, even though the essential elements of a valid contract are absent. In fact, in such

a case, there is neither an agreement nor a promise. Such an obligation, though not contractual, resembles an obligation as created by contract, and the Court would enforce it as if were a contract. Such obligations are called Quasi Contracts, or relations resembling those of contracts. On the other hand, obligations created by agreements are called contracts.

A quasi Contract rests upon the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another. Duty, and not agreement or promise or intention, defines it. Thus, in the absence of any agreement, the law creates an obligation so that a person in possession of money or property should return it if in justice and fairness he ought not to retain it. For example, if a sum of money is paid by mistake, by A to B, then B is bound to return the money to A. This obligation or duty of B has certainly not arisen out of a contract, because B never agreed to return the money to A. This obligation is imposed upon B by law because he cannot be allowed to keep the money which belongs to A.

Sections 69 to 72 of the Contract Act deal with the cases which are deemed to be quasi contracts. The quasi-contracts are as follows;

1. Necessaries supplied to person incapable of contracting (S. 68).
 2. Suit for money had and received (S. 69 and 72).
 3. Quantum Meruit (S. 70)
 4. Obligations of a finder of goods (S. 71).
 5. Obligations of a person enjoying benefit of non-gratuitous act (S. 70).
1. *Claim for necessities supplied to a person incapable of contracting:* We have seen before that a contract with a minor or a person of unsound mind is void; but his estate is liable to reimburse the person supplying him necessities of life. Thus, if A supplies B, a minor necessities suited to B's conditions in life. A can recover price from B's property. Or, where A supplies necessities to the wife and children of B, a lunatic, suited to his condition in life, he is entitled to be reimbursed from B's property.
 2. *Suit for money had and received.* The right to file a suit to recover money under this head may arise in the following cases:
 - (a) Where a person paid money to another person under a mistake of fact or mistake of law or under coercion, the person so receiving the money must pay it back to the person who paid it by mistake of under coercion. A and B jointly owe Rs. 1,000 to C. A pays the amount to C and B, not knowing this fact, also pays Rs. 1,000. C must pay back the amount to B. Again where A is caught travelling without ticket on a tram-car and pays on demand by the inspector Rs.5 as penalty to avoid prosecution, he can recover the amount.
 - (b) In pursuance of a contract the consideration for which has failed. Thus where A paid premium to B for his apprenticeship with B, and before the relationship had started, B died, the money was recoverable.
 - (c) Payment to third party of money which another is bound to pay. Where A's goods are attached in order to realise arrears of government revenue due by B, and A pays the amount to save his goods from being sold, he is entitled to recover the amount from B.

- (d) Money obtained by a party from third parties. Thus, A, who is an agent of B obtains secret commission from a third party, can recover this amount from A.
3. *Quantum Meruit*. The expression quantum meruit means “as much as earned”. It is used where a person claims a reasonable payment for services rendered by him. A claim under quantum meruit generally arises where services are rendered in pursuance of a contract which provides for a lump sum payment after the promise is fully performed, and the party claiming for the part performance is prevented by the other party from completing it. Thus if A has worked for B in pursuance of a contract which has since been discharged by B’s breach, A may obtain reasonable remuneration for his work by suing B on a quantum meruit. The claim on quantum meruit may also arise where work has been done and accepted under a void contract. Thus, A was employed as a managing director by a company under a written contract. The contract was void and not binding because the directors who made it were not qualified. A rendered the services and sued for remuneration. He was entitled to recover on a quantum meruit.

A party in default may also sue on a quantum meruit for what he has done if the contract is divisible and the other party has had the benefit of the part which has been performed. A, the ship-owner failed to carry the full cargo. He was held to be entitled to recover the freight in proportion to the cargo carried. But if the contract is not divisible, the party at fault cannot claim the value of what he has done.

4. *Obligations of a finder of goods*. A person who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a bailee. The finder of goods must take reasonable care of the protection and preservation of the goods. The care must be such as would be taken by a man of ordinary prudence of his own goods. He must not appropriate the goods to his own use and, when the real owner is traced, he must return them to the owner. He is entitled to receive from the true owner all expenses incurred by him for protecting and preserving the goods. He has a lien on the goods for the money so spent and he can refuse to deliver unless he is paid. He may sell the goods if they are perishable. If they are not perishable, he can sell only if the costs and expenses incurred by him amount to two thirds of the value of the goods. Any balance of the proceeds after deducting the costs and expenses must be paid to the owner. It should be noted that only the true owner can recover possession from the finder. If the true owner is not found, the finder can retain the goods and no other person can claim them from him.
5. *Obligations of a person enjoying benefit of a non-gratuitous act*. Where a person lawfully does something for another person, or delivers anything to him, without any intention of doing so gratuitously (i.e., without charge or payment) and the other person enjoys the benefit thereof, the latter is bound to compensate the former or restore to him the thing so delivered. Thus where one of the two joint tenants pays the whole rent to the landlord he is entitled to compensation from his co-tenant. Where a tradesman delivers a bag of wheat by mistake at B’s house instead of at C’s, there is an obligation on the part of B to return the bag of wheat or pay its value. Here the parties never intended to enter into a contract, but the law implies a contract.

DISCHARGE OF CONTRACTS

When the obligations created by a contract come to an end, the contract is said to be discharged or terminated. A contract may be discharged in anyone of the following ways :

1. By performance of the contract.
2. By mutual agreement or consent canceling the agreement or substituting a new agreement in the place of the old one.
3. By impossibility of performance.
4. By lapse of time.
5. By operation of law.
6. By breach of contract made by one party.

1. Termination by Performance

The obvious mode of discharge of a contract is by performance, for that is what the parties had in mind when they made it. Thus, when a party performs a promise, his obligations come to an end. Performance by all the parties puts an end to the contract completely.

An offer of performance or *Tender* has the same effect as actual performance. If a party to a contract is willing and ready to perform his promise at the proper time and place, but the other party does not accept performance, the obligations of the first party are terminated, i.e., the contract is discharged. A tender, to be valid, must be (i) unconditional, (ii) made at a proper time and place, and (iii) the party should be willing -and ready as well as able to perform, (iv) the party should offer to perform the whole of what he is bound by his promise, and (v) the other party should have a reasonable opportunity to see that the article offered is the thing which the promisor is bound by his promise to deliver.

Mode of performance: A person who has to perform a contract must be ready to perform it at the time when he had undertaken to do so. Where the time and place are prescribed by the contract, the performance must be at the specified time and place; otherwise within a reasonable time and at some customary or reasonable place. The performance must also be in strict accordance with the terms of the contract.

Who may demand performance: The person to demand performance is a party to whom the promise is made, even though the promise was made for the benefit of some third person. For example, where A promises to B to give Rs.100 to C, the person who can demand payment is B, and not C.

Who is to perform: In cases involving personal skill or credit, the promisor must himself perform the contract. In all other cases, the promisor or his representative may employ a competent person to perform it. A promises to paint a picture for B, A must paint it personally. But where A promises to pay B a sum of money, A may pay it personally, or cause it to be paid to B by another. Where, however, a promisee accepts performance of a promise from a third person, he cannot afterwards enforce it against the promisor.

Contracts involving personal skill come to an end when the promisor dies. In other cases the legal representatives of a deceased promisor are bound to perform the contract. But their liability is limited to the assets obtained from the deceased.

Reciprocal Promises: A contract consists of reciprocal promises when one party makes a promise to do or not to do something in future in consideration of a similar promise to do or not to do something in future made by the other party. Reciprocal promises are of three classes :

- (1) Mutual and Independent promises; (2) Mutual and Dependent promises; (3) Mutual and Concurrent promises.
- (1) Where each party must perform his promise without waiting for the performance or the readiness to perform of the other, the promises are Mutual and Independent.
 - (a) A and B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before or independent of B's promise to pay for it.
 - (b) If A promises to deliver some goods on 15th July and B promises to pay the price on 10th July, B's paying the price is independent of A's delivering th; goods. Even if B does not pay the price on the 10th of July, A must deliver the goods on the 15th July. A can, of course, sue B for damages and the payments of price.
- (2) Where the performance of one party depends on the prior performance of the other party, the promises are Mutual and Dependent.

A contracts with B to construct a building for fixed price. B supplying the timber and cement. B fails to supply timber and cement and the work cannot be executed. A need not do the work and B is bound to compensate A for the loss caused to A.

- (3) Where each promise has to be performed at the same time they are *Mutual and Concurrent promises*.

A and B contract that A shall deliver goods to be paid for by B on delivery. Here the promise of each be performed at the same time. A need not deliver the goods unless B is ready and willing to pay for the goods on delivery; and B need not pay unless A is ready and willing to deliver the goods on payment.

When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promises, the contract becomes voidable at the option of the party so prevented. He is also entitled to claim compensation from the other party for any loss which he may sustain.

Appropriation of Payments When a debtor owes several distinct debts to the same creditor and makes a payment to the creditor, the question may arise against which debt the payment is to be appropriated. Sections 59, 60, 61 of the Contract Act contain the answer to this question. The rules laid down in these sections are :

- (i) Where the debtor at the time of payment states that the payment made by him should be applied to the discharge of some particular debt, the creditor must, if he accepts the payment, apply it to that debt.

A, a monthly tenant, owes rent for the months of May, June, July and August. He sent the amount of the rent for the month of August, without clearing the rents for the earlier months. The landlord may refuse to accepthis amount but if he accepts he must apply it to the discharge of the rent for August.

- (ii) If there is no express appropriation, but there, are circumstances which imply that the debtor intended appropriation to a particular debt the debtor's intention must be followed, if the payment is accepted.

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

- (iii) If there is no express or implied appropriation by the debtor, the creditor may apply the money to any lawful debt which is due and payable by the debtor. He may even apply it to debt which is barred by the law of limitation.

A had a running account with B, borrowing from B different amounts from time to time over a period of ten years. A did not repay any debt so that some of them became time-barred. After the expiry of the 10th year, A paid a certain sum of money. B could appropriate it to any debt he liked, even if it were barred by time.

- (iv) Where neither party makes any appropriation, the payment must be applied for the discharge of the debts in order of time, whether they are or are not barred by the law of limitation. If the debts are of the same date, the payment must be applied in discharge of each proportionately.
- (v) Where there is a debt carrying interest, and some money is received without a definite appropriation by the debtor, the money is first to be applied in payment of the interest, and then in payment of the capital.

Devolution of Joint Rights and Liabilities

Where two or more persons enter into a joint agreement with one or more persons, the following rules apply to their rights and liabilities, as laid down in Section 42-45 :

- (i) When two or more persons have made a joint promise, all such persons must fulfil the promise. But after the death of any one of them, legal representative jointly with the survivors, and after the death of the last survivor, the legal representative of all the joint promisors must fulfill the promise.
- (ii) When two or more persons make a joint promise, the promisee, in the absence of an express agreement to the contrary, can compel any one or more of such joint promisors to perform the whole promise.
- (iii) If one of the joint promisors is made to perform the whole contract, he can ask for equal contribution from others. Where A, B and C had jointly borrowed from D a sum of Rs.3,000 and A is compelled to pay the whole amount, he can force upon B and C to pay him Rs. 1,000 each.
- (iv) If any one of the joint promisors fails to contribute, the remaining joint promisors must bear the loss arising from such default in equal shares.
- (v) When one person has made a promise to several persons jointly, the right to claim, performance rests on all the promisees jointly.

Assignment of Contracts

Assignment means transfer. As a rule, an obligation or liability created by a contract cannot be assigned; for instance, if A owes B Rs.100 and A transfers his liability to C, i.e., asks C to pay the sum to B. This will not bind B and B may not concede to this arrangement. A will continue to be liable to B. But if B accepts performance from C, there is substitution of a new contract and the old contract is discharged and all rights under it are extinguished. This is technically called "Novation". Similarly, contracts involving personal skill, ability of credit cannot

be assigned. Thus, a contract to marry, a contract to make a picture, etc, must be personally performed.

But a contract may be performed through the agency of a competent person, if the contract does not contemplate performance by the promisor personally. However, the original party remains responsible for the proper performance of the obligations under the contract.

Though the liability under a contract cannot generally be assigned without the consent of the promisee, the rights and benefits under a contract may be assigned, and the assignee can demand performance against the promisor. Thus, if A is entitled to get Rs.500 from B, he can assign his right to C, whereupon C will become entitled to receive the money from B.

The rights of a party under a contract may amount to an "actionable claim". An actionable claim means a claim to any debt (except a secured debt) or to any beneficial interest; e.g., a money debt, book debts, the interests of a buyer of goods in a contract for forward delivery, an option to repurchase property sold, etc. Actionable claims are those claims, which can be enforced only through the court.

Actionable claims can be assigned only by a written document. Notice of assignment must be given to the debtor.

Assignment by operation of law occurs on death or insolvency. Upon the death of a party, his rights and liabilities under a contract devolve on his heirs and legal representatives. In case of insolvency of a person, his rights and liabilities pass to the Official Assignee or Official Receiver.

2. Discharge by Mutual Agreement or Consent

By agreement of all parties a contract may be cancelled or a new agreement substituted for it. Whenever any one of these happens, the old contract is terminated.

Termination by mutual agreement may occur in any one of the following ways (Section 62-63) :

Novation takes place by the substitution of an old contract by a new contract. This substitution may be between the same parties-or between different parties: consideration in novation is the discharge of old contract. Novation should occur before the old contract is (or existing contract) put to an end.

A owes money to B under a contract. It is agreed between A, B and C that B shall accept C as his debtor, instead of A. There is novation. The old debt of A to B is at an end, a new one from C to B has been contracted.

Alteration: Alteration of a contract takes place when one or more of the terms of the contract are changed with the consent of all the parties to contract.

Remission: Remission is the acceptance of a lesser sum than what was contracted for or a lesser fulfillment of the promise made. Thus, where A owes Rs.5,000 to B and pays Rs.4,000 and B accepts the amount in full satisfaction of the debt, the whole debt is discharged.

Waiver: Waiver means intentional giving up of a right which a person is entitled to. If a party waives his right under a contract, the other party is discharged from his obligation.

Merger: When a superior right and an inferior right coincide and meet in one and the same person, the inferior right vanishes into a superior right. This is known as merger. Where a man,

holding property under a lease buys it, his rights as a leasee (inferior right) are merged into his rights of ownership (superior right) which he has now acquired.

3. Discharge by Impossibility of performance

Section 56 of the Contract Act lays down the law relating to impossibility of performance and discharge of a contract under this heading.

- (i) A contract to perform something which is impossible in its very nature is void and creates no rights and obligations, e.g., a promise to ride a horse to the moon.
- (ii) A contract which at the time it was entered into, was capable of being performed, may subsequently become impossible to perform or unlawful. In such cases also the contract becomes void. This is sometimes described as the 'Doctrine of impossibility'.

A contract will be void by subsequent or supervening impossibility in any of the following ways:

- (a) Where there is a contract in respect of a particular subject matter that is later destroyed without the fault of the parties, the contract is discharged. A music hall was agreed to be let out for a series of concerts. The hall was burnt down before the date of the first concert. The contract was held to have become void.
- (b) When a contract is entered into on the basis of the continued existence of a certain state of things, the contract is discharged if the state of things changes or ceases to exist. A and D contract to marry each other. Before the time fixed for the marriage A goes mad, the contract becomes void.
- (c) Where the personal qualification of a party is the basis of the contract, the contract is discharged by the death or physical disablement of that party. A contracted with B that he should play the piano at concert given on a specific day. B was very ill on that day and unable to perform. The contract was discharged and B was excused from performance.
- (d) *Discharge by supervening Illegalities:* We have seen earlier that a contract which is contrary to law at the time of its formation is void. But if after the making of the contract owing to change of law, the performance of the contract becomes impossible, the contract is discharged.

A contract entered into during war with an alien enemy is void, if war breaks out after the contract is entered into it becomes void and discharged of its performance if this aids the enemy in the pursuit of war. *Instance where a contract is not discharged on the ground of impossibility:* Apart from the case mentioned above, impossibility does not discharge contracts. Therefore, in the following cases the contract is not discharged :

- (i) The mere fact that performance is more difficult or expensive or less profitable than the parties anticipated does not discharge the duty of performance. A promised to send certain goods from Bombay to London in September. In August war broke out, and the shipping space was available only at very high rates. The increase of rates did not excuse performance.
- (ii) Commercial impossibility to perform a contract does not discharge the contract. A contract is not to be said to be impossible because expectation of high profits is not realised.

- (iii) The principle of supervening impossibility does not extend to the case of a third person on whose work the promisor relied. A agreed to sell B a specified quantity of cotton goods to be manufactured at a particular mill. A could not supply the goods as agreed as the mill failed to produce the goods. It was held that the failure of the mill to produce did not make it impossible for A to perform his promise, the contract was not discharged on ground of supervening impossibility.
- (iv) Strikes, lockouts and civil disturbances like riots do not terminate contracts unless there is a clause in the contract to the contrary e.g., A dock strike does not set free a labour contractor from unloading the ship within a specified time.

4. Discharge by Lapse of Time

If a contract is not performed at the stipulated time it is discharged and the other party need not perform his part of the contract. Also where the limitation period is over party entitled to sue the other party, is deprived of the remedy.

5.. Discharge by operation of Law

A contract may be discharged by operation of law in. The following cases :

- (a) By death. In contracts involving personal skill or ability, the contract is terminated on the death of the promisor.
- (b) By merger. Merger takes place when an inferior right accruing to a party under a contract merges into a superior right accruing to the same party under the same or some other contract.
- (c) By insolvency. When a person is adjudged insolvent, he is discharged from all liabilities incurred prior to his adjudication.
- (d) By unauthorised alteration of the terms of a written agreement. Where a party to a contract makes any material alteration in the contract without the consent of the other party, the other party can avoid the contract. A material alteration is one which changes, in a significant manner, the legal identity or character of the contract or the rights and liabilities of the parties to the contract.
- (e) By rights and liabilities becoming vested in the same person, e.g., when a bill gets into the hands of the acceptor, the other parties are discharged.

6. Discharged by Breach of Contract

Breach of contract may arise in two ways: (i) by anticipatory breach, and (ii) by actual breach.

Anticipatory breach of a contract occurs when a party repudiates his liability under the contract before the time for performance is due to when a party by his own act disables himself from performing the contract.

- (a) A agrees to supply B with certain articles on June 15. Before that date A informs B that he will not be able to supply the goods.
- (b) A agrees to marry B on a certain date. Before the agreed date of marriage, he marries C. When anticipatory breach occurs, the aggrieved party can take the following steps :
 - (1) He can treat the contract as discharged, so that he is no longer bound by any obligations under the contract; and

- (2) He can immediately take the legal action available to him for breach of contract, namely, file a suit for damages or specific performance or injunction.

But an anticipatory breach of contract does not by itself discharge the contract. It is discharged only when the aggrieved party elect to treat it as discharged by actual breach. If he does not accept his repudiation, the contract continues to exist and may be performed by the other party, if possible. And if in the mean time an event happens which discharges the contract legally (e.g., a supervening impossibility) the aggrieved party loses its right to sue for damages.

- (a) A agrees to employ B as secretary the service to begin from first May. On 20th April, he informs B that his services will not be required. On 21st April, A files a suit for damages. He is entitled to do so even though the date of performance of the contract has not arrived.
- (b) A promised to assign to B within 7 years from the date of promise all his interest in house for Rs. 10,000, but before the end of 7 years he assigned his interest to C, B could file a suit for breach of contract without waiting for the expiry of 7 years.
- (c) A agreed to load a cargo of wheat on B's ship at Hamburg within a certain number of days. When the ship arrived, A refused, to load the cargo. B did not accept the refusal and continued to demand the cargo. Before last date of loading had expired the war broke out, rendering the performance of the contract illegal. The contract was discharged and B cannot sue for damages.

Actual breach of contract occurs when during the performance of the contract or at the time the performances of the contract are due; one party either fails or refuses to perform his obligations under the contract. A promise to deliver to B, 10 tonnes of sugar on 15th June. There is a breach of contract by B, if on the sugar being offered by A on the 15th June, B refuses to accept it without any valid reason.

Remedies for Breach of Contract

Parties to a contract are expected to perform their respective promises. But one of the parties may break the contract by refusing to perform his promise. In that event the parties become connected by a new obligation. One of them has a right of action against the other.

Remedies: When a contract is broken, the injured parties become entitled to any one or more of the following reliefs: (1) Rescission of the contracts; (2) Suit for damages; (3) Suit upon a quantum meruit; (4) Suit for specific performance of the contract; (5) Suit for an injunction.

A contract may be rescinded by agreement between the parties at any time before it is discharged by performance or in some other way. For example, a contract for the sale of goods can be discharged by mutual agreement between the buyer and the seller at any time before delivery of the goods or the payment of the price.

Rescission may also take place in the following manner; where a party to a contract fails to perform his obligations, the other party can rescind the contract without prejudice to his rights to receive compensation for breach of contract is a voidable contracts, one of the parties has the options of rescinding the contract.

Damages: When a party suffers by a breach of contract, he has a right to claim damages or compensation from the party who has broken the contract. The damages that may be allowed by the Court are of four kinds: (1) Ordinary, general or compensatory (2) Special (3) Exemplary, punitive or vindictive; (4) Nominal.

Ordinary Damages: Ordinary or general damages are calculated in such a way as to compensate or make up the loss suffered by the aggrieved or injured party. They are restricted to the natural and proximate consequences of the breach of contract and the remote or indirect consequences are not considered. The measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of the contract.

- (a) A agreed to sell and deliver a radio-set to B on 2nd April for Rs. 1,000 to be paid on delivery. A breaks his promise, and B had to pay Rs. 1,200 in the market for a similar set. He can recover from A the sum of Rs.200 being the difference between the contract price and market price therefore, Rs.200 is the direct loss resulting from the breach.
- (b) A sent by rail a wagon-load of certain goods from Delhi to Bombay. The goods were delayed in transit and arrived after the season for their sale was over. A sued the railway administration for damages, including profits which he would have earned if the goods had arrived in due course. A was awarded the damages equal to the difference between the price at which he purchased the goods and the value on re-sale, but no profits were awarded.

Special Damages: Special damages are those damages which result from the breach under special or peculiar circumstances. They need not arise naturally from the breach if the damages may reasonably be supposed to have been in the contemplation of both the parties at the time they made the contract. If any unusual damages are likely to be sustained as the result of the breach of contract, their nature should be communicated to the other party before the contract is made, so that he contract to pay the special damages.

A bought from B some copra cake (cattle feed). A sold the copra cake to farmers who used it for feeding cattle. The copra cake was poisonous and cattle fed on it died. The farmers claimed and got the damages for the loss of cattle and the cost the copra cake from A. A in turn, got the same from B, as it was within the contemplation of the parties that the copra cake was to be used for feeding cattle.

Exemplary or Vindictive Damage : These damages are awarded by way of punishment only, in two cases, namely, (1) for breach of promise to marry, and (2) for wrongful dishonour by a banker of his customer's cheque. In a breach of promise to marry, the amount of damages will be determined by the extent of injury to the lady's feelings. The amount may be quite heavy. Similarly, a drawer of the cheque wrongfully dishonoured, may be awarded heavy damages against the banker, depending upon the loss of credit and reputation of the drawer on account of the dishonour of the cheque. A businessman whose credit has suffered will get exemplary, damages even if he has sustained no pecuniary loss. The rule is the smaller the amount of cheque dishonoured, the greater the damage.

Nominal Damages: Nominal damages consist of a sum of money which is very small in quantity, e.g., a rupee. Where the court finds that party has not actually suffered much damage or when the court is of the opinion that the breach complained of was too petty or insignificant, the court allows a petty sum as damages.

Rules regarding amount of damages: The amount of damages is calculated in accordance with the following rules :

- (a) The injured party is to be, as far as money can do it, placed in the same financial position as if the contract had been performed.

- (b) Ordinarily, the injured party can recover by way of compensation only the actual loss suffered by him.
- (c) Remote damages i.e., damages for remote consequences, or those not naturally arising out of the breach are usually not allowed.
- (d) Special damages may be recovered, if such damages may reasonably be supposed to have been in the contemplation of both the parties at the time they made the contract.
- (e) In order to recover special damages the special circumstances must be communicated to the other party at the time of the contract.
- (f) If the parties agree about the amount of damages for breach of contract, no more than the agreed amount can be recovered.
- (g) It is the duty of the injured party to minimise the loss as much as possible, e.g. A took a shop on lease and paid an advance to B. B could not give A possession of the shop for 8 months, and A chose not to do any business during this period, although other shops were available in the vicinity. It was held that he was entitled only to a refund of his advance as his duty was to minimise damages and he could have done so by taking another shop.

Liquidated Damages and Penalty: A contract sometimes contains a clause in which a sum of money is named as the amount payable in case of breach of contract. In such cases the question arises whether the court will accept this figure as the measure of damages. According to English law, the amount of money payable is regarded as liquidated damages” or as a “penalty”. It would be treated as liquidated damages if the amount fixed is based upon a reasonable estimate of the probable actual loss which a party will suffer in case of breach. On the other hand, the amount fixed is considered to be penalty if it is not based upon reasonable calculation of actual loss but is fixed by way of punishment and as a threat. In case of liquidated damages English Courts allow only the amount stipulated, but penalty clause is treated as invalid.

In India, the distinction between liquidated damages and penalty is not recognised. Section 74 of the Contract Act lays down that if the parties have fixed the amount, the court will allow only a reasonable compensation, not exceeding the sum named by the parties. But the Court may allow less.

- (a) A contracts with B to pay Rs. 1,000 if he, A fails to pay Rs.500 on a given day. A fails to pay Rs.400 on that day. B is entitled to recover from A such compensation not exceeding Rs. 1,000 as the Court considers reasonable
- (b) A borrows Rs. 100 from B at 15 per cent per annum interest and agrees to pay back the principal and the interest within 12 months. He further agrees to pay three times the rate of interest if he fails to pay either the interest or the principal or both. This is a stipulation by way of penalty and the Court will not allow this rate.

Quantum Meruit: We have already seen that the term “quantum meruit, means as much as merited or earned”. A person can, under certain circumstances, claim payment for work done or goods supplied where the contract has terminated by breach of contract by one party or has become void for some reason. Thus, where there is a breach of contract the injured party is entitled to claim reasonable compensation for what he has done under the contract.

A contractor is engaged by B to build a house for him. After a part is constructed, B prevents the contractor from working any more. The contractor is entitled to reasonable compensation for the work done.

Specific Performance : Specific performance means the actual carrying out by the parties of their contract. In a proper case the Court will order the party breaking the contract to perform what he has promised to do. Generally speaking, specific performance will be ordered only in cases where monetary compensation is not an adequate remedy, for example, in contracts for the sale of a particular house or of some rare article, e.g., an art piece, money compensation is not enough because the injured party will not be able to get an exact substitute in the market. In such cases, specific performance will be ordered. In the following cases specific performance is not ordered :

- (1) Where monetary compensation is an adequate remedy.
- (2) Where the contract is of personal nature, e.g., a contract to marry, or a contract of personal services such as painting a picture or working as a secretary.
- (3) Where one of the parties is a minor.
- (4) Where the contract was not certain, fair or just.

Injunction: An injunction is an order of the Court restraining a person from doing some act. It will be granted to enforce a negative stipulation in a contract where damages would not be an adequate remedy. If a party has agreed not to do something and then does it, the other party can obtain an injunction from the Court stopping him from doing it. For example, a film actor agreed to act exclusively for Gemini Film Co., for a year. During the year he contracted to act for Prabhat Studio also. He could be restrained by an injunction from acting for Prabhat Studio.

Restitution of benefit: When a person, at whose option a contract is voidable, rescinds such contract, he must restore to the other party any benefit which he may have received from him. For example, when a contract for the sale of house is avoided on the ground of undue influence, any money received on account of price must be refunded.

Further, when an agreement is discovered to be void or when a contract becomes void, any person who has received any advantage under such agreement contract is bound to restore it or to make compensation for it, to the person from whom he received it. For example, A pays B Rs. 1,000 in consideration for B's promising to marry C, A's daughter. C is dead at the time of promise. The agreement is void, and B must pay back to A Rs. 1,000.

CONTRACTS OF INDEMNITY, GUARANTEE AND BAILMENT

Contracts of Indemnity

A contract of indemnity is a contingent contract. It is a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of any other person or by accident. The person who undertakes to indemnify or make good the loss is called the “indemnifier” and whose loss is made good is called the “indemnified” or “indemnity holder”.

A contracts to indemnify B for any consequences of any proceedings which C may take against B in respect of a certain sum of Rs.200. This is a contract of indemnity. If B is ordered to pay to C Rs.200, A shall be required to pay this amount to B.

A promise to indemnify may be express or implied. The illustration given above is an example of an express promise to indemnify. The following is an example of an implied promise to indemnify:

A broker forged the signature of the holder of government promissory note and endorsed it to the Bank of India. The bank got the note renewed from the government. The holder sued the government and recovered damages. The government sued the bank for indemnity. The suit was decreed. There was an implied promise by the bank that the note was genuine.

As we shall study that shortly, in a contract of guarantee there is an implied promise by the principal debtor to indemnify his agent for any expenses incurred in the performance of all lawful act done by the agent while acting for the principal. Similarly, a contract of insurance is a contract of indemnity. In short, the indemnity-holder is entitled to recover from the indemnifier all damages paid by him and all costs incurred by him and all other sums paid by him on account of the indemnifier.

Rights of Indemnity holder when sued

According to sec. 125 an indemnity holder is entitled to recover from the promisor :

- (i) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies.
- (ii) all costs which he may be compelled to pay in bringing or defending such suits. But the indemnified should have acted as any prudent man would act under similar circumstances in his own case, or with the authority of the indemnifier;
- (iii) all sums which he may have paid under the terms of any compromise of any such suit. The compromise should not be contrary to the orders of the indemnifier and should be prudent or authorised by the indemnifier.

Rights of indemnifier

The Indian Contract Act does not speak about the rights of indemnifier in a contract of indemnity. But on the basis of the authority of English Law, it may be stated that the rights of the indemnifier are similar to the rights of a surety under section 141. These rights have been discussed later on in this lesson itself.

Time of commencement of the liability of the indemnifier

No mention is found regarding the time of the commencement of the indemnifier's liability in the Indian contract Act. In this connection various High Courts have held different views. It has been observed by certain High Courts that the indemnifier is not liable until the indemnified has incurred the actual loss, where as other High Courts have held that the indemnified can force the indemnifier to make good his loss even before he discharges his liability. This position has been supported by Buckley. L.J. According to him, "Indemnity is not given by repayment after payment. Indemnity requires that the party indemnified shall never be called upon to pay." This view is based on equitable principles, as such it is followed by the courts. In an English case, it has been observed, "...to indemnify does not merely mean to re-imburse in respect of moneys paid, but to serve from loss in respect of liability against which the indemnity has been given ... if it be held that payment is a condition precedent to recovery, the contract may be of little value to the person to be indemnified, who may be unable to meet the claim in the first instance."

On similar lines it was observed by Justice Chagla that "If the indemnified had incurred a liability and that liability is absolute, he is entitled to call upon the indemnifier to same him from that liability and pay it off." [Gajanan Moreshwar Vs. Moreshwar Madan, A.I.R. (1942) Bombay 302].

Contract of Guarantee

A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the 'surety' or 'guarantor', the person for whom the guarantee is given is called the "principal debtor", and persons to whom the guarantee is called the "creditor".

A lends Rs. 1,000 to B and C stands surety for the payment of the debt. This is a contract of guarantee. If B does not pay the debt when it becomes due, then C shall have to pay the amount to A.

A contract of guarantee may be either oral or written. It should satisfy all the essentials of a valid contract. However, two points should be noted. In a contract of guarantee, the principal debtor may be a minor, although the surety must be a major. Secondly, the consideration received by the principal debtor is taken to be a sufficient consideration for surety's promise.

Fiduciary Relationship

In a contract of insurance utmost good faith is essential, but a contract of guarantee is not a contract of utmost good faith in the sense that there is an obligation on the part of the creditor to disclose to the surety every circumstance within his knowledge material to the surety to know. Still the surety is entitled to know so much as will tell him what is the transaction for which he is making himself answerable. He will be discharged, if there is either active misrepresentation of the matter by the creditor, or silence amounting to misrepresentation. A situation of this kind exists where an employer continues to employ the principal debtor, but fails to tell the surety that the employee, whose conduct has been guaranteed by the surety is a defaulter, thus representing him to be honest, therefore, a contract of guarantee may not be a contract of utmost good faith, but the suretyship relation is that of trust and confidence, and the validity of the contract depends upon good faith on the part of the creditor. A creditor must disclose these facts which under the circumstances the surety would expect not to exist, for omission to state that such facts do not exist is an implied representation that they do exist. A creditor in possession of unusual and important facts must impart those facts to the surety at the time the agreement is made. It is,

however, not every disclosure that a surety can require. The rule is that the creditor need not offer information if the surety has equal opportunity to discover such facts.

Difference between a contract of Indemnity and Guarantee

1. In a contract of indemnity, the promisor undertakes an independent liability, in a contract of guarantee the liability of the surety is secondary, so that he is liable to pay only if the principal debtor fails to pay.
2. In a contract of indemnity there are two parties-the indemnifier and the indemnity holder. In a contract of guarantee, there are three parties the creditor, the principal debtor and the surety.
3. In a contract of guarantee, there is an existing debt or duty, the performance of which is guaranteed by the surety. In a contract of indemnity, the liability of the indemnifier arises only on the happening of a contingency.
4. In a contract of guarantee, the surety, after he has discharged the debt owing to the creditor, can proceed against the principal debtor. In a contract of indemnity the loss falls on the indemnifier except in certain special cases.

Nature of surety's Liability. The liability of a surety is secondary. The surety is liable only on default of the principal debtor. Therefore, unless the principal debtor makes a default the surety cannot be called upon to pay. But the moment the principal debtor defaults hi the payment, then immediately, the surety becomes liable, as if he were the principal debtor. Therefore, as soon as the time for payment has come and the principal debtor does not, or is unable to pay, the surety becomes liable to pay. The creditor may file a suit against the surety without suing the principal debtor.

Once the liability of the surety arises, it is co-extensive with that of the principal debtor, it will be neither more nor less, although by a special contract it may be made less than that of the principal debtor but never greater. If the principal debtor is a minor and, therefore, not liable to pay back the debt to the creditor, the surety will be liable to pay.

Kinds of Guarantee :- A guarantee may be simple or specific or it may be continuing. A guarantee covering a single debt is called a simple specific guarantee, and comes to an end when the debt guaranteed has been paid.

A lends Rs.5000 to B and C promises to A that if B does not pay the money, C will pay it. This is a specific guarantee.

A continuing guarantee extends to a series of distinct and separate transactions, it is a continuing guarantee where A guarantees to B for 12 months the due payments of bill of exchange of C upto Rs. 10,000 if B discounts them during the period and upto the said amount, in case C fails to pay. Similarly A guarantees payment to B, a tea dealer, to the amount of Rs.5,000, for any tea he may from time to time supply to C.

Revocation of Continuing Guarantee: A continuing guarantee may be revoked by the surety as to future transactions, by notice to the creditor; but the surety remains liable for all transactions previous to the notice of revocation.

A. guarantees to B the payment by C of all sums lent by B from time to time to C during the period of 12 months upto Rs. 10,000. This is a continuing guarantee. If during the period of six months B had lent to C Rs.6,000 and A revokes the guarantee, then A will be discharged of

all liability to B for any subsequent loan. But A is liable to B for the payment of Rs.6,000 already advanced, if .C fails to pay.

The death of the surety operates, in the absence of a contract to the contrary, as a revocation of a continuing guarantee, as regards future transactions. But the estate of the surety will be liable for all transactions entered into prior to the death of the surety.

Discharge of Surety: A surety may be discharged from liability in anyone of the following circumstances :

1. Notice of Revocation: In the case of a continuing guarantee, a notice by the surety to the creditors stating that he will not be responsible any more, will revoke his liability as regards all future transactions.

2. Death of Surety: In the continuing guarantee the death of the surety discharges him from liability as regards transactions after his death unless there is a contract to the contrary.

3. Variation of Contract: Any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

4. Release or Discharge of Principal Debtor: The surety is discharged if the creditor makes a contract with the principal debtor by which the principal debtor is released, or acts or makes a commission which results in the discharge of the principal debtor. But mere forbearance on the part of the creditor to sue the principal debtor within the limitation period or to enforce any other remedy against him, does not discharge the surety:

- (a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.
- (b) A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber, C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.
- (c) B owes to C a debt guaranteed by E. The debt becomes payable. C does not sue B for a year after the debt has become payable. E is not discharged from his suretyship.

5. Compounding by Creditor with Principal Debtor: A contract between the creditor and the principal debtor by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety. But if the surety assents to such contract, he will not be discharged.

6. Creditor's Act or Omission Impairing Surety's Eventual Remedy: The surety is discharged when the creditor does any act which is inconsistent with the rights of the surety or omits to do any act which is his duty to the surety requires him to do, and the eventual remedy of the surety against the principal debtor is thereby impaired.

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

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

7. By Invalidation of Contract: A contract of guarantee may be avoided, and surety discharged, because it is either voidable or illegal. If the debt itself is void for illegality, it cannot be recovered from the surety. If a guarantee is obtained by coercion or under undue influence or by fraud, it would be void.

8. Failure of Consideration: A surety will be discharged on the failure of consideration. Where it was intended that three sureties should join, but it was discovered that they did not join, then the surety who actually signed the surety-bond under the impression that the others were going to join is discharged from his suretyship.

Right of surety on Payment: Where a surety has paid the guaranteed debt on its becoming due, or has performed the guaranteed duty, on the default of the principal debtor, he is invested with all the rights the creditor had against the principal debtor.

The surety is also entitled to the benefit of every security which the creditor had against the principal debtor at the time when the contract of suretyship was entered into: and if the creditor loses or without the consent of the surety, parts with such security the surety is discharged to the extent of the value of the security.

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

In every contract of guarantee there is implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee.

- (a) B is indebted to C, and A is surety, for the debt. C demands payment from A and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs as well as the principal debt.
- (b) A surety settled with the creditor by paying a sum smaller than the amount guaranteed. He can recover only what he actually paid.

Contributions between co-sureties : Sometimes it may happen that one and the same debt has been guaranteed by two or more sureties, either jointly or severally. Section 146 provides for a right of contribution between co-sureties.

When a surety has paid more than his share of the debt to the creditor, he has a right of contribution from other co-sureties, who are equally bound to pay with him.

A, B and C are sureties to D for the sum of Rs.3,000 lent to F. F makes a default in payment. A, B and C are liable as between themselves, to pay Rs. 1,000 each. If any one of them has to pay more than Rs. 1,000, he can claim contribution from the other to reduce payment to only Rs. 1,000. If any one of them becomes insolvent and nothing can be recovered from his estate, then the other two will have to pay the whole amount equally.

Where co sureties have agreed to guarantee different sums, they are liable to pay equally upto the maximum of the obligation of each one.

- (a) A, B and C, as sureties for D, enter into three several bonds, each in a different and separate penalty, namely, A in the penalty of Rs. 1,000, B, in that of Rs.2,000 and C in that of Rs.4,000 conditioned by duly according to E. D's makes default to extent of Rs.3,000. A, B and C are each liable to pay Rs. 1,000.
- (b) If, in the above illustration, D makes default to the extent of Rs.4,000, then A is liable to pay Rs. 1,000 and B and C Rs. 1,500 each.
- (c) If D makes default to the extent of Rs.7,000, A, B and C will have to pay each the full penalty of this bond; namely, Rs. 1,000, Rs.2,000 and Rs.4,000 respectively.

Contract of Bailment

Definition of Bailment: Bailment is the delivery of goods by on,- person called the bailor to another, called the bailee, for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the direction of the person delivering them (i.e., the bailor).

To constitute a bailment :

- (1) goods are delivered by one person to another;
- (2) the goods are delivered for some purpose;
- (3) the goods are to be returned to the bailor or disposed of according to his direction when the purpose is accomplished.

Illustrations

- (a) A lends a book for one week to B.
- (b) A delivers a watch to B for repair.
- (c) A gives his watch to B as security for a loan.
- (d) A gives a piece of cloth to B, a tailor for making into a suit.
- (e) A delivers his goods to a carrier to be conveyed from one place to another.
- (f) A gives to B some furniture on hire.

A bailment may be gratuitous, i.e., without any charge, or it may be for reward i.e., non gratuitous. Loan of an article and articles kept in safe custody without charge are two examples of gratuitous bailment, the parting with the possession of goods by the bailor is sufficient consideration. In a bailment for reward the consideration is the payment either by the bailor or the bailee. For example when A gives his car for repair to workshop, or when A gives his car on hire to B. In the first case consideration is paid by bailor and in second case by the bailee.

Duties of Bailee:

1. The bailee must take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods. As long as the bailee takes reasonable care that a man of average prudence would take of his own goods, he is not liable for any loss, damage, or destruction of goods.

A deposits his goods in B's warehouse: The warehouse is properly locked and watched. However, the goods are stolen. B is not liable for the loss.

2. The bailee must not make any unauthorised use of the goods bailed. If he makes an unauthorised use of the goods, he will be liable for all damages to the goods, and the bailor may terminate the bailment.

A lends a horse to B for his own riding only. B allows C to ride the horse. C rides with care, but the horse accidentally falls and is injured. B is liable to compensate A for the injury to the horse.

3. The bailee must keep the goods bailed to him separate from his own goods, and must not mix them without the consent of the bailor :

A deposits a tin of pure ghee with B who mixes vegetable ghee with it. B is liable to pay the price of pure ghee to A.

4. The bailee must return the goods to the bailor, or deliver them according to his directions, with the time for which they were bailed *[and]* expired, or the purpose for which they were given is accomplished. If the bailee does not return or deliver as directed by the bailor, or tender the goods at the proper time, he becomes liable for any loss, destruction or deterioration of goods, even when he is not negligent, or has taken reasonable care.

A delivered gold to B for turning it into ornaments and B promised to complete the work within a fortnight and hand over the ornaments to A. A pressed for the delivery of the ornaments, but B failed to do so, although a month had elapsed. In the mean time, B's shop was burgled. B was held liable to pay the price, although he was not negligent in keeping the goods.

5. In the absence of any contract to the contrary, the bailee must deliver to the bailor any increase or profit which may have accrued from the goods bailed.

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

Duties of Bailor :

1. The bailor must disclose all the faults in the goods bailed in so far as they are known to him. If he fails to do that, he will be liable to pay damages to the bailee which the latter may have suffered on account of the faults in the goods.

A lends a horse, which he knows to be vicious, to B, without disclosing this fact. The horse runs away and B is injured, A is responsible to B for the damages sustained.

2. If the goods are bailed for hire, the bailor is liable to pay damages, even if he did not know of the faults in the goods bailed.

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

3. In a bailment without remuneration (gratuitous bailment) the bailor must pay to the bailee all the necessary expenses incurred by him in connection with the bailment.

A is going on a holiday for a fortnight. He requests B to take care of his dog in his absence, and B agreed to do so. A must pay to B all the expenses incurred by B on the dog.

4. The bailor is bound to indemnify the bailee for any cost or loss which bailee may incur because of the defective title of the bailee to the goods bailed.

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

Bailee's Rights :

1. If the bailor does not perform any of his duties the bailee can sue him and get an order for their performance.
2. He has a right of lien. When the goods are bailed for a particular purpose, and bailee, in due performance of bailment expends skill and labour, he has a lien on the goods i.e., he can retain the goods until his charges are paid to him. But if the bailee does not complete the work within the agreed time, or a reasonable time, he cannot exercise the right of lien on the goods.

A gives a piece of cloth to B, a tailor, for making it into a suit. B promises to have suit read for delivery within ten days. B has the suit ready for delivery. He has a right to retain the suit until he is paid his duties. But if B had taken a fortnight to make the suit, he has no lien.

Liens are of two kinds: Particular Lien and General Lien. Particular lien is available only against that property in respect of which the skill and labour are used. A general lien is a right to detain any property belonging to the other and in the possession of the person trying to exercise the lien in respect of any payment lawfully due to him. A bailee has a particular lien. The bankers, factors, wharfingers, attorneys of a High Court, and policy-holders have general lien. These persons can, in the absence of a contract to the contrary, retain the goods bailed with them as security for any debt due to them.

Bailor's Rights :

1. The bailor can enforce by suit all the liabilities or duties of the bailee.
2. The bailor can terminate the bailment if the bailee does any act with regard to the goods bailed which is inconsistent with the terms of bailment.

A lets to B, for hire, a horse for his own riding. B drives the horse in his carriage. A can terminate the bailment.

3. When goods are lent gratuitously, the bailor can demand their return whenever he pleases, even though he lent them for a specified time or purpose. But if the bailee suffers any loss in excess the benefit derived by him because of premature return of goods, the bailor shall have to indemnify him.

Lien

Lien means a right of one person to retain possession of some goods belonging to another until some debt or claim of the person in possession is satisfied.

It may be particular Lien or a general Lien.

Particular Lien : A particular lien is one which is available to the bailee against those goods only in respect of which he has rendered any service involving the exercise of labour or skill. Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to claim such goods until he receives due remuneration for the services he has rendered in respect of them. Particular lien can be exercised under the following conditions :

- (1) In respect of those changes which have accrued as a result of labour or skill exercised by the bailee in respect of the goods bailed;
- (2) if the contract has been fully performed, i.e., the services have been performed in full by the bailee;
- (3) if there is no agreement between the bailor and the bailee for payment of price in future;
- (4) if the goods are in possession of the bailee. If possession is lost. Lien is also lost.

General Lien. A general lien is a right to retain all the goods or any property of another until all the claims of the holder are satisfied. This right is available to bankers, factors, wharfingers, attorneys of High Court, policy brokers.

A lien is extinguished by:

- (a) abandonment;
- (b) payment or tender of the amount due; and
- (c) loss or surrender of possession of the goods.

Rights of Bailor and Bailee against Third Parties

1. If a person other than the bailor, claims the goods bailed, he may apply to the court to stop delivery of the goods bailed and decide the title to the goods.
2. If a third party Wrongfully deprives the bailee of the use of the goods or does them any injury, the bailee may file a suit for deprivation or damages. He can also recover the goods from the wrong-doer. The bailor may also sue the third party for the injury or the deprivation caused by him.
3. Whatever is obtained by way of relief in such suits shall be divided between the bailor and the bailee according to their respective interest.

Termination of Bailment

A contract of bailment terminates under the following circumstances :

1. If the bailment is for a stipulated period, it terminates as soon as that period expires.
2. If the bailment is for a specified purpose, it terminates as soon as the purpose is accomplished.
3. If the bailee does any act, with regard to the goods bailed, which is inconsistent with the terms of the bailment, the bailment terminates.
4. A gratuitous bailment can be terminated any time but if the premature termination causes any loss to the bailee, the bailor must indemnify the bailee.
5. A gratuitous bailment terminates upon the death of either the bailor or the bailee.

Rights and Obligations of Finder of Goods

We have seen under Section 71 of the Contract Act that the position of finder of goods is exactly that of a bailee. As a bailee, therefore, he must take as much care of the goods that he finds as a man of ordinary prudence would, under similar circumstances, take of his own goods of like description, quality and value. Thus, so far as the real owner of the goods is concerned the finder is the bailee and must try to find out the owner and must not appropriate the property

to his own use. If the owner is traced, the finder restores the goods to him. The rights of the finder of goods are as follows :

1. He can retain possession of the goods against everybody except the true owner. A finds a diamond ring on the road and picks it up. A can keep it as his own as against the whole world, except the owner. .
2. He is entitled to be compensated for the trouble and expense incurred by him to preserve the goods and to find out the owner. He can refuse to return the goods until the owner pays such charges.
3. He can sue the owner for any reward that might have been offered and may retain the goods until he receives it.
4. If the owner cannot with reasonable diligence be found or if he refuses to pay the lawful charges of the finder, the finder may, sell the goods, provided :
 - (i) the thing is in danger of perishing or losing greater part of its value; or
 - (ii) the lawful charges of the finder amount to two-thirds of the value of the thing.

Bailment by Way of Pledge or Pawn

The deposit of goods as security for a payment of a debt or performance of a promise is called a Pledge or Pawn. The bailor or depositor is called the Pledger or Pawner. The bailee or the deposittee is called the Pledgee or the Pawnee.

Rights of the Pledgee

1. The pledgee or pawnee can retain the goods pledged, not only for the payment of the debt, but also for the payment of the interest on the debt, as well as any other expenses incurred in respect of the possession or for the preservation of the goods.
2. The pawnee's lien is a particular lien, i.e., he cannot retain the goods for any debt other than for which the security was given, unless there was a contract to the contrary.
3. The pawnee is entitled to receive from the pawner extraordinary expenses incurred by him for the preservation of the goods; but he cannot retain the goods until such payment is made.

A pawned a horse with B. The horse fell ill and B incurred certain expenses for curing it. B can sue A for the amount so spent, but he cannot retain the horse.

4. If the pawner makes a default in payment of the debt, or performance of the promise, in the stipulated time, the pawnee may—
 - (i) file a suit for the recovery of the amount due to him and retain the goods pledged as collateral security; or
 - (ii) sue for the sale of the goods and realisation of the money due to him; or
 - (iii) himself sell the goods pawned, after giving reasonable notice to the pawner.

If the proceeds of the sale either under (ii) or (iii) is less than the amount due, the pawner is still liable to pay the balance. If the proceeds are greater than the amount so due, the pawnee must pay over the surplus to the pawner.

Rights of Pledger

1. Where the pawner makes default in payment of the debt at the stipulated time, he may redeem the goods pledged at any time before the actual sale of them: but he must in that case, pay, in addition, any expenses which have arisen from his default.
2. If the pawnee makes an unauthorised sale, i.e., without giving a reasonable notice, the pawner may-
 - (i) file a suit for redemption of the goods by depositing the money, and treating the sale as if it had never taken place; or
 - (ii) ask for damages on the ground of conversion.
3. The pawner can enforce the preservation and proper maintenance of the goods pledged.

Pledge by Non-owners

The owner of goods can always pledge them. But in certain cases even a non-owner can make a valid pledge, these circumstances are as follows;

1. A mercantile agent who is, with the consent of the owner, in possession of the goods, can make a valid pledge of the goods while acting in the ordinary course of his business of a mercantile agent. Such a pledge will be valid and will bind the owner, even if the agent had no authority to pledge, provided that the pawnee acts in good faith and does not have, during the whole duration of the pledge, any notice that the pawner had no authority to pledge the goods.
2. A seller of goods, left in possession of goods sold, is no more the owner of goods but a pledge created by him will be valid, provided the pawnee acted in good faith and had no knowledge of the sale of the goods to the buyer. Again, where a buyer or a person who has agreed to buy, obtains possession of goods with the seller's consent, before the payment of price, pledges these goods to a pawnee who takes them in good faith and without notice of the seller's right to lien or any other right of the seller, the pledge is valid.
3. When the pawner is not the owner of the goods but has a limited interest in them, and pawns such goods, the pawn will be valid to the extent of the interest. A mortgagee or a person having lien over the goods may pledge them to the extent of his interest.
4. One of the co-owners in sole possession of the goods, with the consent of the other, can make a valid pledge of the goods.
5. A person having possession of goods under a voidable contract can make a valid pledge of the goods so long as the contract is not rescinded. The pawnee gets a good title to the goods provided he acts in good faith and without notice of the pawner's defective title.

AGENCY

Definition and General Rules: An “Agent” is a person employed to do any act for another or to represent another in dealings with a third person.

The person for whom such act is done, or who is so represented, is called the “Principal”. The appointment of such a person to act on his behalf results in the creation of agency. P appoints A to sell bales of cotton on his behalf. P is the principal and A is his agent.

The function of an agent is to bring about contractual relations between the principal and third parties. The agent does not make contracts on his own behalf, but acts only as a connecting link between his principal and third parties. Therefore, the act of the agent (within the scope of the authority or instruction) binds the principal as if the principal has done them himself. In other words, the acts of the agent are the acts of the principal.

As the agent brings about a contract between the principal and the third parties, it is essential both the principal and third party must have contractual capacity. A principal who has no contractual capacity (e.g., if he is a minor), cannot make a contract even by employing an agent who has contractual capacity. As the agent is only a connecting link and his acts are the acts of the principal, the agent need not have contractual capacity. A minor be appointed an agent. But the minor will not be liable to his principal for any misconduct.

P gives A, a minor, a ring worth Rs.500 and asks him not to sell it on credit and not for less than Rs.590. A sells the ring to B on credit for Rs.400. The transaction binds P and B, but P has no right to claim damages as against A for his misconduct, as A is a minor. (If A had been major, P could have recovered damages for his misconduct).

Methods of creating Agency

Agency may be created in any one of the following ways :

1. *Agency by Express Agreement.* A contract of agency may be created by express agreement. The agreement may be either oral or written. The usual form of written contract of agency is the power of Attorney which contains the terms and conditions according to which the agent is to act.
2. *Agency by Implied Agreement.* Implied authority may arise by conduct of the parties or necessities or circumstances of the case. Implied agency would therefore include Agency by estoppel, agency by holding out, and agency by necessity.
 - (i) Agency is created by estoppel or by implication of law in the following manner. When a man has, by his conduct or words, induced others to believe that a certain person is his agent, he is precluded from subsequently denying it. He will be bound by the acts of that certain person as if he had expressly authorised them. A tells B in the presence and within the hearing of P that he (A) is P’s agent and P does not contradict this statement. After some time B enters into a contract with A honestly believing that A is P’s agent. P is bound by the contract made by .A on his behalf, even though A is not P’s agent in reality.

- (ii) *Agency by Holding Out.* It is a variation of agency by estoppel; but in agency by holding out there is an affirmative conduct or statement by the principal. A person is held out as an agent, although he is actually not so.

P allows his servant A to buy goods for him on credit regularly. On one occasion the servant buys some goods on credit, but the goods were not ordered by P. P shall have to pay the price of goods because A has been held out as his agent.

- (iii) *Agency by Necessity* is said to be created when circumstances force a person to act on behalf of another without any express authority from him. Three conditions must be satisfied before an agency of necessity is created; (1) it must be impossible to get the principal's instructions; (2) there must be an actual and beneficial commercial necessity for acting on principal's behalf; and (3) the agent of necessity must act bonafide in the interest of all parties concerned.

A wife deserted by her husband, and thus forced to live separately from him, can pledge her husband's credit to buy all necessaries of life. If a ship is in port, and the necessaries for the voyage are waiting, or repairs to the ship are required, the master of the ship can pledge the owner's credit for these purposes. Also, a carrier of goods, in case of accident or upon an emergency, becomes an agent by necessity for the owner of goods to take care of them, and for that purpose can pledge the owner's credit.

- 3. *Agency by Ratification.* If the agent had no authority to contract on behalf of a principal or exceeded such authority as he had, the contract is not binding on the principal. The principal may, however, afterwards confirm or adopt the contract so made, and this is known as ratification; and agency by ratification or by subsequent authority is created. This is also known as *expost facto* agency arising after event. The effect of ratification is to render the contract as binding on the principal as if the agent had been properly authorised before hand. Ratification relates back to the original making of the contract, so that the agency is taken to have come into existence from the moment the agent first acted, and not from the date of principal's ratification.

A made an offer to B, the managing director of a company. B accepted the offer on behalf of that company, although he had no authority to do so. A then gave notice to the company that he withdrew the offer. The company subsequently ratified B's unauthorised acceptance. It was held that, as the ratification dated back to the time of the acceptance of the offer by B, the withdrawal of the offer was not operative. An offer once accepted cannot be withdrawn.

Ratification may be expressed or implied, i.e., it may be expressed by words or by conduct.

A, without authority, buys goods for B. Afterwards B sells them to C on his own account. B's conduct implies a ratification of the purchase by A for him. To be valid, a ratification must fulfill the following conditions :

1. The agent must expressly contract as .agent for a principal in contemplation. A person cannot enter- into a contract in his own name and later shift it on a third party.
2. The contract can only be ratified by a principal who was named or identified when the contract was made.
3. The agent must have a principal who is in actual existence at the time of the contract.
4. The principal must have contractual capacity at the date of the contract and at the date of ratification.

5. The principal must at the time of ratification, have full knowledge of the facts.
6. The ratification must be of the whole contract. The principal cannot ratify a part and reject another part.
7. Ratification must take place within a reasonable time after the contract is made.
8. The fact to be ratified must be a lawful one. There can be no ratification of an illegal act or an act which is void.

Ratification cannot be made so as to subject a third party to damages, or terminate any right or interest of a third party.

Kinds of Agent

The relationship between the principal and agent and the extent of the authority of the agent are matters to be determined by agreement between the parties.

Accordingly, an agent may be *A Special or General*. A *special agent* is appointed for a specific purpose or occasion to which his authority is restricted. He has authority only to do that particular act or acts in that particular transaction. If he does anything outside that particular authority, the principal is not liable.

A *general agent* is appointed to do anything within the general authority given by the principal. He acts in all transactions relating to the specified trade or matter. Third parties may assume that such an agent has power to do all that is usual for a general agent to do in the business involved. His acts are binding on the principal if they are within the scope of his apparent authority, although they may be outside the scope of his actual authority. Therefore, a private limitation of the apparent authority is not binding unless it is known by the other party to the contract. As examples of the two kinds of agents, it may be pointed out that the managing director of a company is the general agent of the company, and a man sent by a friend to bid from him at an auction sale is the special agent of his friend only for that purpose. Agents may also be classified as Mercantile Agents and Non-Mercantile Agents. A mercantile agent is an agent who, in the ordinary course of his business as agent, buys and sells goods on behalf of the principal.

Mercantile Agents

Factor: A factor is a mercantile agent with whom goods are kept for sale. He usually sells goods in his own name. He has a general lien on the goods for moneys due to him as agent. He has also an insurable interest in the goods and can insure them.

Broker: A broker is one who makes bargains for another and receives brokerage commission for doing so. The broker does not keep the goods of the principal in his possession. His duties are at an end as soon as the principal and the third party are brought together.

Commission Agent: A commission agent is one who secures buyers for a seller of goods and sellers for a buyer of goods, in return for a commission. He may have possession of the goods or not. He may sell or buy goods in his own name.

Del Credere Agent: A del credere agent is an agent who, for an extra remuneration guarantees to his principal that the third parties with whom he enters into contracts shall perform their obligations. If the other party fails to pay the price of goods or otherwise causes damages to the principal, the del credere agent must pay compensation to the principal. Del credere commission is in addition to his normal commission.

Auctioneer: An auctioneer is an agent who sells goods by public auction, i.e., to the highest bidder in public competition. He has no authority to warrant the goods sold and can deliver the goods on receipt of the price. As he has the possession of the goods he must arrange for their proper storage and is responsible to the owner for any damage caused through his negligence. He enjoys a particular lien on the goods for his charges.

Non-Mercantile Agents

Non-mercantile agents are: (1) Estate Agents, who are employed to negotiate the sale and purchase; or lease of immovable property, or (2) House Agents, who are similarly engaged with respect to house, shops, etc., or (3) Law Agents, whose business is to look after the legal affairs of their principals. In addition, there are attorneys, who act on behalf of their clients. Wife is also under certain circumstances, her husband's agent.

Wife as Agent: Where the husband has expressly authorised his wife to borrow money or pledge his credit; the husband is liable. But the question becomes difficult when the wife is regarded to have implied authority as her husband's agent. The position may be stated as follows: Where the husband and wife are living together, the wife is presumed to have implied authority to pledge the husband's credit for necessities. But the husband can escape liability if he can prove that (i) he has expressly forbidden his wife from borrowing money or buying on credit; (ii) the goods purchased were not necessities, (iii) he has allowed sufficient funds for purchasing the articles she needed to the knowledge of the tradesman; or (iv) the tradesman has been expressly told not to give credit to the wife.

Where the wife lives apart from the husband through no fault of hers, and is not provided with funds for her maintenance, she can bind the husband for necessities. But if the wife lives apart of her own will without justification, she is not her husband's agent and cannot bind him even for necessities.

Extent of Agent's Authority: The extent of an agent's authority may be either expressed or it may be implied by the circumstances of the case. An expressed authority may be given by the principal by Word of mouth or in writing. An implied authority can be inferred from words spoken or written or from the ordinary course of dealing between the parties and others.

A owns a shop in Delhi; but lives in Bombay, and visits 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 purpose of the shop.

Further more, an agent has an implied authority to do all that may be necessary for doing the act expressly authorised by the principal. Thus, an agent having authority to carry on business has authority to do every lawful thing necessary for the purpose, or usually done in the course of conducting such business.

A is employed by B, residing in London, to recover at Delhi a debt 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.

Again, an agent has authority to do all such things which may be necessary to protect the principal from loss in an emergency and which he would do to protect his own property under similar circumstances.

A consigns fresh fruits to B at Calcutta, with decisions to send them immediately to C at Cuttack. B may sell the fruits at Calcutta, if they will perish in transit to Cuttack.

Delegation of Authority:

The general rule is that an agent cannot appoint an agent to do what he has himself undertaken to do. But there are some exceptions to this rule (1) An agent may appoint a sub-agent where expressly authorised by the principal; or (2) where the custom of the trade permits such appointment; or (3) where the principal knows that the agent intends to delegate authority; or (4) where the nature of the authority is purely clerical or routine work; or (5) in an emergency an agent can always appoint a “sub-agent”.

An agent appointed by an agent is called “sub-agent” and works under the control of the original agent. The principal is bound by the acts of the sub-agent as if he were appointed as an agent by the principal. The agent is responsible to the principal for the act of the sub-agent. The sub-agent is responsible for his act to the agent; but the sub-agent is not responsible to the principal in case of fraud and wilful wrong. If the agent improperly appoints a sub-agent the agent is responsible for his act both to the principal and to third parties. The principal in such cases is neither represented by the sub-agent nor he is responsible for the act of the sub-agent.

A “Substituted Agent” is a person appointed by the agent according to the authority of the principal, to act on behalf of the principal in the business of the agency. Such a person is the agent of the principal and is responsible to him. In case of substituted agent there is direct privity of contract between him and the principal. In case of sub-agent there is no such privity between him and the principal, but in case of substituted agent the privity between principal and agent is a must.

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

Duties of an Agent: The duties of an agent are :

1. To carry out the work according to the instructions of the principal. If he does not act within the scope of his authority according to the principal’s instructions, he will be liable for any loss.
2. To follow the customs of trade in the absence of instructions.
3. To carry out the work with reasonable care, skill and diligence, where, by the nature of his profession, the agent purports to have special skill, then he must show as much skill as would be expected of men in that profession.
4. In case of the difficulty the agent must communicate with the principal and get his instructions.
5. As the agent acts on behalf of his principal all money received by him on behalf of the principal must be paid over to the principal. The agent is not to make any profit out of his agency except the receipt of remuneration.
6. It is the duty of the agent to keep and render true and correct account of all his transactions and to be always ready to produce them to his principal.

7. An agent must not deal on his own account in the business of the agency. In other words, he must not become principal as against his employer. For example, if the principal asks his agent to buy for him some shares of a company and the agent sells his own shares without informing, the latter can rescind the contract.
8. The agent must not disclose confidential information or documents entrusted to him by the principal.
9. Subject to the five exceptions noted above (delegation of authority) an agent must not delegate his authority to another person, but perform the work himself. *Duties of Principal: The duties of the principal are :*
 1. To pay the agent the commission or the other remuneration agreed between them.
 2. To indemnify the agent for acts lawfully done and liabilities incurred in the course of the agency. But the agent loses his right to an indemnity if he acts beyond his authority or negligently performs his duty.
 3. To make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.

A employs B, a brick layer in building a house, and puts up the scaffolding himself. The scaffolding is unskillfully put up, and B is hurt. A must make compensation to B.

Rights of Principal

The principal can enforce all the duties of the agent which are indirectly the rights of the principal when an agent fails in his duties towards the principal, then he has the following remedies against an agent :

1. To recover damages-If principal suffers any loss due to disregard by the agent of the directions given by him or by not following the customs of trade in the absence of directions, or where he suffers due to lack of requisite skill, care or diligence on the part of the agent, he can recover damages accruing as a result from the agent.
2. To recover secret profits-He can recover from the agent any secret profits made by the agent out of the agency and can resist agent's right to any commission in respect of that transaction.
3. To resist agent's claim for indemnity-Where he can show that the agent has acted as a principal himself, he can resist the agent's claim for indemnity against liability incurred by him in such a transaction.

Responsibilities of the Principal to Third Parties

1. The principal is bound by all acts of the agent done within the scope of actual, apparent and ostensible authority. This liability of the principal for acts done by the agent extends not only to acts actually authorised by the principal but also to such - acts of the agent as are necessary for the proper execution of the authority.
2. The principal is liable for misrepresentation or fraud of the agent committed in the course of the employment or within the scope of the employment or within the scope of the agent's apparent authority.
3. The principal is bound by the admission made by the agent.

4. The principal is bound by the information obtained by the agent in the course of the business of the principal. The agent is required to inform the principal of all matters relating to the agency, and therefore, it is presumed that he has done his duty and the principal is aware of the facts. Knowledge of the agent is said to be the knowledge of the principal.
5. *Liabilities of Undisclosed Principal:* Where, at the time of the contract, the agent disclosed the existence of the principal but not his name, such undisclosed principal is liable for the contracts made by the agent when he is disclosed.

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

6. *Concealed Principal:* Where neither the existence nor the identity of the principal is disclosed, the third party may sue either the principal, when discovered, or the agent at his option or both. Conversely the third party is liable to be sued either by the principal or the agent.

A concealed principal can require the performance of the contract by the third party subject to the rights and obligations subsisting between the agent and the other party.

A, who owes Rs.500 to B, sells Rs. 1,000 worth of rice to B. A is acting as agent for P in the transaction, but B has no knowledge that A is P's agent. P cannot compel B to take the rice without allowing him to set off A's debt.

Personal liability of Agent to Third Party

Where an agent contracts on behalf of a principal whom he names to the other party, the agent is merely a connecting link between his principal and the third party. As soon as contract is made, he drops out and incurs no personal liability. There are certain exceptions to his general rule, and accordingly an agent is personally liable to the third party in the following cases:

1. When the contract with the third party expressly provides for the agent's personal liability.
2. When the agent acts for a foreign principal; it is the agent who is liable, not the principal.
3. When the agent signs a negotiable instrument in his own name; without making it clear that he is signing as an agent.
4. The agent is personally liable when he acts for a concealed principal.
5. Where an agent acts for a principal who cannot be sued e.g., if he is a minor, the agent is personally liable.
6. When an agent acts for a non-existent principal, or acts without or beyond authority and the principal does not ratify his act.
7. Where the custom or usage of a trade makes the agent liable e.g., a Jobber may hold a broker liable as per custom of trade of stock exchange.
8. When the authority is "coupled with interest", the agent is personally liable. Where an agent has interest in the subject matter of the contract which he signs, his authority

is said to be coupled with interest. For example, P authorises A to sell his (P's) land and out of the sale proceeds of that land to pay himself the debt due to him from P. A's authority is coupled with interest.

Termination of Agency : An agency may be terminated by act of parties or by operation of law. In particular, a contract of agency comes to an end in the following ways :

1. Where the agency is one for a single transaction, it terminates when the transaction is completed.
2. It can be terminated at any time by mutual agreement between the principal and the agent.
3. If the authority is given for a fixed period, the agency comes to an end on the expiry of the period.
4. An agency terminates by the death or insanity of the principal or of the agent.
5. An agency terminates by the insolvency of the principal and of the agent.
6. Where the principal or agent is a company, the agency comes to an end by its dissolution. ;
7. It also terminates by the destruction of subject matter.
8. The agent may, by giving reasonable notice to the principal, renounce the contract of agency.
9. The principal can revoke the authority of the agent at any time, by giving notice to the agent.

Termination of agency takes effect when it becomes known to the agent, and so far as the third parties are concerned, when it becomes known to them.

Irrevocable Agency

When the authority given to an agent cannot be revoked by the principal, it is said to be an irrevocable agency. An agency becomes irrevocable in the following three cases:

1. *Where an agency is one coupled with interest.* When a creditor is employed as an agent to collect rent due to a principal for adjusting the amount towards his debt, the authority of the agents is coupled with interest and it is irrevocable during the subsistence of the interest. It should be noted here that this rule applies only if the agency is created for the protection of interest of agent. It does not apply if the interest arises after the creation of agency.

Example

A consigns, 1000 bales of cotton to B, who has made advances to him on such cotton. A desires B to sell the cotton, and to repay himself, out of the price of cotton, the amount of his own advances. A cannot revoke his authority, nor is it terminated by his insanity or death.

2. Where an agent has incurred personal liability. The revocation would cause agent personal loss. The principal cannot in such a case revoke the agency leaving the agent exposed to the risk or liability he has already incurred.

Example

P gives authority to A to pay P's creditor C and places the necessary money in the hands of A for that purpose. Thereupon A informs C that he has received the money in his hands for payment of his debt and that C may collect the same any time from him. P cannot revoke A's authority to pay C as A has incurred a personal liability.

3. Where the authority has been partly exercised by the agent, the principal cannot revoke it, so far as regards such acts and obligations as arise from acts already done in the agency.

THE INDIAN PARTNERSHIP ACT, 1932

The law of partnership is contained in the Indian Partnership Act, 1932, which came into force on 1st Oct., 1932. This is based on the English Law on the subject as contained in the Partnership Act, 1890. The main principles are the same. The most important change is regarding provision for registration of firms.

Definition and Nature of Partnership : Section 4 of the Partnership Act defines Partnership as “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”. The English Partnership Act defines Partnership as “the relation which subsists between persons carrying on business in common with a view of profit”. If we elaborate we find this definition points out the following essential elements of partnership:

1. There must be at least two persons.
2. That it is the result of an agreement.
3. That it is organised to carry on a business.
4. That the persons concerned agree to share the profits of the business.
5. That the business is to be carried on by all or anyone of them acting for all.

1. Association of at least Two Persons: In order to constitute a partnership legally there must be an association of at least two persons. Regarding the maximum number of Partners in a firm Sec. II of the Companies Act provides that the number of partners in a firm carrying on banking business should not exceed 10 and in any other business 20.

2. Agreement: According to Section 5 a partnership is created by contract and not by status. It is however, not necessary that there should be a very formal or written agreement. The agreement to create a partnership may as well arise from the conduct of the parties concerned. Where, the parties agree to enter into partnership at some future date, the relation of partnership does not arise until that date.

3. Business: A partnership can be formed only for the purpose of carrying on business. Business includes every trade, occupation and profession. The word business generally conveys the idea of running business involving numerous transactions. The business to be carried on by the firm must be legal.

4. Sharing of Profits: The word Partnership is derived from the word “to part” which means “to divide”. Thus division of profits is an essential condition of the existence of a partnership. The object of partnership should be to make profits and distribute among the partners.

5. Mutual Agency: The business of partnership may be carried on by all or anyone of them acting for all. Thus, if a person carrying on the business acts not only for himself but

for others also, so that they stand in the position of principals and agents, they are partners. It is not necessary that all of them should actively participate in the affairs of business. The necessary element is that the business must be carried on, on behalf of all the partners.

Test of Partnership: In a partnership, all the elements mentioned above must be present. Thus, although sharing of profits is a strong evidence of the existence of partnership, yet the true test is the element of agency. For this reason, creditor who advances money on the understanding

that he would have a share in the profits of business in lieu of interest is not a partner. Similarly, an employee getting a share of profits as a part of his remuneration, or the seller of goodwill of the business receiving a portion of the profits, is not a partner. In all these cases the third element of partnership, namely, agency is absent. A creditor or an employee or the seller of the goodwill cannot bind the firm by their actions, can be called partners. Thus, in the absence of definite partnership agreement the Court, in order to determine the existence of partnership, must take into account all the relevant circumstances, such as, the conduct of parties; the mode of doing business; who controls the property; the mode of keeping accounts; the manner of distribution of profits; evidence of employees and correspondence.

To sum up, for determining the existence of partnership, the following must be considered:

- (1) There must be an agreement-oral or written;
- (2) the agreement must be to share the profits ;
- (3) those profits must arise from a business; and

(4) that business must be carried on by all or anyone of them acting for all. **Partnership distinguished from other Associations**

Partnership and Co-ownership : Co-ownership means joint ownership. A and B jointly buy a horse for their riding. They are co-owners of the horse and not partners.

(1) Co-ownership is not always the result of agreement. It may arise by the operation of law or from status, e.g., co-heirs of a property, persons to whom property is jointly, given. Partnership, on the other hand, is necessarily the result of agreement, express or implied. (2) Partnership necessarily involves working for profit. Co-ownership does not. (3) One co-owner can, without the consent of the others, transfer his rights and interest to stranger; a partner cannot do so without the consent of all the partners (4) A partner is the agent of the partnership to bind the firm. A co-owner has no implied authority to bind the other co-owners. (5) Partnership always implies a business. Co-ownership can exist without any business, e.g., joint ownership of a residential house. (6) A partner, being an agent of other partners has a lien on the partnership property. A co-owner has no such lien on the joint property.

Partnership and Company : The points of distinction between the two may be summed up as follows :

1. A company comes into existence after registration under the Companies Act. In the case of partnership, registration is not compulsory.
2. The maximum number of persons required to form a company is seven in the case of public company and two in the case of a private company. A partnership can be formed with two persons.
3. A public company may have any number of members. A private company cannot have more than 50 members. A partnership carrying on banking business cannot have more than 10 members and a partnership carrying on any other business cannot have more than 20 partners.
4. A company is regarded by law as a single person separate from the members, who constitute it. It has a legal personality. The partnership is a collection of partners. It is not a legal entity and has no rights and obligations separate from its partners.

5. The property of a partnership is the joint property of the partners. Each partner has authority to bind the firm by his acts. The property of a company belongs to the company. A shareholder in his individual capacity cannot bind the company by his acts.
6. A company has perpetual succession. The death or insolvency of a member does not affect its existence. A partnership firm, in the absence of a contract to the contrary, comes to an end when a partner dies or becomes insolvent.
7. The liability of partners for the debts of the firm is always unlimited. The liability of the members of a company is usually limited.
8. The creditors of a partnership firm are creditors of the individual partners, and a decree obtained against a firm can be executed even against the individual partners. The creditors of a company are not creditors of individual shareholders. A decree obtained against a company can be executed only against the company, and not against the shareholders.
9. A partner of a firm cannot transfer his interest in the firm to an outsider and make the transferee a partner without the consent of all the others. A shareholder of a company can transfer his shares and the transferee can become a member of the company.

Partnership and Joint Hindu Family Firm. A joint Hindu family which carries on a business handed down from its ancestors is called a Joint Hindu Family Firm. The interest in the business passes by survivorship to the surviving members, and every member acquires by birth an interest in the profits and assets of the business. This is not partnership, but a co-parcenary, a relationship created by Hindu Law, and each member is called a co-parcener. The points of distinction between Hindu family firm and a partnership may be enumerated as follows:

1. A partnership is created by agreement: A Joint Hindu family firm comes into existence by operation of law. Membership of joint family firm is the result of status, i.e. position of the person concerned as member of a joint family.
2. In a partnership, the death of a partner dissolves the firm, the death of a coparcener does not dissolve the joint family firm.
3. In a joint family firm only the manager or Karta has authority to bind the members by his acts, in a partnership each partner can do this.
4. In a partnership every partner is personally liable to an unlimited extent for the debts of the firm. In a joint Hindu family firm, only the Karta has unlimited liability. The other members are liable only to the extent of their share in the joint family business. Minor members are not liable.
5. Minor members of a joint family are members of the firm from the date of their birth. In a partnership a minor cannot *be* a partner, as a partnership is the result of an agreement and a minor does not have capacity to enter into a contract.
6. The partners have a right to demand accounts of the partnership firm, a co-partner cannot ask for an account of past dealings; his only right is to ask for partition of the assets of the firm.
7. A partnership is governed by the Partnership Act; a joint Hindu family firm is governed by Hindu Law.

Partnership and Club. A club is an association of persons formed for social purpose. It is not formed for gain and is not, therefore, a partnership. A club differs from a partnership in the following respects :

1. A club is not a business, and there is no motive of earning profits and sharing them. A partnership is formed to carry on business and to share profits of the business. A club may be having profit by running a club canteen but it can not be called partnership because its object is not to carry on a business and share its profits.
2. A member of a club is not the agent of the other members and so members of a club are not liable for each other's acts. A partner is an agent of the other partners and all partners are liable for the acts of a partner.
3. A member of a club is not liable for the debts of the club, but a partner is liable for the debts of the firm.
4. The death or resignation of a member does not affect the existence of the club. The death or insolvency of a partner dissolves the firm .
5. A member of a club has no transmissible interest in the club so that on his death his heirs cannot claim to inherit any of his rights. A deceased partner's heirs inherit his interest in the partnership firm.

FORMATION OF PARTNERSHIP

In a contract of partnership all the elements of a valid contract must be present. There must be free consent, consideration, lawful object and the parties must have capacity to contract. Thus an alien friend can enter into partnership, an alien enemy cannot. A minor is not competent to be a partner. A minor can, however, be admitted to the benefits of partnership, if all the partners agree to do so.

A partnership agreement may be oral or it may be implied or inferred from the conduct of the parties. When it is reduced to writing it is incorporated in a document known as the Deed of Partnership or Articles of Partnership. The deed must be stamped according to the provisions of the Stamp Act. Thereafter, the firm may be registered with the Registrar of Firms, although registration is not compulsory. Because of the disabilities suffered by an unregistered firm, it is advisable to register every firm.

According to S.58 the registration should be made in the form of a Statement signed by all the partners and giving :

- (1) the name of the firm;
- (2) the principal place of business of the firm;
- (3) name of the other place (if any) where the firm carries on business;
- (4) the date on which each partner joined the firm;
- (5) the names in full and addresses of the partners;
- (6) the duration of the firm. Furthermore, every change in the names and addresses of the partners or place of business should be notified to the Registrar of Firms from time to time.

REGISTRATION OF A FIRM

Effect of Non-registration of a Firm: Unlike English law registration is optional under Indian Partnership Act, But it becomes indirectly necessary, so that if a firm is not registered, the following consequences will ensue :

1. A partner of an unregistered firm cannot file a suit against the firm or any partner to enforce a right arising from a contract or conferred by the Partnership Act [S.69(1)] Where A, B, C and Dare partners in an unregistered firm. D is wrongfully expelled from the firm by the rest of partners D can not file a suit for his wrongful expulsion, the only remedy available to him is to file a suit for the dissolution of firm.
2. An unregistered firm cannot file a suit against any third party to enforce a right arising from a contract. [S, 69(2)]. This clause does not prohibit an unregistered firm to enter into contract with third parties, the bar is only against taking action against third parties. However, the third parties are free to take action against unregistered partnership.
3. An unregistered firm cannot claim a set off above Rs.100 in a suit [S.69(3)].

According to Section 69 of the Partnership Act the *non-registration of a firm does not affect the following :*

1. The right of a third party to sue the firm or any partner.
2. The right of a partner to sue for dissolution of the firm or for settlement of accounts if the firm is already dissolved or for his share of the assets of the dissolved firm.
3. The right of an unregistered firm to sue to enforce a right arising otherwise than out of contract, e.g., for an injunction against a person wrongfully using the name of the firm; or for wrongful infringement of a trade mark. Registration is not necessary for a suit in respect of tort committed by a partner.
4. The power of an Official Assignee or Official Receiver to realise the property of an insolvent partner.
5. A suit or set-off not exceeding Rs. 100 in amount
6. The rights of firms or partners of firms having no place of business in India.

Registration Time: An unregistered firm can get itself registered at any time before it is actually dissolved. But in any case it should be registered before filling a suit in the court, otherwise the court will reject such suit. In order to institute a suit not only the firm must be a registered one, but all the partners suing must also be shown as partners in the register of firms.

Example: A partnership firm consisting of A, Band C as partners was formed and it commenced its business before getting itself registered. The firm filled a suit against X for a claim of Rs.5000 for goods supplied to him and immediately after filling the suit, the firm was registered. The court will dismiss the suit because the firm was unregistered at the time of filling the suit.

But where a suit is dismissed because of the non-registration of a firm or it is with-drawn before it is dismissed by the court, the firm can subsequently get itself registered and file the suit again provided the suit has not become time barred.

Firm and Firm Name: Persons who have entered into partnership with one another are called individually “partners” and collectively “a firm”, and the name under which their business is carried on is called the “firm name” (Sec. 4).

A firm is not an artificial and legal person like a company. It is merely a collective name for the partners. It is just a convenient way of describing the partners. The rights and obligations of the partnership firms are really the rights and obligations of the partners constituting it.

Duration of Partnership: The parties may fix the duration of the partnership or say nothing about it. Where the partners decide to carry on the business for a certain period of time, it is called a “partnership for a fixed period”. When the period is over, the partnership comes to an end. Where the partnership is formed for the purpose of carrying on particular venture, it is called a “particular partnership”. It comes to an end on the completion of the venture. It is also open to partners to say nothing about the duration or to agree that the business shall be carried on not for a fixed period, but so long as the partners are inclined to carry it on. Such a partnership is called “Partnership at will”. It is dissolved by notice by a partner to his copartners.

Partnership Property: The property of the firm includes (i) all property and rights and interests in property originally brought into the stock of the firm, or subsequently added thereto; (ii) the property acquired in the course of the business with money belonging to the firm; (iii) the goodwill of the business, the property of the firm is acquired to be used by the partners for the exclusive use of the firm.

Examples of Partnership Property

- (a) A partnership is formed with A, B and C as partners. A contributes to the stock of the firm a plot of land. B a motor lorry and C the sum of Rs. 10,000. Subsequently, the firm purchases, out of its earnings, a house. All these properties and the goodwill of the business are properties of the firm.
- (b) A colliery owned by A was taken on lease by a firm consisting of A and B as partners and was worked. The profits were shared by the partners. The colliery was taken to be property of the firm for the time being. But if the colliery were only worked in partnership by A and B who shared profits of the venture, the colliery remained the property of A, and did not become the property of the firm.

Partnership Deed. The agreement creating partnership may be express or implied, and the latter may be concluded from the conduct or the course of dealings of the parties or from the circumstances of the case. But it is in the interest of the partners that the agreement must be in writing. The document which contains this agreement is called Partnership Deed. It contains provisions relating to the nature and principal place of business, the name of the firm, the names and addresses of the partners, the duration of the firm, profit sharing ratio, interest on capital and drawings, valuation of goodwill on the death or retirement of a partner, management, accounts, arbitration, etc. The Indian Stamp Act, 1889, requires that the Deed must be stamped.

Who can become a partner

Any person who is competent to contract can enter into partnership agreement. The position of following persons need special consideration :

1. **Minor:** A minor is not competent to contract, hence he can not enter into partnership contract. However he may be admitted to the benefits of partnership, if all the partners agree to do so.
2. **Alien:** An alien enemy can not be partner in an Indian firm.
3. **Person of unsound mind:** A person of unsound mind, not being competent to contract can not enter into a partnership contract.

4. **Company:** A company, if authorised by its articles of association can enter into partnership because it is a person competent to contract in the eyes of law.
5. **Firm:** A firm can not enter into partnership contract. If a firm, at all enters into partnership in that case, the members become partners in the other firm in their individual capacity.

Position of a Minor admitted as a partner to the Benefits of Partnership

We have seen earlier that partnership results from a contract. Consequently, a minor cannot enter into a contract of partnership as an agreement by a minor is void. It follows that a minor cannot become a partner, nor can a partnership be created with a minor as a partner. But if all the partners agree a minor may be admitted to the benefits of an already existing partnership firm. It should be remembered that even after such admission the minor does not become one of the group of persons called the firm.

Section 30 of the Partnership Act lays down the rights and liabilities of a minor admitted to the benefits of a partnership as follows :

1. The minor has a right to such share of the property and of the profits of the firm as may be agreed upon by the partners.
2. The minor has access to and inspect and copy any of the accounts of the firm.
3. The minor is not personally liable for the debts and obligations of the firm although his share in the profits and of the assets of the firm will be liable for the same.
4. So long as the minor continues to be in the firm, he cannot file a suit against the other partners for an account or for the payment of his share of the property or profits of the firm. He can file such a suit only when he wants to sever his connection with the firm.
5. At any time within six months of his attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, the minor has to elect either to become or not to become a partner in the firm. Such election may be made by a public notice. If he gives no notice to this effect he shall become a partner in the firm on the expiry of the said six months.
6. A minor who thus becomes a partner will become personally liable for all debts and obligations of the firm incurred since the date of his admission to the benefits of partnership.
7. Where the minor elects not to become a partner the following rules will apply:
 - (a) His rights and liabilities continue to be those of a minor upto the date on which he gives public notice to not to become its partner.
 - (b) His share will not be liable for any act of the firm done after the date of the notice.
 - (c) He can sue the partners for his share of the property and profits of the firm.

Classes of Partners

A person who deals with a firm would like to know who are the partners, and to what extent they are liable to him for his claim against the firm. The position of different classes of partners may be examined as follows :

Actual Partner: A person who has by agreement become a partner and who takes actual part in the conduct of partnership business is an actual and working partner. He is the agent of other partners for the purposes of the business. All his acts in the ordinary course of the business bind him and the other partners to third parties.

Partner by Holding Out: A person may, under certain circumstances, be liable for the debt of the firm although he is not a partner. If a person by words spoken or written, or by conduct represents himself or knowingly permits to be represented, to be a partner in a firm, he is liable as a partner in that firm to anyone who has, on the faith of such representation, given credit to the firm (Sec. 28). So, where a person conducts himself as to lead another to believe that he is a partner, although really he is not, and on that belief the other person gives credit to the firm, he is deemed to be a partner by holding out.

- (a) A, B and C carry on a business for profit. C contributes neither labour nor money, and does not receive any share of the profits, but his name is used as a partner in the firm. He is liable to every outsider who gives credit relying on his being there as partner.
- (b) Suresh carried on business in the name of the business as Ram Saran and Co., employed a person named Ram Saran to act as manager of the business. Ram Saran was regarded as partner by holding out or estoppel.

The position of a partner by holding out is peculiar. He is liable to make good the loss which the person giving credit to the firm may suffer, but he has no claim upon the firm. A partner who has retired from the firm but allows the use of his name to continue with the firm may become liable to third parties by the principle of holding out.

Example: P retired from a firm consisting of P, X and R as its partners. He failed to give notice of his retirement. After his retirement S joined the firm and the firm continued its business under the old name. One creditor filed a suit for the recovery of his debt after the retirement of P. It was held the creditor could make P and his co-partners X and R liable for his debt on the principle of estoppel. But he can not file a suit against P, X, R and S, all of them together.

Dormant or Sleeping Partner: A person who is in reality a partner but whose name does not appear in any way as partner, nor does he take part in the management of the business, and is not, therefore, known to outsiders as partner in the firm, is called a dormant or sleeping partner. Such a partner is liable to third parties who gave credit to the firm even without knowing of his being partner but subsequently discovering the fact. A sleeping partner's liability rests on his being in the position of an undisclosed principal.

One important distinction exists between a sleeping and active partner with regard to liability towards third parties. A sleeping partner is responsible for the debts of the firm taken during the tenure of his partnership like an active partner. But his liability ceases immediately on retirement and he is not supposed to give a notice on his retirement like other active partners.

Partners in Profits only: A partner may stipulate with his co-partners that he will be entitled to a certain share of the profits without being liable for losses. But he will be liable to outsiders for all debts and obligations of the firm.

Sub-partner : Where a member of a firm agrees to share the profit derived by him from the firm with a stranger, there arises a sub-partnership between him and the stranger. Such

stranger is said to be a sub-partner, although he is in no way a partner in the original firm, has no rights against it, nor he is liable for its debts.

Incoming Partner: A person who is admitted as a partner into an already existing firm with the consent of all the partners is called an incoming or new partner. The incoming partner does not become liable for any act of the firm done before he becomes partner, unless he agrees to be so liable. His liability commences from the date of admission as a partner.

Retired or Outgoing Partner: A partner who goes out of a firm in which the remaining partners continue to carry on the business is called retired or outgoing partner: A retired partner continues to be liable for all debts and obligations of the firm incurred before his retirement.

A, B and C are partners and D is the creditor of the firm. A retires from the firm. A remains liable to D. Two years after A's retirement the firm becomes insolvent. A will be liable for the debts existing at the time of his retirement.

A retired partner will be liable for all debts incurred after his retirement if he fails to give proper notice of his retirement. In that case he is deemed to be a partner by holding out. A retiring partner will also be liable to third parties for all transactions of the firm began but unfinished at the time of his retirement, even though notice of his retirement is given to third party.

A retiring partner may, however, be discharged from the liability by the consent of the creditors. The remaining partners will be liable in such a case. This rule is the application of the general rule of the law of contract known as "Novation".

Right after retirement to share profits or interest -(Sec. 37)

Where a member of a firm ceases to be the partner of the firm and the continuing partner carry on the business with the property of the firm without any final settlement of accounts, i.e., without the share of the assets of the outgoing partner being paid over, or without his interest being purchased by the remaining partners, the estate of the partner is entitled to share in the profit earned with the aid of the assets of such outgoing partner, or interest at 6% per annum at the option of the out going partner. The option to claim a share of the profits or interest can be exercised only when the accounts of the subsequent business are made. But a claim both for share of the subsequent profits as well as interest will not be allowed. Also, once the outgoing partner has decided, then he will not be allowed to go back on it, nor he be permitted to claim profits for part of the period and interest for remaining period.

Nominal Partner: If a person's name is used as a member of the firm, although he is not a real member and not entitled to the share of profits of the firm, is known a nominal partner. Such a person is a necessary party only in cases of negotiable instruments.

RELATION OF PARTNERS

Relation of Partners to One Another

The relation of partnership comes into existence by an agreement between the partners and such an agreement usually provides for the mutual rights and duties of partners. The Deed of Partnership usually contains the clauses with regard to the conduct and management of the business, the contribution of capital by each partner, the proportion in which profits are to be shared, and the rights and duties of the partners in the business. If there is no written partnership agreement, their relations, will be governed by the course of dealing among themselves. Where partners fail to provide for their relations the rules laid down in the Partnership Act will apply.

It should be remembered that the partners, relations whether governed by written articles of partnership or defined by the Partnership Act can be changed by the consent of all the partners.

The Partnership Act lays down the rights and duties of partners as follows :

Rights

1. Subject to any contract to the contrary, every partner has a right to take part in the management of the business.
2. Every partner has a right to be consulted and heard in all matters affecting the business of the firm. In all matters of importance and those affecting the policy and nature of the business or any change in the constitution of the firm, all the partners must agree, mere majority will not be sufficient. But in ordinary routine matters the majority rule may apply.
3. Every partner, active or dormant, has a right of free access to all records, books and accounts of the business and also to examine and copy them.
4. Every partner is entitled to equal share in the profits, unless different proportions are stipulated.
5. A partner who has contributed more than his share of the capital for the purposes of the business is entitled to interest at a rate agreed upon and where no rate is agreed upon, at 6 per cent per annum. But a partner is not entitled to any interest on the capital subscribed by him unless there is an agreement or a trade custom to that effect exists.
6. Subject to a contract to the contrary, a partner is entitled to be indemnified by the firm for all acts done by him in the course of the partnership business, for all payments made by him to discharge the debts and liabilities of the firm and for expenses made by him in an emergency.
7. Every partner is joint owner of the partnership property and is entitled to have the property used exclusively for the purposes of the partnership.
8. A partner has power to act in emergency for protecting the firm from loss.
9. Every partner is entitled to prevent the introduction of a new partner into the firm without his consent. .
10. An incoming partner is not liable for any debts and obligations of the firm incurred before he joined it, excepting by his own consent.
11. Every partner has a right to retire from the firm.
12. Every partner has a right to continue in the partnership and not to be expelled from it unless power of expulsion is provided in the partnership agreement.
13. Every outgoing partner has a right to carry on competing business, but without using the firm's name and without soliciting the customers. He may, however, agree not to do so for a specified period and within specified local limits.
14. Where a partner dies or otherwise ceases to be a partner because of his retirement, expulsion, insolvency, insanity, and the other partners carry on the business with the property of the firm without any final settlement of accounts, the estate of the deceased partner, or the partner himself, as the case may be, is entitled to share in the profit

earned with the aid of the assets of the outgoing partner, or interest at 6 per cent per annum, if so desired by the legal representatives of the deceased partner, or by the partner himself.

Duties of Partners

The relation of partners is based on mutual confidence and the law required that a partner must act towards the other partners with the utmost good faith. In particular, the Partnership Act provides for the following duties :

1. Every partner must carry on the business of the firm to the greatest common advantage.
2. Every partner must be just and faithful to the other partners.
3. A partner is bound to keep and render true, proper and correct account of the partnership. He must permit the other partners to inspect such accounts and take copies of them. All money of the firm that may come to his hand must be handed over to the firm.
4. Every partner is an agent of the other partners and as such is bound to communicate full information relating to the business of the firm to the other partners.
5. Every partner is bound to indemnify the firm for any loss caused by his fraud in conduct of business. Also, if a partner commits a fraud on his co-partner, he must indemnify him for any loss caused to him.
6. Every partner who is guilty of wilful neglect in the conduct of the business and the firm suffers loss in consequence, is bound to make compensation to the firm and other partners.
7. Subject to a contract to the contrary, every partner is bound to share losses equally with the others.
8. Every partner is bound to attend diligently to the business of the firm and in the absence of an agreement to the contrary, he is not entitled for any remuneration; whether in the form of salary, commission, or otherwise, on account of his own trouble in conducting the business of the firm.
9. In the absence of an agreement to the contrary, every partner is bound to hold and use the partnership property for the firm.
10. A partner cannot make private gain by reason of his membership with the firm. Thus, where a partner in the course of the business has received an information and uses it for his personal gain as against the interest of the firm, he must pay over any benefits he may have obtained by the use of this information. He cannot bargain for a private gain from the customers of the firm.
11. No partner can carry on any business which is likely to compete with the business of the partnership except with the consent of the other partners. If he does so, he shall have to account for the profits of such business to the firm, and also to compensate the firm for any loss sustained by his carrying-on such- competing business.
12. Every partner is bound to act within the scope of the actual authority conferred upon him. If he exceeds his authority, he shall have to compensate the other partners for any ensuing loss, unless they ratify his act.

13. No partner can assign or transfer his partnership interest to any other person so as to make him a partner in the business. But a partner may assign his share in the profits and assets of the firm. The assignee or transferee will have no right to ask for the accounts or to interfere in the management of the business. He can only share the actual profits. On dissolution he can ask for the share of the assets and also the accounts since the date of dissolution.

Use of property of the firm exclusively for the firm. According to Section 15, subject to contract between the partners, the property of the firm shall be held and used by the partners exclusively for the purposes of the firm's business.

Personal profits earned. Subject to contract between the partners 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 firm name, he shall account for that profit and pay it to the firm.

Secondly, if a partner carries on any business of the same nature as and competing with that of the firm, then he shall account for and pay to the firm, all profits made by him in that business.

It is open to partners to determine by agreement amongst them as to what shall be the property of the firm and what shall be the separate property of one or more of the partners. Subject to a contract amongst the partners, the property of the firm includes :

- (a) all property and rights and interests in property acquired by purchase or otherwise, by or for the firm;
- (b) all property and rights and interests in property originally brought into the common stock of the firm;
- (c) all property and rights and interests in property acquired for the purpose, and in the course of the business of the firm;
- (d) goodwill of the business of the firm.

SELF CHECK TEST

- (a) A partner without the knowledge of his co-partners obtains for his own benefit the renewal of the lease of the business premises of the firm. Will he be able to enjoy the lease?
- (b) B and C were partners, and C was employed to buy sugar for the firm. C with B's knowledge, sold his own sugar to the firm at the market price and made a considerable profit. Advise C.
- (c) Partnership Deed, signed by B and C, gave B power to introduce into the partnership any of his son on their attaining the age of 21, B's son D attained 21 and B proposed to make him a partner. C refused to consent. Could C prevent D from being a partner?
- (d) A was a common partner in two firms publishing newspapers. He communicated information and news of one firm to the other. Can he be prevented from doing so?
- (e) A, B and C were partners in a firm. By his wilful neglect and misconduct B caused serious loss to the business of the firm. After several warnings to B, A and C passed a resolution expelling B from the firm. B objects to his expulsion. Is he legally entitled to do so? V

Answer :

- (a) No, the lease so renewed was partnership property,
- (b) C must account for to the firm for the profit made,
- (c) No, C could not prevent D from being introduced as a partner, as the partnership deed signed by him and B operated as a consent by both partners.
- (d) Yes, A can be prevented by Injunction from doing so. He may also be required to compensate the firm for any loss caused to it by his misconduct.
- (e) No, B cannot object to his expulsion by the other partners. He has miscondacted and caused serious loss to the firm and, in spite of several warnings, has not mended his ways.

RELATION OF PARTNERS TO THIRD PARTIES

Power of partner to bind the firm: Every partner is the agent of the firm and his copartners for the purposes of the business of the firm. When two or more persons agree to carry on a partnership business and share its profits, each is a principal and each is an agent for the others. Each is bound by the other's contract in carrying on the business, just as a single principal would be bound by the acts of an agent. The principal of agency governs the relationship between the partners. It is because of this that the law of partnership is said to be a branch of the law of agency.

The authority of a partner to act on behalf of the firm may either be express or implied. Any authority which is expressly given to a partner by agreement of partnership is called Express Authority. The firm is bound by all acts done by a partner by virtue of any express authority given to him. Implied Authority means the authority to bind the firm which arises by implication of law-from the fact of partnership.

IMPLIED AUTHORITY OF A PARTNER

Section 19(1) and 22 read together provide that the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm, provided that the act is done in the firm name or in any manner expressing or implying an intention to bind the firm. Such an authority of a partner to bind the firm is called the implied Authority of a partner.

Therefore the test, to judge whether a transaction entered into by a partner comes within his implied authority is quite simple. For successful application of this test the following three conditions must be fulfilled. Absence of even one condition will vitiate the transaction and will not come under the ambit of implied authority of a partner. These conditions are :

1. The nature of the transaction—Is to carry on business of the kind carried on by the firm?
2. The manner in which the transaction has been transacted—Is it done in the usual way?
3. In whose name the transaction has been done-Is it done in the name of the firm ? Or is the intention to bind the firm clear?

Every partner has an implied authority to bind the firm by the following acts :

- (1) He may sell the goods of the firm.
- (2) He may purchase on the firm's behalf goods of the kind usually employed in the firm's business.
- (3) He may receive payment of the firm's debts and give receipt for them.
- (4) He may engage servants for the partnership business.
- (5) Accept, make and issue negotiable instrument (cheques, bills of exchange, promissory notes) in the firm's name.
- (6) Borrow money on the firm's credit and pledge the firm's goods to effect that purpose.
- (7) Buy goods on credit for the firm.
- (8) Engage and instruct an advocate in a suit by or against the firm for a trade debt. (A trading firm is one which carries on the business of buying and selling of goods).

Examples :

- (a) A, the partner of a firm of confectioner, buys sugar on credit in the firm name. The firm is bound to pay for the sugar.
- (b) A, the partner of a firm of bankers, accepts a bill of exchange on behalf of the firm does not inform the firm of this receipt and afterwards the money is appropriated by A for his own use. The firm is liable to make good the payment.
- (c) A and B are partners. A, with the intention of cheating B, purchases on behalf of the firm. The goods were of the type used by the firm. He uses the goods for his personal use. The firm is liable to pay for the price of the goods.

If a partner pledges the credit of the firm for a purpose apparently not connected with the firm's ordinary business the firm is not bound unless he was specially authorised by other partners. The partner is personally liable, although his act may subsequently be ratified by the firm.

- (a) A, the partner of a firm of confectioners, buys a horse on credit in the firm's name. The firm is not bound to pay the price of the horse, as this act does not fall within the scope of a confectioner's business.
- (b) B, the partner of a firm of solicitors, accepts a bill of exchange on behalf of the firm. The firm is not bound to pay the bill, as it is no part of ordinary business of a solicitor to draw, accept or endorse bills of exchange.

Limitations of Implied Authority of a Partner: Section 19 (2) of the Partnership Act expressly provides that in the absence of usage or custom of trade to the contrary the implied authority of a partner does not empower him to :

- (a) submit a dispute relating to the business of the firm to arbitration;
- (b) open a banking account on behalf of the firm in his own name;
- (c) compromise or relinquish any claim or portion of a claim by the firm;
- (d) withdraw a suit or proceeding filed on behalf of the firm;
- (e) admit any liability in a suit or proceeding against the firm;
- (f) acquire immovable property on behalf of the firm; or
- (g) transfer immovable property on behalf of the firm; (h) enter into partnership on behalf of the firm.

According to S.20 of the Partnership Act, it is open to the partners by express agreement to extend or limit the implied authority. The third parties will be bound by express limitation only when they have notice of such limitation or curtailment of the implied authority.

According to sec. 21 a partner has authority to do all such acts during emergency which are necessary to protect the firm from loss. In such a case, the firm would be liable even for the unauthorised acts of a partner.

Liability of Partner for Acts of the firm: Section 25 of the Act lays down the general rule that every partner is liable for all acts of the firm done while he is a partner and that the liability is joint and several.

An act of the Firm is an act or commission by all the partners or by any partner or agent of the firm which gives rise to a right enforceable by or against the firm.

It follows that all partners are liable jointly or severally for all acts or commissions binding on the firm. In order that an act done may be an act of the firm and, therefore binding on all and every partner, it is necessary that the partner or agent doing the act on behalf of the firm must have done that act in the name of and on behalf of the firm and not in his personal capacity, and the act must have been done in the ordinary course of the business of the firm.

Examples :

- (a) A, the partner of a firm of cloth merchants, buys cloth from a mill on credit. This is an act of the firm and all partners are liable to pay the price jointly as well as severally.
- (b) A, the partner in the above mentioned firm, orders on credit 5 cases of Kashmir apples on his own initiative, but sends the order on the firm's letterhead and in the firm's name. The firm is not liable to pay for the apples, as the order is not for the purpose of the business of the firm of cloth merchants. A is personally liable to pay.

Liability for Wrongful Acts of Partner: Every partner is liable for the negligence and fraud of the other partners in the course of the management of the business. **Examples :**

- (a) A, the partner of a firm, bribed the clerk of a rival firm and obtained certain confidential information. The firm was held liable for the wrongful act of A.
- (b) A, the partner of a firm of taxi drivers, injures P by his negligent driving. The firm was held liable to pay damages to P.
- (c) A, the partner of a firm of jewellers, misappropriates Rs. 10,000 which P had deposited with him for buying gold and making ornaments. The firm is liable.

Dissolution of Partnership

OR

Reconstitution of the Firm

When there is a change in the relations of partners and the firm continues as a new firm, then it is called dissolution of the partnership or reconstitution of the firm. Reconstitution of the firm may take place in various ways, namely; (1) by admission of a partner, (2) by retirement of a partner (3) by expulsion of a partner, (4) by insolvency of a partner, (5) by death of a partner and (6) by transfer of a partner's share.

1. *Admission of a partner (31)*

A new partner can *be* introduced in a firm with, consent of all the existing partners of the firm. This is because the relations of partners are based on mutual trust and confidence, as such, only that person can be admitted as a new partner who enjoys the confidence of all the partners. A new partner can also be introduced in the firm if there is a contract between the partners in this regard. Therefore, it means that a new partner can be admitted either with the consent of all the partners or in accordance with the contract. A new partner is also called incoming partner. Liability of a new partner according to Sec. 31 (2), "Subject to provisions of Sec. 30, a person who is introduced as a partner into a firm does not thereby become liable for any act of the firm done before he became a partner." This means the liability of a new partner starts from the date of his admission. However, the new partner may agree with his partners to be liable for the liability of the firm incurred by the firm before the date of his admission. .But such an agreement is finding only between the new partner and existing partners, and does not give any right to the creditor to sue the new partner for part debts of the firm. But a new partner may be made liable to the creditors of the firm for the past debts of the firm only, if,

- (a) The new partners or the reconstituted firm should have assumed the liability of the past debts.
- (b) The creditors should be informed of the new arrangement. The new partner becomes liable to those of the creditors who expressly or impliedly accept the new arrangement.

2. *Retiring partner*

The retirement of a partner from a firm takes place when he leaves the firm. When a partner retires or withdraws from the firm and the remaining partners continue with the firm, reconstitution of the firm takes place. A partner may retire from the firm —

- (a) where all the partners give their consent to retirement.
- (b) where it is a partnership agreement that a partner might retire without seeking the dissolution of the firm.
- (c) where partnership is at will, by giving notice to all other partners of his intention to retire.

Liability of a retiring partner. This may be discussed under two heads—

- (i) **Liability for the acts of the firm done before retirement.** According to sec. 32 (2), a retiring partner remains liable to the creditors of the firm for all the acts of the firm done by the firm done before the date of retirement. In addition, he will also be liable for all the transactions of the firm begun but remain unfinished at the date of retirement.

However, a retiring partner can be discharged from such liabilities if there is an agreement in this connection between the retiring partner, the remaining partners and the creditors of the firm. This agreement is called 'novation'. But in order to discharge him from the creditors by novation two things must be fulfilled—

- (i) The remaining partners must have agreed with the retiring partner to release him from existing debts and liabilities.
- (ii) The creditors must be informed of the retirement and the new arrangement. After this the retiring partner will be released from liability to the creditors who have expressly or impliedly agreed to release the retired partner and to accept the reconstituted firm

as their debtor. An implied agreement arises when a creditor continues to deal with reconstituted firm after notice.

- (iii) Liability for the Acts of the firm done after retirement (sec. 32 (3))—The retiring partner remains liable to third parties for the acts of the firm done after his retirement until a public notice of his retirement given. This liability of the retiring partner is based on the principle of holding out. But the act should be within the scope of the authority of the partner doing it. But the retiring partner is liable only to those persons who deal with the firm under the assumption that the retiring partner was still a partner. But he is not liable to the third parties who have no knowledge that he was a partner. However, a public notice is not required in case of a sleeping partner and he will not be liable for the acts of the firm done after his retirement. This is because such a partner is not known to the third parties.

3. *Expulsion of a partner* (sec. 33)

Ordinarily a partner cannot be expelled from the firm by any majority of the partners. But the authority of expulsion can be given to the majority only by an express provision in the partnership agreement. But this power of expulsion can be exercised if three conditions are satisfied. These conditions are :

- (a) the right of expulsion should be given to the partners by an express contract,
- (b) the power of expulsion should be exercised by a majority of partners,
- (c) the power should be exercised in good faith. The test of good faith is that, first, the expulsion must be in the interest of the firm, two, that the partner to be expelled is served a notice and three, that he is given an opportunity to explain his position.

Where the expulsion of a partner takes place without satisfying any of the conditions mentioned above, the expulsion is irregular. In such a case, the expelled partner may either claim re-instatement as a partner, or sue for the refund of his share of capital and profits in the firm. An irregular expulsion is ineffective and inoperative and the expelled partner does not cease to be a partner. But while expelling a partner it must be ensured that all the three conditions have been satisfied to make it a proper and regular expulsion. Then the rights and liabilities of an expelled partner are the same as those of a retired partner.

4. *Insolvency of a Partner* (sec. 34)

Where a partner in a firm is declared insolvent, he remains no more a partner on the date on which the order of declaring him insolvent is made, whether the firm is thereby dissolved or not. The other effects resulting from the insolvency of a partner are :

- (a) The firm is dissolved on the date of order of insolvency but the partners may specifically provide that on such an event the firm shall not be dissolved.
- (b) The estate of the insolvent partner shall not be liable for the acts of the firm done after the date of the order. A public notice of the order of adjudicating insolvent is not required.
- (c) the firm is not liable for the acts of the insolvent partner after the date of order.

5. *Death of a partner (sec s. 35 and 42 (c)).*

A firm is dissolved, subject to contract between the partners, by the death of a partner. However, when under a contract between the partners the firm is not dissolved, the estate of the deceased partner is not liable for any act of the firm done after his death. Further, no public notice is required of the death of a partner.

6. *Transfer of a partner's Interest (sec. 29).*

A partner may transfer his interest in firm by sale, mortgage or charge. But the transferee is not entitled to interfere in the conduct of the business of the firm, to require accounts of the firm and to inspect the books of the firm. When the partner transfers the share, the transferee only becomes entitled to receive the share of profit of the partner who has transferred his share. But he has to accept the account of profits provided by the partners. [Sec. 29 (1)]

If the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled to receive the transferring partner's share in the assets of the firm. For knowing that share, he is entitled to an account from the date of dissolution, [sec. 29 (2)]

DISSOLUTION OF FIRM

Dissolution of a firm: Dissolution of a firm means the end of a firm by the break up of the relation of partnership between all the partners. But where the relation between only some partner is broken it is called dissolution of partnership. For example, where A, B and C were partners in a firm and A died or retired or was adjudged insolvent, the partnership firm would come to an end. But if the partners had agreed that death, retirement or insolvency of a partner would not dissolve the firm, then on the happening of any of these contingencies the "partnership" would certainly come to an end, but the firm might continue under the same name. It would be a "reconstituted firm"; for where A had gone out of the firm on account of any reason; the relationship between A, B and C is broken up and a new relationship between B and C is created. Therefore, "dissolution of partnership" involves a change in the relation of the partners, but it does not mean the end of the partnership firm.

A firm may be dissolved on any of the following grounds :

1. By Agreement: A firm may be dissolved with the consent of all the partners of the firm, partnership is created by contract. It can be terminated by contract (S. 40).

2. By Notice: Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. The dissolution takes place from the date mentioned in the notice, or, if no date is mentioned then from the date of communication of the notice to the other partners (S. 43).

3. On the happening of certain contingencies: (S.42) : Subject to contract between the partners to continue the business in spite of the contingency, firm is dissolved

- (a) if formed for a fixed -term, by the expiry of that term;
- (b) if formed to carry out one or more adventures or undertakings, by the completion thereof;
- (c) by the death of partner; and
- (d) by the insolvency of a partner.

4. Compulsory Dissolution: According to Section 41 the dissolution of a firm is automatic under the following circumstances :

- (a) If all the partners of a firm or if all the partners except one become insolvent, there must necessarily be dissolution of the firm. When a partner is declared insolvent, then he ceases to be a partner from the date of such declaration, since, there must be at least two partners in a firm, if all partners or all the partners except one become insolvent then the firm is dissolved.
- (b) **By business becoming illegal :** A firm is in every case dissolved if the business of the partnership is prohibited by law, i.e., the object for which the partnership was formed is unlawful, or becomes illegal as a result of some subsequent events. This is by operation of law. But if the firm is carrying on more than one business, if one business becomes illegal the firm is not dissolved.

5. Dissolution through the Court (S.44): At the suit of a partner, the Court may dissolve a firm on any one of the following grounds :

- (a) If a partner becomes of unsound mind. The suit for dissolution may be filed by the next in kin of the insane partner or by any other partner.
- (b) If a partner becomes permanently incapable, of performing his duties as a partner, e.g., he becomes blind, or paralytic, etc., The suit will be filed by a partner other than the partner who has become incapable.
- (c) If a partner is guilty of misconduct which is likely to prejudice the business of the firm, the court may dissolve the firm at the instance of the other partners. The Court will order dissolution if the act complained of is likely to affect the credit and customers of the partnership business. Gambling by the partner, misapplication of clients money by a solicitor are the examples of misconduct.
- (d) If a partner wilfully and persistently commits breach of the partnership agreement regarding management, and the other partners find it impossible to carry on the partnership business, the Court may order dissolution of the firm at the instance of any of the other partners. For example, constant refusal to perform duties, or continuous quarrels, or erroneous accounts by a partner are good grounds for dissolution.
- (e) If a partner has transferred the whole of his interest in the firm to an outsider or has allowed his interest to be sold in execution of a decree, the other partners may sue for dissolution.
- (f) If the business of the firm cannot be carried on except at a loss, the court may order dissolution.
- (g) Where the court considers it just and equitable to dissolve the firm. It may do so at the instance of any partner. Dissolution has been granted under this clause in the following cases: deadlock in the management; complete destruction of confidence between the partners that they are not even on speaking terms any more; the substance of the business gone, etc.

Dissolution of partnership and Dissolution of Firm

It is said that dissolution of partnership does not necessarily lead to dissolution of firm, whereas dissolution of firm does lead to dissolution of partnership. It is because :

- (1) Dissolution of firm means the complete break down of partnership relation. Dissolution of partnership simply means a change in the relation or constitution of partners. Even after dissolution of partnership, the partners may agree among themselves to continue the business.
- (2) Dissolution of a firm means closing down the business of the firm. But in dissolution of partnership, the business continues as before except the firm is re-constituted,
- (3) In case of dissolution of partnership, a partner retires, dies or becomes insolvent but in case of a dissolution of firm, there is complete termination of relation between partners.
- (4) When the firm is dissolved, its assets are realised and distributed among partners. While in case of dissolution of partnership, only thing to be done is the ascertainment of the share of the outgoing partner, because the business continues as before.

Consequences of Dissolution

1. On the dissolution of a firm, it comes to an end and its affairs have to be wound up according to the rules laid down in the Act. The assets of the firm to be collected and applied in payment of the debt and liabilities. The deficit, if any is to be distributed among the partners according to their rights. The deficit, if any, is to be paid by the partners according to the terms of the agreement of partnership. These proceedings are called “winding up”.
2. Until public notice is given of the dissolution, the partners continue to be liable to third parties for all acts done in connection with the affairs of the firm.
3. Notwithstanding the dissolution, the authority of each partner to bind the firm continues (i) so far as may be necessary to wind up the affairs of the firm, and (ii) to complete transactions begun but unfinished at the time of dissolution.
4. If any partner makes any profit from any transaction connected with the firm after its dissolution, he must share it with the other partners and the legal representatives of the deceased partners.
5. Where a partner has paid premium on entering into partnership for fixed term, and the firm is dissolved before the expiration of that term otherwise than by the death of a partner he shall be entitled to repayment of the premium or of such part thereof as may be reasonable, according to the terms of admission and the unexpired period of the term. But he will not get anything if the dissolution is due to his misconduct or it is in pursuance of an agreement containing no provision for the return for the premium or any part of it.
6. Where a contract creating partnership is rescinded on the ground of the fraud of any of the parties thereto, the party entitled to rescind it is entitled (a) to a lien on the assets of the firm remaining after the debts of the firm have been paid, for any sum paid by him for the purchase of a share in the firm and- for the capital contributed by him; (b) to rank as a creditor of the firm in respect of any payment made by him towards the debts of the firm; and (c) to be indemnified by the partner guilty of the fraud against all the debts of the firm (S.52).
7. After a firm is dissolved, every partner or his representative may, in the absence or a contract between the partners to the contrary, restrain any other partner from carrying

on a similar business in the firm name or from using any of the property of the firm for his own benefits, until the affairs of the firm have been completely wound up. But a partner who has purchased the goodwill of the firm, cannot be restrained from using the firm name (S. 53).

8. Partners may, upon or in anticipation of the dissolution of a firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such an agreement will not be void on the ground of restraint of trade (S. 54).

Partner's lien -Section 46 provides to the same effect and lays down the rule that on dissolution of a firm, for the discharge of the liabilities, each partner or his representatives has a right to have the property of the firm applied in payment of the debts of the firm. If there is any surplus asset, a partner has a right to have the accounts adjusted and the net assets divided among the partners according to their rights. Or, he has a right to have whatever may be due from co-partners deducted from what would be otherwise payable to them in respect of their shares. This right of a partner is often called a partner's lien.

Goodwill -It is an important item in a partnership. It may be sold either separately or along with the other property of the firm. Its valuation will depend upon the facts and circumstances of each case. In case of *Page vs. Ratcliffe* (1896), 75 L T. 173, it was observed that the value of the goodwill could be determined and taken equal to the total of three years' net profits. It is up to a partner to decide to purchase the goodwill of the firm and carry on the business under the firm.

Settlement of Accounts

Usually the Partnership Deed contains an "accounting clause" according to which the final accounts between the partners are settled. But in the absence of any agreement between the partners the rules stated in Sec. 48 of the Act apply. Accordingly the mode of settlement of accounts between the partners after dissolution is as follows :

1. Where the firm has suffered losses, or where capital has dwindled, in either case, the undistributed profits, if any, are first of all to be applied to the payment of such losses or to the making up the deficiency of capital. If the profits prove insufficient, the capital must be applied for the payment of the losses. If even then there is loss, partners must contribute individually in proportion to the profit sharing ratio.

2. The assets of the firm including any sums contributed by the partners to make up deficiencies of capital, must be applied in the following manner and order :

- (a) in paying the debts due to third parties;
- (b) in paying to each partner rateably what is due to him from the firm for advances as distinguished from capital contributed by them;
- (c) in paying to each partner rateably what is due to him on account of capital; and
- (d) the residue, if any, must be divided among the partners in the proportion in which they were entitled to share profits.

3. If a partner becomes insolvent or otherwise cannot pay his share of the contribution, the capital of the solvent partners cannot be returned in full. In this case, the solvent partners must share rateably the available assets (including their own contribution to the capital deficiency), i.e., the available assets will be distributed in proportion to the original capital. **Example :**

A, B and C are three partners in a firm who have agreed to share profits and losses equally. Their capital contributions are: A- Rs. 10,000 ; B- Rs.5,000 ; C -Rs. 1,000, making a total capital of Rs. 16,000.

On dissolution it is found that reliable assets are Rs.20,000 and debts payable are Rs.13,000 with the result that the available assets are Rs.7,000. Therefore, capital deficiency is Rs.9,000. According to Rule 1 stated above, each partner must contribute Rs.3,000 capital deficiency, because they share profits equally.

The final position will be that A is to pay Rs.3,000 and receive Rs. 10,000; B is to pay Rs.3,000 and receive Rs.5,000; C is to pay Rs.3,000 and receive Rs. 1,000.

Consequently, C contributes Rs.2,000. This contribution together with the available assets of Rs.7,000 amounts to Rs.9,000. Out of this amount A gets Rs.7,000 and B gets Rs.2,000.

If C is insolvent (Rule 3); he will pay nothing. The available assets will be Rs.7,000 plus Rs.6,000 (the contribution of A and B), i.e., in all Rs.13,000. This amount will be divided between A and B in the ratio of 2 : 1 which is the ratio between their capital. A will get Rs.8,666.67 p. and B will get Rs.4,333.33 P.

Payment of debts of the firm and private debts

Where there are joint debts due by the firm, and separate debts due from any partner, the partnership creditors should be paid first out of the partnership assets, and similarly private creditors should be paid first out of the private assets of the partner. In both cases, if there be surplus, the other set of creditors will be entitled to share in it.

A and B are partners and become insolvent. A's private debts are Rs. 10,000 and B's Rs 15,000. The partnership debts are Rs.50,000, and the assets Rs. 60,000. The partnership creditors will be paid in full, and the surplus of Rs.10,000 will be divided among the private creditors of A and B in proportion of their rights in the partnership property.

SELF CHECK TEST

- (a) A and B were partners under an agreement which provided that the partnership should be terminated by mutual agreement only. Can A terminate the partnership by giving notice to B ?
- (b) A, an Indian, and B, a Chinese subject, are partners in trade. War breaks out between India and China. What is the position of the partnership ?
- (c) A and B were partners, and A was convicted of traveling on the railway without ticket and with intent to defraud. Will the Court order dissolution of the firm ?
- (d) A and B carried on business as partners. After some time the relations between them became so strained that neither would speak to the other. Communications having to be conveyed between them through the accounts clerk. The firm had made and continue to make large profits. Can the court order its dissolution ?
- (e) A and B carried on business in partnership. On B's death the partnership was dissolved but A carried on the business for a further period of one year. How should the profits earned since B's death be divided ?
- (f) B, C and J carried on a business as J & Co. J retired and B and C carried on business under a new name with the addition of "Late J & Co". J found a new firm carrying on the same kind of business in premises adjoining the old firm's premises in the

name of J & Co. and sent circulars about his business to the customers of the old firm. What are J's rights and those of Band C ?

Answers :

- (a) No, A cannot terminate the partnership by giving notice. He must get B's consent to do so. .
- (b) The partnership becomes unlawful and is dissolved.
- (c) Yes, the court would order dissolution of the firm. The conviction was for dishonest and calculated to be detrimental to the partnership business,
- (d) Yes, the court would order dissolution of the firm on just and equitable ground, deadlock between the partners had arisen.
- (e) B's estate is entitled to share in such part of the profits as were earned by the use of the partnership assets, proportionate to his share in the total partnership assets.
- (f) J could carry on his new business in competition with the old firm and in the immediate vicinity, but without soliciting the customers of the old firm. The old firm could restrain him from canvassing their customers. Further, although his name was J, he could not carry on his new business in the name of J & Co., as the old firm had retained J & Co., as part of its name.

CONTRACT OF SALE OF GOODS

Contract of Sale

According to Section 4 of the Sale of Goods Act a contract of the sale of goods is a contract whereby the seller transfers, or agrees to transfer, the property in (i.e., ownership of) goods to the buyer for a price.

A contract of sale may be (i) absolute or (ii) conditional, i.e., according to the wishes of the parties to the contract.

The term “contract of sale” is a generic term. It includes an ‘actual sale’ as well as an ‘agreement to sell’. Where under a contract of sale the property in the goods (i.e., the ownership has passed from the seller to the buyer, the contract is called a sale. Where the transfer of ownership is to take place at a future date, or subject to some condition to be fulfilled later, the contract is called an agreement to sell: An agreement to sell becomes a sale when the time elapses or the condition is fulfilled subject to which the ownership of the goods is to be transferred.

A has a book. He transfers his right or ownership to B for Rs.15. There is a sale. Where

A agrees to transfer the ownership of the book to B after two months for Rs.15, this is an agreement to sell, when the two months expire, it becomes a sale.

The main distinction between a sale and an agreement to sell is that in a sale the buyer owns the goods, while in an agreement to sell, the ownership does not pass from the seller to the buyer at the time of the contract. The seller continues to be the owner until the agreement to sell becomes an actual sale by the expiry of the stipulated time or on the fulfilment of some condition.

Essentials of a Contract of Sale

A valid contract of sale must consist of the following essentials :

- (1) *Two parties*: There must be two parties viz., buyer and seller to constitute the contract. So where a person buys his own goods through some agent, there is no contract. However, a part-owner can sell his share to other part-owners.
- (2) *Goods*: Subject matter of contract of sale must be the goods of any kind except immovable goods.
- (3) *Transfer of property*: Passing of property is necessary and not the physical delivery of goods.
- (4) *Price*: Consideration for a contract of sale must be money. If some goods are supplied as remuneration for work done or in exchange for some goods, it does not amount to contract of sale.
- (5) Lastly, it must contain all the essentials of a valid contract.

Contract of sale how made. No particular form is necessary to constitute a contract of sale. It is, like any other contract, made by the ordinary method of offer by one party and its acceptance by the other party. It may be made in writing or by word of mouth, or partly in writing

and partly by word of mouth. It may also be implied from the conduct of parties, or from the course of dealings between the parties.

Difference between Sale and Agreement to Sell

1. *Nature of contract:* Sale is an executed contract while an agreement to sell is an executory contract. In an agreement to sell something remains to be done. It shall become sale only when the conditions of contract are fulfilled.
2. *Transfer of property:* In a sale the transfer of property takes place immediately but in an agreement to sell, it does not pass to the buyer immediately. As the buyer, in a sale immediately becomes the owner of goods, so the risk also passes to him. But in an agreement to sell seller still remains the owner so the risk does not pass to the buyer and if the goods are destroyed, the loss will fall on the seller even though they are in the possession of the buyer.
3. *Creation of right:* An agreement to sell creates a 'Jus in personam', i.e., a personal right only against the buyer while a sale creates 'Jus in rem', i.e., right in the goods against the whole world.
4. *Remedies in case of breach:* In an agreement to sell, the seller can sue only for damages for non-performance of contract by the buyer. But in a sale, the seller can sue for the price of the goods. In addition to that he has the right of lien, stoppage in transit and re-sale.

In case of breach of contract of sale by the seller, the buyer can sue for the delivery of goods or for damages but in an agreement to sell the buyer has only a personal remedy against the seller.

5. *Consequences of Insolvency:* In a sale if the buyer is adjudged insolvent; the seller must deliver the goods to the official receiver and can claim rateable dividend like other unsecured creditors for the price unpaid on his goods. In an agreement to sell the seller can refuse to deliver the goods unless paid for the goods.

In a sale, if the seller is adjudged insolvent, the buyer is entitled to receive the goods from the official receiver. But in an agreement to sell, if the buyer has made the payment in advance to the seller, he can only ask for rateable dividend and not the delivery of goods.

Subject matter of Contract of Sale

The subject matter of contract of sale is essentially the goods. Section 2 (7) says that "goods", means every kind of movable property other than money or actionable claims, it includes stock and shares, growing crops, and things attached to the earth which are to be removed because of the contract of sale. According to this definition money and actionable claims are not goods and cannot be bought and sold. Money here means legal tender money; It does not include old coins which are sold like goods, e.g., silver rupee coins in our country. An actionable claim means a debt or a claim for money which a person may have against another and which he can recover by suit.

Goods may be classified into three types :

(1) Existing goods (2-) Future Goods, and (3) Contingent Goods.

- (1) **Existing Goods are goods** which are already in existence and which are physically present in some person's possession and ownership. Existing goods may be either (i) Specific and Ascertained or (ii) Generic and Unascertained.

- (i) **Specific goods are those goods** which are identified and agreed upon at the time of the contract of sale; i.e., a particular painting by a painter, a horse pointed out and recognised as separate from other horses in a stable. The term Ascertained goods is used in the same sense as Specific Goods.
- (ii) **Generic or Unascertained Goods** are those goods which are not specifically identified but are indicated by description. If A agrees to supply one bag of wheat from his godown to B, it is a contract relating to unascertained goods because it is not known which bag will be delivered. As soon as a particular bag is separated from the lot and making or identified for delivery it becomes specific goods.
- (2) **Future Goods** are goods which the seller does not own or possess at the time of the contract, but which he will manufacture or produce or acquire after the making of the contract. For example, A agree to sell to B all the oranges which will be produced in his garden next year. This is an agreement for the sale of future goods.
- (3) **Contingent goods** are those goods which the seller will acquire on the happening of a contingency. An agreement to sell contingent goods can also be made. For example, A's father has a rare copy of book which is out of print. A hopes to get it on his father's death. A agrees to sell it to B for Rs. 10,000 even before his father's death. This is an agreement for .the sale of contingent goods.

Perishing of Goods: If in a contract for the sale of specific goods, the goods have, without the seller's knowledge, perished at the time when the contract was made, the contract is void. Where A sold 700 bags to B, but only 591 bags were in existence at the date of contract, the remaining having been stolen. In this case B cannot be compelled to accept the 591 bags.

The Price: Price, which means money consideration for a sale of goods, constitutes the essence of a contract of sale. It may be money actually paid or promised to be paid accordingly as the agreement is for cash sale or credit sale. If consideration^other than money is given, it is not a saie.

In an agreement to sell when the seller becomes insolvent the only remedy available to buyer is to claim for rateable dividend if the buyer has paid the price. But in a sale if seller becomes insolvent, the buyer can recover the goods from the liquidator because the ownership in goods has passed to him.

The price may be fixed by the contract or may be determined by the course of dealing between the parties. In the absence of either of these provisions the buyer must pay a reasonable price, the amount of which is determined by the facts of each particular case.

Sale and contract for work and materials. A contract of sale must be distinguished from a contract for work and materials. The Sale of Goods Act applies to the former and not to the latter. A contract of sale contemplates the delivery of goods whereas a contract for work and materials involves exercise of skill and labour by one party in respect of materials supplied for another, the delivery of goods being only subsidiary or incidental.

Earnest or Deposit Money

An earnest money is some amount which the buyer pays to the seller at the time of the contract as a token of good faith, and as a guarantee that he will fulfill his contract. If he fails to fulfil the contract, the earnest money is forfeited by the seller, but if he fulfills the contract

the earnest or deposit will be treated as part-payment of the price, only the balance being required to be paid to make up the full price.

Sale and Hire-Purchase Agreement

A hire purchase agreement is one under which a person takes delivery of goods promising to pay the price by a certain number of installments and, until full payment is made, to pay hire charges for using the goods. It is in fact bailment for hire with an option to the hirer to buy the goods in his possession on making the full payment. Until the full payment is made the agreement remains a contract of hire and the hirer can return the goods to the owner and the owner can get them back, as the ownership of the goods remains with him. When the hirer pays full price he buys the goods. The essence of hire purchase agreement is that there is no purchase or agreement to purchase, but only an *option* is given to the hirer to buy so that when he has paid the full price it becomes a sale and he becomes the owner. In a sale, on the other hand, the property passes to the buyer immediately on making the contract even if the payment of the price is to be made by instalments.

The transaction of hire-purchase protects the owner against the insolvency of the buyer, for if the buyer becomes insolvent or fails to pay the instalments, the seller has the right to take the goods as owner and treat all the money already received as hire-charges. Again, until the full price is paid and the agreement remains that of hire, no title will pass even to an innocent and bonafide parties. **Sale and Bailment**

Bailment is the delivery of goods from one person to another upon a condition that he shall return the goods to the bailor when his purpose is accomplished. Bailment may be with or without consideration. Sale is delivery of goods in return of monetary payment and there is no provision of return of those goods. In a sale, the buyer becomes the absolute owner of goods but in bailment, the question of transfer of ownership does not arise at all.

Agreement to sell at valuation. According to section 10 the parties may agree to sell and buy goods on the terms that price is to be fixed by the valuation of a third party. If such third party cannot or does not make such valuation, the agreement becomes void. But if the goods or any part thereof have been delivered to and appropriated by the buyer, he shall pay a reasonable price therefore. If the third party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault may maintain a suit for damages against the party in fault.

SELF CHECK TEST

- (a) A agreed to sell to B oil, not yet pressed from seeds in his possession. It is a contract of sale ? .
- (b) A changes with B a 100 rupee note with coins for 100 rupees. Is this transaction a sale ?
- (c) A buys Victoria Rupees from a jeweller and pays for them in 10 rupee notes. Is there a sale ?
- (d) A exchanges 32 bullocks for the entire crop of wheat harvested from B's land. Does this transaction amount to sale ?
- (e) A agrees to buy 100 bales of cotton from B and takes delivery after one week. He deposits Rs.100 with B as a guarantee for performance by him of the contract. A fails to take delivery of the goods on the expiry of one week. What are B's rights?

Answer :

- (a) Yes, it is a contract of sale of future goods.
- (b) No, it is exchange and not sale.
- (c) Yes, it is sale of victoria Rupees which are no more legal tender, and can be treated as goods.
- (d) No, it is barter.
- (e) Rs.100 deposited by A with B is earnest money. It will be forfeited by B for A's nonperformance of the contract. If the contract falls through due to the fault of seller B, the deposit is returnable. If the contract-is performed, the amount of Rs.100 will be counted towards the price.

CONDITIONS AND WARRANTIES

The parties may enter into a contract with any terms they like. In the case of sale of goods, the ordinary maxim is CAVEAT EMPTOR which means let the Buyer Beware! The doctrine, of caveat emptor means that, ordinarily, a buyer must buy goods after satisfying himself of their quality and fitness. If he makes a bad choice he can not blame the seller to recover damages from him. It is not part of the seller's duty to point out the defects in the goods he is selling. But the buyer may want to be sure of the quality and fitness of the goods and may make known to the seller's skill or Judgement, and buys them depending upon the representations made by the seller. Such representation may rank either as conditions or warranties. In such a case the principle of caveat emptor will not apply, and the contract will be subject to the condition or warranty.

Caveat Emptor

According to the doctrine of 'Caveat Emptor' the buyer should be aware at the time of buying the goods, because a seller never-points out the Defects of the goods being sold by him. Ordinarily, a buyer buys goods on his own risk ^that is, if the goods turn out to be defective or of low quality or it is not fit for the specific purpose, then the seller cannot be held responsible. If the seller sells the good by fraud, then the buyer can reject the goods. Thus, according to this doctrine it is the duty of the buyer that before buying the goods he should enquire into the goods that whether the goods are fit for his purpose or not.

According to Section 16, the explanation of this doctrine is that 'According to this Act and according to the explanation of any other act prevalent at a particular time there is no implied condition or warranty regarding the fitness of the goods for a specific purpose under a contract of sale of goods. Therefore it is clear that the buyer should fully satisfy himself. If seller does fraud or intentionally conceals the defects of the goods or the nature of the defect is such that it cannot be detected with ordinary enquiry, then the seller will be held responsible.

If this doctrine is strictly followed, then the buyers will have to face difficulties, because every buyer is not as clever as to enquire into the quality or fitness of the goods. There are certain exceptions to protect such buyers.

1. When the buyer clearly states the purpose of purchasing the goods to the seller and he depends on the knowledge and expertise of the seller, then it is an implied condition that the sold goods shall be fit for the purpose. Thus when the buyer makes, the purpose of purchasing the goods, known to the seller, this doctrine does not apply.

2. When the goods are sold by description, then it is implied condition that the goods shall be merchantable and the goods shall be according to description. If the buyer has examined the goods, the seller will be liable for latent defects.
3. When the goods are purchased under a trade or patent name, there is no implied condition regarding the fitness of the goods for a specific purpose.
4. If the seller sells goods by fraud or intentionally conceals the defects or there are latent defect in the goods,- even then this doctrine will not apply.

A condition is a stipulation essential to the main purpose of the contract and forms the very basis of the contract. Its breach gives rise to a right to treat the contract as repudiated. Thus, if the condition is not fulfilled the buyer has a right to repudiate the contract, and refuse the goods. If he has already paid the price, he can recover it from the seller.

A warranty is a stipulation collateral to the main purpose of the contract, that is to say, it is a subsidiary promise. Its breach does not entitle the aggrieved party to repudiate the contract. He can only claim damages. Where there is a breach of warranty on the part of the seller, the buyer must accept the goods and claim damages.

Where A purchases 100 bags of wheat from B. Wheat must be fit for human consumption. This is an essential stipulation. Hence it is called as condition. Other stipulations like packing, etc., is a minor one, hence called as warranty.

Conditions and warranties may be express or implied. An express condition or warranty is one stated definitely in so many words as the basis of the contract. Implied conditions or warranties are those which attach to the contract by operation of law. The law incorporated them into the contract unless the parties- agree to the contrary.

A sold to B timber to be properly seasoned before shipment. It was agreed between the parties, that in case of dispute the buyer would not reject the goods but accept or pay for them against documents. It was held that the provision as to seasoning was not a condition but only a warranty. If the timber was not properly seasoned B had to accept it and claim damages for the breach of warranty.

The points of distinction between a condition and warranty can be summed up as under :-

- (1) A condition is a stipulation essential to the main purpose of a contract while a warranty is a stipulation collateral to the main purpose of contract.
- (2) Breach of condition gives the right to treat the contract as repudiated while the breach of warranty gives the right to claim for damages alone. The contract cannot be repudiated because the breach of warranty does not defeat the purpose of contract.
- (3) A breach of condition may be treated as breach of warranty but a breach of warranty cannot be treated as breach of condition.

Let us take an example to make these two terms clear. So where a man buys a particular horse which is warranted quiet to ride. The horse, turns out to be a vicious one. Buyers remedy is to claim damages unless he has expressly reserved the right to return the horse. Suppose instead of buying a particular horse, he specifically asks for a quiet horse-that stipulations is a condition. Now the buyer can either return the horse or retain the horse and claim damages. (Hartley v. Hymans)

When condition to be treated as Warranty

Section 13 of the Sales of Goods Act mentions 3 cases in which a condition sinks or descends to the level of a Warranty. A condition descends to the level of a warranty in the following cases :

- (1) Where the buyer waives the condition;
- (2) Where the buyer treats the breach of condition as breach of warranty;
- (3) Where the contract is indivisible and the buyer has accepted the goods or part of the goods.

In all the above three cases the breach of a condition is deemed to be a breach of a warranty and buyer can only claim damages or compensation for the breach of the condition. He cannot repudiate the contract or refuse to take delivery of the goods.

In the first two cases, a condition is treated a warranty, at the will of the buyer; but in the third case the breach of condition can be treated only as breach of warranty; for once the buyer has accepted the goods he cannot reject them on any ground. If on subsequent inspection, a breach of condition is disclosed, he can treat **that** as breach of warranty and sue for damages.

Example: Suppose A promises to deliver 100 bales of cotton to B on 1st August, 80. A delivers the bales of cotton on 10th of August. Now in this contract, time is the essence of contract. B can refuse to accept the delivery. But he can also waive this right. He may treat this breach of condition as breach of warranty by accepting the goods and claim damages instead.

IMPLIED CONDITIONS AND WARRANTIES

Even where, in a contract of sale, no definite representations are made, the law implies certain representations as having been made. Such implied representations may amount to conditions or warranties. Section 14 to 17 of the sale of Goods Act give a list of conditions and warranties which are implied unless the circumstances of the contract are such as to show a different intention.

Implied Warranties

Subject to a contract to the contrary the following warranties are implied in every contract of sale.

1. *That the buyer shall have and enjoy quiet possession of the goods.* If his possession is disturbed either by the seller or some other person claiming superior title, buyer can recover damages from the seller for the breach of an implied warranty of quiet possession. A bought a typewriter from B for Rs.200. A spent Rs.110 on overhauling it. Unknown to A and B the typewriter was stolen property and A had to return it to the real owner. A was held entitled to claim from B the sum of Rs.200+110=310 as damages for breach of warranty of quiet possession.

2. *That the goods are free from any charge or encumbrance in favour of a third party not declared or known to the buyer before or at the time when the contract is made.* If the buyer has to discharge the amount of the charge or encumbrance on the goods, there is a breach of implied warranty and he can claim the amount as damages from the seller.

A sells to B a used motor-car which was previously mortgaged to C, but B has no knowledge of the mortgage and A does not inform B of its existence. A is liable to B for breach of the implied warranty against encumbrances.

Implied Conditions

1. Conditions as to title

There is an implied condition on the part of the seller that, in the case of sale, he has the right to sell the goods, and in the case of an agreement to sell, he will have the right to sell the goods when the property is to pass. Thus if the seller has no title to the good, the buyer can reject the goods, or if he has taken possession of the goods and is deprived of it by the real owner, the buyer can recover the full price of the goods even if he has made use of them.

A bought a motor-car from and used it for 4 months. B had no title to the car because he has obtained the possession by theft and consequently A had to surrender it to the real owner. A was entitled to recover from B the full price even though he used the car for 4 months. (Rowland Vs.Divall).

2. Sale by Description

Where there is a sale of goods by description, there is an implied condition that the goods shall correspond with the description. Goods are sold by description when they are described by the contract by means of words, symbols, number of grade, and the buyer relies on them when buying. The rule that the goods shall correspond with the description applies both to specific and unascertained goods.

A bought a truck load of corn from B on the basis of a letter from the seller which referred to the corn as “No.3 Yellow 21 per cent moisture”. When the corn was received, it was 49 per cent moisture, mouldy and unfit for use, A could reject the goods or accept them and sue for damages.

1. *Condition as to quality or fitness:* This condition in respect of merchantability and wholesomeness discussed below are exceptions to the doctrine of caveat emptor.

Ordinarily, in a contract of sale of goods, there is no implied warranty or condition that the goods supplied are of particular quality or are fit for a particular purpose. But in the following cases, there is such an implied condition.

(a) *Where the buyer makes known to the seller the purpose* for which he is buying the goods and indicates that he is relying upon the skill and judgement of the seller, and the goods are of a description which it is in the course of seller’s business to supply, there is an implied condition that the goods shall be reasonably fit for that purpose.

A asked B to supply him a certain number of clay pots which are suitable for heating and retaining molten glass, the buyer relied upon the judgement and skill of the seller. If the clay pots are not suitable for the purpose there is a breach of implied condition as to fitness for a particular purpose.

If the buyer purchases an article under its patent or their trade name, there is no implied condition as to its fitness for any particular purpose.

(b) *Condition as to merchantable quality:* But if the seller sells an article of the description in which he usually deals, even under its patent and trade name, there is an implied condition that it is of merchantable quality, i.e., it is saleable. Thus in the sale of a refrigerator, the name of the article itself implies that the seller warrants the machine to be fit for a particular purpose.

Although there is an implied condition as to merchantability, yet if the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed.

Examples

(a) A agreed to deliver motor-horns to B by instalments. The first instalment was good and was accepted by B, but the second contained a large quantity of horns which were damaged. B was held entitled to reject the whole instalments as the goods were not of saleable quality.

(b) B wanted to buy some glue. As the seller showed him the glue which was stored in his warehouse in casks. B did not have the casks opened, which he could have done easily, but merely looked at the outside of the casks. The glue was found to have defects which could have been discovered if B had inspected the contents of the casks. It was held that there was no implied condition as to merchantable quality.

(c) In *Baldry vs. Marshall* the plaintiff wanted to buy a comfortable car suitable for touring purpose. The defendant stated, that their “Budgatticar” would serve the purpose. The car was seen by plaintiff. He ordered for the car. When the car was put on road, it was found to be unsuitable for touring purposes, the plaintiff claimed to return the car and recover the price paid for it. It was held that the plaintiff could return the car because the term that the car should be comfortable for touring purposes was a condition and not a warranty.

(c) *Condition as to wholesomeness* : In a sale of goods for human consumption, there is an implied condition on the part of the seller that the goods are wholesome and fit to be eaten or drunk by human beings. B bought from A tinned salmon. B fell ill and his wife died as a result of eating the salmon. There was a breach of implied condition as to wholesomeness and A was liable to pay damage to B.

A bought milk from B, and the milk contained typhoid germs. A’s wife got infected and died. B was liable for damages for breach of implied condition of fitness as to wholesomeness of milk.

3. Sale by Sample

When the goods are to be supplied according to sample agreed upon the following conditions are implied

- (a) The bulk shall correspond with sample in quality.
- (b) The buyer shall have a reasonable opportunity of comparing the goods with sample.
- (c) The goods shall be free from any latent defects rendering them unmerchantable which would not be apparent on reasonable examination of the sample.

Example

- (i) A sold to B by sample some apples put up in cans. The sample can appeared to be satisfactory , but the remainder of the goods were found to be spoiled. A was liable to pay damage to B for a breach of implied condition. B could reject the goods, if he liked.
- (ii) A sold two parcels of wheat by sample to B. B went to inspect the goods. One parcel was shown, not both. On finding the other parcel defective B was entitled to rescind the contract.
- (iii) Some “worsted coating” quality equal to sample was sold to tailors. The cloth was found to have a defect in the texture which could not be detected on reasonable

examination, and consequently the cloth was unfit for stitching into coats. The seller was held liable to pay damages to the buyers even though the same defect existed in the sample, but was not detected on examination.

4. Sale by Sample as well as by Description

Where goods are sold by sample as well as description, the goods must correspond both with the sample and with the description. In such cases, if the seller has seen and approved the sample and the goods are according to the sample, he can repudiate the contract if these are not according to description.

A agreed to sell B some oil described as “foreign refined rape oil, warranted only equal to sample”. The oil tendered was the same as the sample, but it was not “foreign refined rape oil” being a mixture of it and hemp oil. The buyer could reject the oil.

5. Condition as to quality or fitness.

In a contract of sale there is no implied condition as to quality or fitness of goods for a particular purpose. The buyer must examine the goods thoroughly before he buys them in order to satisfy himself that the goods will be suitable of the purpose for which he is buying them. The points to be noted are :

(1) Where the buyer, expressly or by implication, makes known to seller the particular purpose for which he needs the goods and depends upon the skill and judgement of the seller whose business is to supply goods of that description, there is an implied condition that the goods are reasonably fit for that purpose.

(2) An implied condition as to quality or fitness for a particular purpose may also be annexed by the usages of trade.

(3) In case the goods can be used for a number of purposes, the buyer must tell the seller the particular purpose for which he requires the goods. If he does not, he cannot hold the seller liable if goods do not suit the particular purpose for which he buys the goods.

6. Condition as to merchantability.

Where goods are bought by description from a seller who deals in goods of that description, there is an implied condition that the goods are of merchantable quality.

If goods are of such a quality and in such a condition that a reasonable person acting reasonably would accept them after having examined them thoroughly, they are of merchantable quality.

But where the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed.

7. Condition as to wholesomeness.

In the 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.

Example :

A sold to B a tin of disinfectant powder, knowing that it was likely to be dangerous to B if it was opened without special care being taken. B opened the tin whereupon the powder flew into her eyes, causing injury. A was held liable to pay damages to B, as he should have warned B of the probable danger.

SELF CHECK TEST

- (a) A, while showing a piece of cloth to B, says “this is the best piece of cloth in the market”. B buys the cloth.1. Does this settlement amount to a condition ?
- (b) A tells B, “this radio will get all the European stations” or “this truck will do 15 miles on 5 litres”; Are these representation conditions ?
- (c) A ordered a certain quantity of a specified grade of leather. He plans to use it for making suit cases. When he finds that the leather is not suitable for that purpose he sues the seller for damages on a breach /of implied conditions. Will he succeed ?
- (d) A sold certain grain by description to B, a retailer. Part of the grain delivered by A was wet and decayed. Was there a breach of condition ?
- (e) R Ltd. agreed to supply 500 tons of coal to Manchester Liners for S.S. “Manchester Importer”. The coal was found to be unsuitable for that particular ship. Has the buyer any remedy ?
- (f) A bought 100 bales of “Fair Bengal” cotton by sample and after having inspected the bulk, the cotton proved not to be such as was known in the market “Fair Bengal”. Was there a breach of condition.

Answer :

- (a) No. the statement does not amount to any condition, but only an opinion or sales talk B has no right against A.
- (b) Yes, these representations amount to express conditions and their breach entitles the buyer to repudiate the contract or claim damages.
- (c) No, he will not succeed because he had ordered a specific grade of leather and there is no implied condition as to fitness for a particular purpose in such a case.
- (d) Yes, there was a breach of implied condition as to merchantability.
- (e) The buyer can reject the coal or claim damages as the coal is not suitable for the particular ship.
- (f) Yes, there is a breach of implied condition as the cotton did not correspond to description.

TRANSFER OR PASSING OF PROPERTY IN GOODS

The main object of a sale is the transfer of ownership of goods from the seller to the buyer. As the risk of loss follows ownership, it is important to know the precise moment at which the seller ceases to be the owner and the buyer becomes the owner of the goods. Subject to any contract between the parties, the Act lays down the circumstances when the ownership passes from the seller to the buyer. The fundamental rule is that property or ownership passes only in ascertained goods and not in unascertained goods.

Passing of property or ownership in specific or ascertained goods: In a sale of specific or ascertained goods the property passes to the buyer at the time when the parties intend it to pass. But, unless a contrary intention appears, the following rules are applicable for ascertaining the intention of the parties :

(1) 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, even though the payment of the price or the delivery of the goods or both are to take place at a later date. Deliverable state means such a state that the buyer would be bound to take delivery, as nothing remains to be done by the seller either to the goods or for the purpose of ascertaining the price. Therefore, property in goods passes at the time of entering into the contract of sale if the following conditions are fulfilled :

- (i) The goods are specific goods;
- (ii) The goods are in a deliverable state, that is to say., they can be immediately delivered;
- (iii) The contract of the sale is without any condition;
- (iv) The parties themselves have not fixed a different time for the passing of property,

Examples :

(a) A bought from B on 4th January a stack of hay lying on B's land. The price was to be paid on 4th February and the haystack was to remain on B's land till the first of May. The haystack was destroyed by fire. The buyer, A had to bear the loss as the property had passed to him on 4th January, the date of the contract, although the payment of price and the delivery of the goods were postponed.

(b) A sold a motor-car to B, the price being payable by monthly instalments and on default of payment of any instalment, the seller was at liberty to take possession of the car. The property in the car passed only on the payment by B of all the instalments.

(2) Where there is a contract for the sale of specific goods not in a deliverable state, i.e., the seller has to do something to the goods to put them in a deliverable state, the property does not pass until that thing has been done and the buyer has notice of it.

Examples :

(a) A bought from B 200 bottles of hair oil. When B had filled all the bottles and had got them ready for delivery and, A, the buyer came to know of the fact, the ownership passed to A, and the goods at that stage were in a deliverable state.

(b) There was a contract for the sale of certain teak trees. The buyer was to select and the seller was to cut away rejected portion. Unless the rejected portion had been severed from a teak tree, the property in it did not pass to the buyer.

(3) Where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do something with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice of it.

Examples :

(a) 289 bales of goat skins, containing 5 dozens in each bale, were sold at Rs.57.50 per dozen, and the seller had to count over the skins to ascertain the price. Before the counting was done, the whole lot was destroyed by fire. The loss fell on the seller as the property had not passed to the buyer.

(b) A sold wheat lying in a heap at a particular place, and it was to be weighed before delivery to ascertain price. A part of it was weighed and delivered but the remaining wheat was destroyed by high floods. The loss of the unweighed residue fell on the seller as the property had not passed.

(4) Where goods are sold and delivered on 'approval' or "on sale or return" the property therein passes to the buyer

- (i) when he signifies his 'approval' or acceptance to the seller or does any other act adopting the transaction;
- (ii) if he retains the goods without notice of rejection, beyond the time fixed for the return of the goods, or if no time is fixed, beyond a reasonable time.

Examples :

(a) A agreed to sell a horse to B, on the terms that B, should take it away, try it for 8 days, and then return it, if he should not find it suitable for his purpose. This was a sale 'on approval' or 'on sale or return'. The horse died within 3 days without fault of either party. The buyer was not liable to pay the price as the property had not passed; it could only pass after the expiry of 8 days.

(b) A delivered jewellery to B on sale or return. B pledged it with C. The pledge amounted to an act by B adopting the transaction, and therefore, the property in the jewellery passed to him so that A could not recover it from C.

Ownership in Unascertained Goods: We have seen before that according to section 18, the property in unascertained goods does not pass until goods are ascertained. Unascertained goods are goods by description only, e.g., 100 tonnes of coal, and not goods identified and agreed upon when the contract is made. Hence property does not pass in unascertained goods.

Section 23 provides property in unascertained or future goods sold by description passes to the buyer when the goods of that description and in deliverable state are appropriated to the contract, either by the seller with the assent of the buyer, or the buyer with the assent of the seller.

Where, in pursuance of the contract, the seller delivers the goods to buyer or to a carrier for the purpose of transmission to the buyer and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract.

Appropriation: The appropriation of the goods may be made :

- (i) By the buyer with the assent of the seller, where the buyer has the possession of the goods. For example, where the buyer is a warehouseman for the seller in respect of bales of cotton and agrees to buy 25 bales out of them, the buyer may, with the seller's assent, select 25 out of the 60 bales, and when he has done so, the goods (25 bales) become appropriated and ownership in them passes to the buyer.
- (ii) By the seller with the buyer's assent when the goods are in his possession, which is the more common thing. In the above examples, if the bales were lying with the seller and he selected 25 bales with the buyer's consent, the ownership of those 25 bales would pass to the buyer as soon as this was done.

The seller may appropriate the goods :

- (a) by putting the quantity contracted for in suitable receptacles, as for example, putting the oil in bottles or grain in bags and getting the assent of the buyer, or in bottles or bags supplied by the buyer.
- (b) by separating the articles contracted for from the others, as for instance, in a sale of jute, the marking by the seller of the quantity of the goods required by the buyer, will transfer property;
- (c) by delivery to the carrier or other bailee for transmission to the buyer, without reserving the right of disposal, as for example, handing over the goods to a railway administration or a shipping company for carriage and the railway receipt or bill of lading is made out in the name of the buyer.

Contract of Sale Involving Sea Transit

In a sale of goods to be shipped abroad, a number of conditions are attached by the parties or by custom. The most usual of such contracts are as follows :

F.O.B. Contracts: F.O.B. or free on Board means that the property in the goods passes to the buyer only after the goods have been loaded on board, and accordingly the risk attaches to the buyer only on shipment of goods. The goods are at the risk of the seller before they are put on board but after they are on board the buyer runs the risk of loss.

C.I.F. Contracts: Cost, Insurance and Freight with contract is said to be a contract of sale of goods with insurance and freight terms. It may be defined as a contract for the sale of goods to be performed by the delivery of documents representing the goods, i.e., of documents giving the right to have the goods delivered or the possible right, if they are lost or damaged, recovering their value from the ship owner or from the insurer. Where the buyer orders goods from a merchant abroad, the seller will insure the goods, deliver them to the shipping company and send the bill of lading and the insurance policy together with the invoice to a bank and the buyer has to pay the price (which, includes cost of goods, premium of insurance and freight), and receive the above documents from the bank, and get delivery of the goods from the shipping company on producing the documents.

This method protects the seller, for the goods continue to be in his ownership until the buyer pays for them and gets the documents* and the buyer is equally protected; as he is only called upon to pay against the documents, and the moment, he pays he obtains the documents which enables him to obtain delivery of goods, as soon as they arrive. If, in the meantime the goods are lost, neither would be put to loss, for either the seller or the buyer, whoever is the

owner at the time of the loss, can make a claim against the insurers for such loss. If after taking delivery of the goods, the buyer finds that they are not according to the contract he may reject the goods and sue for damages.

Ex-ship Contract: In the case of contracts where delivery has to be made “ex ship”, the ownership of the goods will not pass until actually delivered. The goods are at the seller’s risk during the voyage, and he is not obliged to insure them on the buyer’s behalf. He will, however, insure them to protect his own interests. Even if the buyer has paid the price against the documents, the buyer does not thereby acquire an interest in the goods.

Passing of Risk: Section 26 lays down the rules regarding the passing of risk. The general rule is risk follows ownership. The goods remain at the seller’s risk until the property therein is transferred to the buyer. After the property has passed to the buyer, the goods are at the buyer’s risk whether delivery has been made or not. Thus, where A buys goods of B and property passes to him, but the goods remain in B’s warehouse which catches fire and goods are destroyed the loss will fall on A and he must pay the price to B.

There are two exceptions to the above rule :

- (1) Where delivery has been delayed through the fault of either the buyer or the seller, the goods are at the risk of the party at fault.
- (2) The parties may agree that the risk will pass at a time different from the time when property passed. For example, the seller may agree to be responsible for the goods even after the property has passed to the buyer.

Transfer of Title by Non-owners

General Rule: The general rule is that only the owner of goods can sell them. No one can convey a better title than he himself has. If a person transfers some goods not belonging to him, the transferee gets no title because how can one give what he himself does not own.

A finds a ring and after making reasonable effort to discover the owner sells it to B who buys without knowledge that A was merely a finder. But B does not get title to the ring and the true owner can recover the ring from B.

Exceptions to the General Rule: There are certain exceptions to the general rule, “Nemo dat quod non habet”. In each of the following cases a person who is not an owner, can give to the transferee a good title to the goods,

(1) **Sale by a Mercantile Agent:** Where a mercantile agent is, with the consent of the owner, in possession of the goods or documents of title of the goods, any sale made by him, when acting in the ordinary course of business of mercantile agent, gives a good title to the buyer provided the buyer acts in good faith and has no notice that the agent had no authority to sell. Thus, a buyer who buys from a factor, broker or auctioneer gets a good title to the goods even though the agent has exceeded his authority.

(2) **Sale by a Co-owner :** If one of the joint owners of the goods has the sole possession of them by permission of the co-owners the property in goods passes to any person who buys them in good faith and no notice, at the time of the contract, that the seller had no authority to sell. A, one of the joint owners of a diamond, holds it in his safe custody. He sells it to B who buys in good faith. B gets good title to the diamond.

(3) Sale by a person in possession under a voidable Contract : Where a person in possession of the goods under a voidable contract (through coercion or mis-representation) sells them, before the contract is avoided, to a buyer who buys in good faith and without notice of the seller's defective title to the goods, the buyer gets a good title to the goods (The rule does not apply to a contract which is originally void).

(4) Sale by seller in possession after sale: Where a seller, after having sold the goods, continues to be in possession of the goods, or a document of title to the goods and again sells them or pledges the same either himself or through an agent to a person who acts in good faith and without notice of the previous sale such a person gets a good title to the goods .

A buys a picture from shop and leaves it with the shopkeeper. The shopkeeper sells it to B who .has no knowledge of the sale to A. B gets a good title to the picture. A cannot get the picture from B. His only remedy is to sue the shopkeeper for damages.

(5) Sale by buyer in possession of goods over which the seller has some rights : Where a buyer, having bought or agreed to buy goods, obtains with the consent of the seller possession of the goods or the documents of title to the goods, and then sells, pledger the same either by himself or through a mercantile agent, the buyer or pledgee, who acts in good faith and without notice of lien of any other right of owner (i.e.. the original seller) gets a good title to the goods.

A agreed to buy a car and pay for it, if his solicitor approved, and having obtained, possession of the car, sold it to G, but the solicitor disapproved of the transaction, C the bonafide buyer gets a good title, for A "agreed to buy it".

But a person who has merely an option to buy, as in a hire-purchase agreement, the buyer cannot transfer title to a sub-buyer, however bonafide, for option to buy is not agreement to buy.

A entered into a hire-purchase agreement with B in relation to a piano on the condition that on paying 12 instalments of Rs.100 each the piano should be his property, After paying 6 instalments, B pawned the -piano with C, who took it in good faith. A can take back the piano from C.

6. Sale under the implied authority of the owner or title by estoppel: Under certain circumstances the true ownW may be precluded, by his conduct from denying the seller's authority to sell. When the true owner has acted in such a manner that the buyer has been induced to believe that the goods belong to somebody else and on that belief buys the goods, the owner could not recover goods from such person.

The lesee of a public house who allowed another person to sell the fixtures and fittings as if they were his own whereby third person was induced to buy them bonafide, He could not recover them from the buyer who gets good title to the goods.

Miscellaneous exceptions

There are some other cases in which non-owners can sell and pass good title to the goods. A receiver appointed by the Court, Official Assignee or Official Receiver under the Insolvency Acts, a Liquidator under the Companies Act, or all Executor or Administrator has authority to sell goods and pass good title. Also, an unpaid seller exercise his right of lien or stop the goods in transit even where property has passed to the buyer and then sell them to some other person who will get good title to the goods. A pledgee or pawnee who is not the owner of the goods can sell them if-the pledger fails to pay on the agreed date and the buyer will get good title.

Safe in market overt. A person who buys goods in market overt, obtains a good title to the goods. 'Market overt' means an 'open, public and legally constituted market'. Where goods are sold in market overt, the buyer acquires a good title to them irrespective of the seller's title provided,

- (1) The goods are sold in accordance with the usage of the market; and
- (2) The buyer bought the goods in good faith and without notice of any defect of want or title on the part of the seller,

This practice is followed in England.

SELF CHECK TEST

- (a) A buys a ring from B at a low price by undue influence and sells it to C who is an innocent buyer without notice of A's defective title. Can B recover the ring from C?
- (b) A obtained goods under an agreement which was found to be void, Did A get good title to the goods.
- (c) A horse was sold at a public auction,. The horse was stolen property but this was not known to either the auctioneer or the buyer. Did the buyer get good title to the horse?
- (d) A sent a piano to B on sale or return basis. After a week, from the date of the receipt of the piano by B, B pledges it as a security of a loan advanced to him by C. Does C get a good pledge ?
- (e) A told B that he wished to buy B's car. He drove the car for about 10 minutes came back to B and stated that he wanted to show it to his father, and then left with the car and never returned. Later A sold the car to C who sold it to D, B sued D for the recovery of the car. Will he succeed ?

Answer :

- (a) No, B cannot recover the ring from C, even if the contract is subsequently rescinded.
- (b) No, A did not get any title to the goods, even if we were a bonafide buyer for value and without any notice or any defect in the sellers title.
- (c) No, the true owner can recover the horse from the buyer as it does not come under Sec. 27.
- (d) Yes, C gets a good pledge, The Act of pledging the piano by B amounts to acceptance of the goods and the passing of property to him.
- (e) Yes, B will succeed. A was guilty of theft and obtained no title to the car and so could convey no title to any buyer even though the ultimate buyer gave value and acted in good faith.

Lesson 9

PERFORMANCE OF THE CONTRACT OF SALE

Duties of seller and buyer: It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them in accordance with the terms of the contract of sale.

Unless otherwise agreed upon payment of the price and the delivery of the goods are concurrent conditions, that is to say, the seller must be ready and willing to deliver the goods to the buyer and the buyer must be ready and willing to pay against delivery. Both payment and delivery take place at the same time unless otherwise agreed. The seller must deliver the goods according to the terms of the contract and if he fails to do so, the buyer can claim damages. Similarly, the buyer must pay for the goods and accept delivery, and if he wrongfully refuses to accept delivery; he shall have to pay compensation to the seller.

Rules regarding delivery : Delivery is the voluntary transfer of possession from one person to another. Delivery may be made by doing anything which the parties agree shall be treated as delivery. The mode of giving possession is to be determined by the parties.

Delivery may be actual, constructive or symbolic. Actual delivery takes place where the goods are handed over to the buyer or his authorised agent. *Constructive delivery* takes place when the person in possession of the goods acknowledges that he holds them on behalf of and at the disposal of the buyer. For instance, the seller agrees to hold the goods as bailee for the buyer. *Symbolic delivery* is made by indicating or giving a symbol. Here the goods themselves are not delivered, but the means of obtaining possession of the goods is delivered, e.g., the key to the warehouse where the goods are stored is handed over to the buyer, or the bill of lading which will entitle the holder to receive the goods on the arrival of the ship is given.

1. Delivery should have the effect of putting the buyer in possession. For example where the wood of fallen trees is sold the buyer should be able to cart away the wood after cutting it.
2. The seller must deliver the goods according to the contract.
3. Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery.
4. Where goods at the time of the sale are in the possession of a third person, there is no delivery by the seller to the buyer unless and until such third person acknowledges to the buyer that he holds them on his behalf.
5. Where under the contract the seller is bound to send the goods to the buyer, but no time is fixed, the seller must send them within a reasonable time.
6. Demand by the buyer and tender by the seller of delivery must be made at a reasonable hour.
7. Apart from any express contract, the goods are to be delivered at a place where they happen to be at the time of the contract of sale, or if the contract is with respect to future goods, at the place at which goods are manufactured or produced.
8. The seller has to bear the cost of delivery unless the contract otherwise provides.

9. Where goods are delivered to a carrier or wharfinger, the seller is bound to enter into a reasonable contract on the behalf of the buyer with the carrier for the safe transmission of "the goods; if he fails to do so, the buyer may claim damages in case the goods are destroyed. If the transit would be by sea, the seller must inform the buyer in time so that he may have the goods insured, or the seller may insure them on behalf of the buyer.
10. Where the seller is ready and willing to deliver the goods and request the buyer to take delivery and the buyer does not comply with his request within a reasonable time the buyer is liable to the seller for any loss occasioned by his neglect, and to a reasonable charge for the care and custody of the goods.

Acceptance of goods by the Buyer: The buyer has a right to have delivery as per contract, and accepts them when- they are according to the contract.

Acceptance by the buyer takes place when he :

- (1) intimates to the seller that he has accepted the goods or
- (2) does any act to the goods which is inconsistent with the ownership of the seller e.g., pledges or resells them; or
- (3) retains the goods, after the lapse of reasonable time, without intimating to the seller that he has rejected them.

When goods are delivered to the buyer which he has not previously examined he is not deemed to have accepted them until he has had reasonable opportunity to examine them.

If the seller sends to the buyer a large or smaller quantity of goods than ordered, the buyer may-(1) reject the whole, or (2) accept the whole, or (3) accept the quantity he ordered and reject the rest.

But what the buyer accepts he must pay for at the contract rate, If the seller delivers with the goods, ordered, goods of a wrong description, the 'buyer may accept the goods ordered and reject the rest, or reject the whole.

If a buyer has a right to reject the goods, he is not bound to return the rejected goods to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them.

RIGHTS OF AN UNPAID SELLER

Who is an unpaid seller

A seller is an unpaid seller-(1) when the whole of the price has not been paid or tendered; or (2) when a conditional payment was made by a bill of exchange or other negotiable instrument, and the instrument has been dishonoured. In simple words, an unpaid seller is one who has sold goods on cash terms and to whom the price of the goods is payable immediately. It does not include a seller who has sold goods on 'credit and the period of credit has not expired.

An unpaid seller has two-fold rights: (A) against the goods, (B) against the buyer personally.

(A) Rights against the goods

Rights of unpaid seller against the goods

An unpaid seller of goods, even though the property in the goods has passed to buyer, has following rights against the goods :

- (a) a lien on the goods for the price while he is in possession of them;
- (b) a right of stoppage in transit in case of the buyer's insolvency;
- (c) right of resale under certain circumstances;

If the property in the goods has not passed the unpaid seller can withhold delivery of the goods. Right of Lien

An unpaid seller of goods in possession of goods sold by him may exercise his lien on the goods and refuse to deliver them' to the buyer until full payment or tender of the price in cases where

- (a) the goods have been sold without any stipulation as to credit;
- (b) the goods have been sold on credit, but the term of credit has expired;
- (c) the buyer has become insolvent;

The seller may exercise his right of lien even if he is in possession of the goods as agent or bailee for the buyer. Lien can be exercised for the remaining part of shipment, where the seller has already delivered a part of the goods,

lien can be exercised for non-payment or the price, and not for any other charges. For example, the seller cannot claim *lien* for godown charges which he had to incur for storing the goods in exercise of his lien for the price.

Lien depends upon physical possession. Therefore an unpaid seller loses his lien on the goods :

- (a) when he delivers them to a carrier or other bailee for the purpose of transmission - to the buyer without reserving the right of disposal of the goods;
- (b) when the buyer or his agent lawfully obtains possession of the goods;
- (c) by waiver of the lien. Right of stoppage in transit

The right of stoppage in transit is an extension of the right of lien, but it arises only on the insolvency of the buyer It is a right to regain possession of goods not paid for, while in transit, in case the buyer becomes insolvent. So the right of stoppage in transit begins where the right of lien ends.

The goods are deemed to be in transit from the time they are delivered to the carrier or to the time they are delivered to the buyer or his agent. The goods are still in transit if they are rejected by the buyer.

The right of stoppage in transit comes to an end as soon as the buyer or his agent takes delivery of the goods either at the destination or before their arrival at the destination.

It also comes to an end if, after the arrival of the goods at their destination; the carrier acknowledges to the buyer that he holds the goods on his behalf.

The right to stop in transit also ends if the carrier wrongfully refuses to deliver the goods to the buyer or his agent.

If the buyer has in the meantime obtained Bill of Lading or other documents of title to the goods and assigned the same for value to a bonafide purchaser, the right of stoppage would be lost. Where A sells and consigns certain goods to B, A being still unpaid B becomes insolvent;

while the goods are in transit. B assigns the B/L for consideration to C. It was held, the B/L is a document of title to goods. C was not aware of b's insolvency and he had received B/L for consideration. C got a good title to the goods and A though he was an unpaid seller could not stop the goods in transit.

How stoppage in transit is effected

The right to stop goods in transit may be exercised either by taking actual possession of the goods or by giving notice of the seller's claim to the carrier or other person having control of the goods. The carrier upon such notice being given, is bound to re-deliver the goods to the seller or his agent. The expenses of re-delivery are to be borne by the seller .

Effect of sub-sale or pledge by buyer

The unpaid seller's right of lien or stoppage in transit is not affected by the buyer's selling or pledging the goods, unless the seller recognises such sub-sale or pledge.

While the goods are in transit, if the buyer transfers the document of title to the goods or pledges the same to a person taking them in good faith and for consideration then, if the transaction is sale, the right of stoppage in transit is defeated. But if the transaction is a pledge, the seller's right to stop in transit will be subject to the pledge.

Right of re-sale

The unpaid seller who has retained possession of the goods in exercise of his right of lien or who has regained possession from the carrier upon insolvency of the buyer can re-sell the goods.

- (a) if the goods are of a perishable nature without any notice to the buyer; and
- (b) in other cases after giving notice to the buyer, calling upon him to pay or tender the price within reasonable time and upon failure of the buyer to do so.

If the money realised upon such re-sale is not sufficient to compensate the seller, he can sue the buyer for the balance. But if he receives more than what is due to him, he can retain the excess.

Right of re-sale is a limited right

The seller must give the notice of sale to the buyer and he should be given the first opportunity to pay for the goods. A resale does not absolve the buyer from any liabilities to compensate the seller for damages he may have suffered.

The person who buys the goods upon such re-sale gets a good title even if the seller has failed to give notice to the first buyer. The only effect of failure to give notice before selling the goods is that the seller cannot sue the first buyer for damages for breach of contract and must pay back to the first buyer any profit he had realised from the resale.

(B) Unpaid Seller's Rights against the Buyer

An unpaid seller has the following rights against the buyer personally.

1. Where the property in the goods has passed to the buyer, the seller is entitled to sue for price, whether the possession is with the buyer or the seller.
2. Where the price is payable on a certain day irrespective of delivery, the seller may sue for the price, if it is not paid on that day, although the property in the goods has not passed.

3. Where the buyer wrongfully neglects or refuses to accept the goods and pay for them, the seller has a right to sue for damages.

Auction Sale

A sale by auction is a public sale, where goods are offered to be taken by the highest bidder. It is a proceeding at which people are invited to compete for the purchase of property by successive offers of advanced sums.

The following rules, as given in section 64 of the Act apply to auction sales:

1. Where goods are put up for sale in lots, each lot is *prima facie* deemed to be the subject of a separate contract of sale.
2. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in any other customary manner; and until such announcement is made, the bidder may retract his bid. A bid by an intending buyer is an offer, it can be withdrawn any time before acceptance, which in an auction occurs by the fall of hammer, or any other customary manner, e.g., one, two, three, or repeating the final offer or bid three times.

Since an offer can be refused, and a bid is an offer, it follows that the auctioneer is not bound to accept the final or any other bid. A lot can be withdrawn after bidding has taken place for some time.

3. A right to bid may be reserved expressly by or on behalf of the seller. If such right is expressly reserved, the seller or anyone 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 be himself or to employ any person to bid at such sale. The auctioneer cannot take any bid from the seller or his nominee. Any sale contravening this rule may be treated as fraudulent by the buyer.
5. The sale may be notified to be subject to a reserved price, i.e. there may be a price below which the goods will not be sold: The reserve price may be kept secret.
6. If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

RIGHTS OF THE BUYER

1. *Right to have delivery as per contract* -The first right of the buyer is to have delivery of goods as per contract.
2. *Right to repudiate* -Unless otherwise agreed the buyer of goods is not bound to accept delivery thereof by instalments.
3. *Right to examine* -The buyer has a right to examine the goods which he has not previously examined before he accepts them. The seller is bound to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.
4. *Rights against seller for breach of contract* -(a) Suit for damages (Sec.57) where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.

- (b) Suit for damages - If the buyer has paid the price and the goods are not delivered, he can recover the amount paid.
- (c) Suit for specific performance -The buyer may sue the seller for specific performance of the contract to sell when the goods are specific or ascertained. The court may order for the specific performance of the contract.
- (d) Suit for breach of warranty -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 may.
 - (1) set up against the seller the breach of warranty in diminution or extinction of the price; or
 - (2) sue the seller for damages for breach of warranty. [Sec. 59]
- 5. *Repudiation of contract before the date* -Where the seller repudiates his contract before the date of delivery, the buyer may either treat the contract as subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach. This rule is known as the rule of anticipatory breach or contract,
- 6. *Suit for interest* -Where there is breach of contract on the part of the seller and as a result, the price has to be refunded to the buyer, the buyer has a right to claim interest on the amount of the price.

SELF-CHECK TEST

- (a) The Warehouse has two rooms, one inner and the other outer. The goods which have been sold are lying in the inner room. The seller hands over to the buyer the key to the inner room and retains the key to the outer room. Has delivery of the goods taken place?
- (b) A bought of B some cargo on board a ship at sea. B endorsed the bill lading relating to the cargo and handed it over to A along with other documents against payment. On the arrival of the ship at port, A fails to get delivery of the goods from the Master of the ship and sues B for non-delivery of the goods. Is A entitled to sue B ?
- (c) A bought a horse from B and paid for it. B asked A to lend him the horse for a week to which A assented and let him keep the horse in his custody. Is there a delivery of the horse to A ?
- (d) The contract of sale provided that on the arrival of the railway receipt and the invoice, the buyer should receive them on payment of the price. The seller gave notice of the arrival of the goods, and awaits demand by the buyer for delivery and does not send the goods to the buyer. The buyer sues the seller for damages for failure to deliver the goods. Will he succeed?
- (e) A bought some goods from B on one week's credit and left them with D. Later on, he sold them to C and give him a delivery order on B. C was unable to get delivery from B. Meanwhile, A unaware of the non-delivery paid the price to B, and sued C to recover it from him on the ground that he had to pay B by the failure of C to inform him of non-delivery of the goods. Will A succeed in getting the price from C ?

- (f) A sold 32 logs of wood to B on approval. After inspection B rejected the logs, asked A to take them away and sued for the return of Rs.300 which he had advanced on the transaction. The suit was decreed but the goods were destroyed by fire. A demands from B the price of the goods on the ground that he had failed to send back the goods. Will he succeed ?
- (g) A sold certain goods to B to be delivered by instalments to be paid for in cash 14 days after delivery? During the currency of the contract, B became insolvent and the price of one instalment was unpaid. A refused to deliver further instalments. Is he justified in his action?
- (h) A sold certain goods to B and handed them over to B for examination only. While the goods were in B's possession for the purpose, B became insolvent, and A exercised his right of lien. Is his action valid ?
- (i) A sold certain goods to B and forward to him a bill of lading endorsed in blank together with a bill of exchange for the price of the goods for acceptance. B without accepting the bill of exchange made over the bill of lading to C who acting in good faith paid him for the goods. Can A stop the goods in transit ?
- (j) A sold certain goods to B, and B resold them to C and then became insolvent. The bill of lading was made out in the name of C but not delivered to him and so he had not paid for them. Can A stop the goods in transit?
- (k) A bought from B a shipment of nuts and B sent to A the bill of lading. A handed the bill of lading to C in return for a loan, and then became insolvent.
B-attempted to stop the goods in transit, but C claimed them. How would you decide?
Answers :
- (a) No, there is no symbolic delivery as there is no access to the goods.
- (b) No, A is not entitled to sue B for non-delivery by the Master of the ship. The handing over of the bill of lading to A against payment amounted to delivery of the goods. He can sue the shipping company for damages and not the seller .
- (c) Yes, the horse had been delivered to A.
- (d) No, although the seller has to be ready and willing to deliver the goods, he is not bound to deliver unless the buyer demands delivery on payment of the price.
- (e) No, A cannot get the price from C because, although the goods were purchased they were not delivered, Also a buyer who has not obtained delivery is not in law bound to inform the seller that he has failed to obtain delivery.
- (f) A has no right to demand the price of the goods from B who had rejected them had and also asked B to remove them. A buyer is not bound to return the goods that he has rejected; and as he is only a bailee for them, he is not responsible for any loss of goods due to accidents.
- (g) A is justified in his refusal to deliver further instalments. The seller need not make further deliveries unless the price of that instalment is paid and cash is paid against the delivery of subsequent instalments.

- (h) Yes, A can exercise his right of lien; for putting the goods into the possession of the buyer only for examination does amount to surrender of lien. The goods are still deemed to be in the possession of the seller.
- (i) 'No, A cannot stop the goods in transit. The transfer of the bill of lading (document of title) to a sub-buyer who pays the price destroys the right of the seller to stop the goods in transit.
- (j) Yes, A can stop the goods in transit for the purchase money. The bill of lading, though made out in the name of C was not delivered to him so that he did become the owner of the goods.
- (k) C got good, title to the goods which defeated B's right to stop them in transit. In the result, B cannot stop the goods in transit and C can get their possession as owner.

Lesson 10

**PROMISSORY NOTE, BILL OF EXCHANGE, HUNDI,
CHEQUE-CROSSING PARTIES TO NEGOTIABLE INSTRUMENTS**

Introduction

Negotiable instruments are the most common credit devices utilized in business society. Negotiable instruments importance lies in the fact that these are more readily transferred than ordinary claims or contract rights that the transferee of a negotiable instrument may acquire greater rights than would an ordinary assignee. Though basically, negotiable instruments are written promises or orders to pay money, such as promissory notes, bills of exchange and cheques which when in proper form, may be transferred from person to person as a substituted of money.

The law relating to negotiable instruments in India is incorporated in Negotiable Instrument Act, 1881. The Act is not comprehensive. It does not affect the local usage or customs. If any local usage or custom is contrary to the provisions of this act, the local usage overrides the Act. The act includes only three instruments in its ambit, viz. Bill of exchange, promissory note and cheque. But the act will also be extended to other instruments possessing the characteristics of a negotiable instrument, by local customs, for example Hundi. The act also does not prohibit the transfer of instruments by other methods, e.g. by assignment.

Meaning of Negotiable Instruments

According to section 13 (a), Negotiable Instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the 'words' order or 'bearer' appear on the instrument or not. Any other instrument can be added to these three if it satisfies two conditions of negotiability. One is that it is by customs of trade transferable by delivery or by endorsement and delivery; second is that it is capable of being sued upon by the person holding out in his own name.

The nature of negotiable instrument is such that property in it is acquired by every person who takes it bonafide and for value, notwithstanding any defect of title in the person from whom he took it. On this basis a negotiable instrument may be defined as a contractual obligation in writing and signed by the party executing it, containing an unconditional promise or order to pay a sum certain in-money on demand, or at a fixed or determinable future time, payable to bearer or to the order of a specified person.

Essential Elements of Negotiable Instrument :

To be negotiable an instrument must have the following elements :

1. A negotiable instrument must be in writing, which includes typing, printing and engraving.
2. The instrument must be signed by the maker or drawer.
3. There must be a promise if it is a promissory note or order to pay if it is a bill of exchange.

4. The promise or order must be unconditional. If it is conditional the instrument is not negotiable.
5. A negotiable instrument must call for payment in money. If the promise or order is for anything else, the instrument is not negotiable.
6. The instrument must not only call for payment in money but also for a certain sum.
7. A negotiable instrument must be payable at a time which is certain to arrive which may be payable either on demand or at a particular time or at a determinable future time. If it is payable when convenient, the instrument is not negotiable because the day of payment may not arrive. The requirement that there must be a time certain to arrive does not mean that the instrument must specify a fixed date for payment.
8. A negotiable instrument must be payable to order or bearer: Without the words order or bearer, the instrument would not be negotiable because, if they were not there, no one but the payee could present them for payment. If it is merely payable to Ram, it is not negotiable. It is not necessary that the instrument actually use the words 'order' or 'bearer'. And other words indicating the same intention are sufficient. Pay to holder could be used in place of 'order' or 'bearer'.
9. In the case of a bill of exchange or cheque, the drawee must be named or described with reasonable certainty. The purpose of this requirement is to enable the holder of the instrument to know to whom he must go for payment.

Presumptions as to Negotiable Instruments

Since the philosophy underlying the law of Negotiable instruments is that business transactions should be facilitated by making available evidence of right to money that will pass freely from hand to hand.

In order to facilitate the free transfer of negotiable instruments from one party to another, Section 118 of the Act provides that until the contrary is proved, the following presumptions shall be made :

1. That every negotiable instrument was made or drawn, accepted, endorsed and negotiated or transferred for consideration.
2. That it bears the date on which it was made or drawn.
3. That every accepted bill was accepted within a reasonable time after its date and before its maturity.
4. That every transfer of a negotiable instrument was made before maturity.
5. That the endorsements appearing on it were made in the order in which they appear thereon.
6. Where an instrument has been lost or destroyed, that it was duly stamped and the stamp was duly cancelled.
7. That the holder of the instrument is a holder in due course.

The object of these presumptions is to declare the instrument as valid and in good order. If a suit is filed in respect of a negotiable instrument, the Court will presume that the instrument was in good order and valid. If any party challenges its validity, he shall have to prove to the

contrary. These presumptions are necessary in the case of negotiable instruments, as they are credit instruments and intended to be created as money which can pass freely from hand to hand. Negotiable instruments act includes only three types of instruments :

1. Promissory note.
2. Bill of Exchange.
3. Cheque.

PROMISSORY NOTE (Sec. 4)

Definition

Promissory note is defined by Section 4 of the Negotiable Instruments Act. A promissory note is an instrument 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.

An instrument to be a promissory note must possess the following elements :

- (1) It must be *in writing*: Mere verbal promise to pay will not do. The method of writing is important, but it must be in a media that can not be altered easily.
- (2) It must contain an *express promise* or clear undertaking to pay: A promise to pay cannot be inferred; it must be express. A mere acknowledgement is not enough. The following are not promissory notes, as there is no promise to pay:
 - (a) “Mr. A.I.O.U. Rs. 500”.
 - (b) “I am liable to pay you Rs. 1,000”.
 - (c) “I have taken from you Rs. 150; whenever you ask for it; I have to pay.”

But the following is a promise to pay:

- (a) “I promise to pay Ram or order Rs. 1,500.”
- (b) “Ram, I owe you Rs. 1,500 and promise to pay the same for value received.”
- (c) “I promise to pay Ram 1,500 at Kanpur.”

Although the promise to pay may be opposed to public policy and unenforceable, once a promissory note is executed the promise to pay is performed because a promissory note amounts in law to payment and what vitiates a promise does not vitiate a payment.

- (3) The promise to pay must be *unconditional*: We have seen before that an instrument, to be negotiable, must contain an unconditional promise or order. So a promise to pay contained in a note must be unconditional. A conditional undertaking destroys the negotiable character of an otherwise negotiable instrument. But a promise to pay at a particular place or after a specified time or on the happening of an event which must happen is not conditional.

For example, I promise to pay B Rs.50 seven days after C’s death is not conditional, for C is certain to die some time or the other.

- (4) *The maker must Sign the promissory note*: The person who draws the instrument and signs it is known as the maker and the person to whom the promise is made is called the payee. The instrument will be complete only when it is signed by the maker even when it is written by him and his name appears in the body of instrument. Signature

may be in any part of the instrument, and may be expressed by a thumb mark or any other mark, if the executant is illiterate.

- (5) *The maker must be a certain person:* The note itself must show clearly who is the person engaging himself to pay, Where the promisors are more than one they may bind themselves jointly or jointly and severally but not in the alternative.
- (6) *The payee must be certain:* A promissory note must contain a promise to pay to some person or persons ascertained by name or designation or to their order. A promissory note made payable to the maker himself it nullity but if such a note is endorsed by him, it becomes payable to bearer and is valid.
- (7) *The sum payable must be certain* and the amount must not be capable of contingent additions or subtractions. Thus, if A promises to pay Rs.500 and all other sums which shall become due to him or to pay 180 and all fines according to rules, the instrument is not a promissory note.
- (8) Payment must be in *legal money of the country*. Thus an agreement to pay money or grain or to deliver 100 tons of iron is not a promissory note.
- (9) A bank note or a currency note is not a promissory note within the meaning of this section. They are expressly excluded from the definition, as they are treated as money and not merely securities for money. A promissory note or a draft cannot be made payable to bearer, no'matter whether it is payable on demand or after a certain period.
- (10) Other matters of form like number, place, date etc., are usually found given in notes, but they are not essential in law.

Specimens of a Promissory Note

Rs.500.00	Delhi	
	November 4, 1998	
On demand (or six months after date) I promise to pay Ram or order the sum of five hundred rupees with interest at 6 per cent per annum until payment.		
	Sd/- <table border="1"><tr><td>Gopal Stamp</td></tr></table>	Gopal Stamp
Gopal Stamp		

Gopal is make and Ram is the payee.

Rs. 500.00	Delhi	
	Nov. 4, 1998	
On demand I promise to pay Ram the sum of five hundred rupees only.		
	Sd/- <table border="1"><tr><td>Gopal Stamp</td></tr></table>	Gopal Stamp
Gopal Stamp		

A promissory note must bear the stamp duty as required under the Indian Stamp Act. It is better if the stamps affixed are cancelled by the maker's signature. Suit can not be maintained on an insufficient stamped promissory note.

BILL OF EXCHANGE

Definition

According to Section 5 of the Negotiable Instruments Act, A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the Instrument. The definition of Bill of Exchange is very similar to that of a promissory note and for most purposes the rules which apply to notes are in general applicable to bills. The fundamental ingredients are the same. The drawer like the makers must be certain, the order to pay must be unconditional, the amount of Bill and the payee and the drawer, must be certain and the contract must be in writing. The maker of a note corresponds to the acceptor of a bill, and when a note is endorsed it is exactly similar to a bill, for then it is an order by the endorser of the note upon the maker to pay the endorsee. The endorser is, as it were, the drawer, the maker, the acceptor and the endorsee is the payee. But a bill differs from a note in some particulars.

The usual form of a bill of Exchange is given below:

Rs. 700.00	Delhi		
	November 4, 1998		
Three months after date pay to me or Bearer/or order the sum of rupees seven hundred only for value received.			
	Sd/- <table border="1"><tr><td>Stamp</td></tr><tr><td>S Y Z</td></tr></table>	Stamp	S Y Z
Stamp			
S Y Z			
To Sultari Singh Ch. Ch. Delhi			

Hare Sultan Singh is the drawee and X Y Z is the drawer or maker of the bill.

Rs. 500.00	Delhi		
	November 4, 1998		
Three months after date pay to Ram or order the sum of five hundred rupees for value received.			
	Sd/- <table border="1"><tr><td>Stamp</td></tr><tr><td>S Y Z</td></tr></table>	Stamp	S Y Z
Stamp			
S Y Z			
To Sultan Singh Esplanade Road. Delhi.			

Here X.Y.Z. is the drawer, Ram is the payee and Sultan Singh is the drawee.

Essentials of a Bill of Exchange

1. It must be in writing and may be in any language.
2. It must be an order to pay by the drawer to the drawee.
3. The order to pay must be unconditional. If the order to pay is conditional, the bill of exchange becomes invalid.
4. There are three parties in a bill of exchange.
 - (a) Drawer: The person who makes the bill.
 - (b) Drawee: The person who is ordered to pay or on whom the bill is drawn.
 - (c) Payee: The person who is to receive the payment.
5. The bill must be signed by the drawer otherwise it will become an inchoate instrument.
6. The order to pay must be of a certain sum and it must be in money only.
7. The payee and drawee must be certain.
8. It must be properly stamped under the Indian Stamp Act.

Distinction between Bill and Note

The below given differences are enumerated from the above meanings of both the instruments—

- (1) In a note there are only two parties - the maker and the payee. In a bill there are three parties namely, drawer, drawee, and payee; though two out of three capacities may be filled by one and the same person. In a bill the drawer is the maker who orders the drawee to pay the bill to a person called the payee or to his order. When the drawee accepts the bill he is called the acceptor.
- (2) A note cannot be made payable to the maker himself, while in a bill the drawer and payee or drawee and payee may be the same person:
- (3) A note contains an unconditional promise by the maker to pay to the payee or his order; in a bill there is an unconditional order to the drawee to pay according to the drawer's directions.
- (4) A note is presented for payment without any prior acceptance to the maker. A bill payable after sight must be accepted by the drawee or some one else on his behalf before it can be presented for payment.
- (5) The liability of the maker of a note is primary and absolute, but the liability of the drawer of a bill is secondary and conditional. He will be liable only if the bill is not accepted or paid by the drawer.
- (6) The maker of the note stands in immediate relation with the payee, while the maker or drawer of an accepted bill stands in immediate relation with the acceptor and not the payee.
- (7) Foreign bills must be protested for dishonour when each protest is required to be made by the law of the country where they are drawn but no such protest is necessary in the case of the note.

- (8) When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate indorsers, but no such notice need be given in the case of a note.

Types of Bill of Exchange

A bill of exchange may be an Inland bill or a Foreign bill. Originally, bill was a means by which a trader in one country paid a debt in another country without the transmission of coin. An Inland bill is drawn and payable in India or drawn in India upon some person resident in India, even though it is made payable in a foreign country. A bill which is not Inland is a Foreign Bill (Sec. 12).

Accommodation Bill

Legitimately speaking, an accommodation bill is not a bill as such. It is simply a mode of accommodating a friend in business. For example, A may be in want of money and approach his friend B and C who, instead of lending the money directly, propose to draw an 'Accommodation Bill' in his favour. A promises to reimburse C before the period of the bill is up (which is generally 3 months). If the credit of B and C is good, this device enables A to get an advance from his banker at the commercial rate of discount. The real debtor in this case is not C, the acceptor, but A the payee who has engaged to find the money for its ultimate payment, and A is here the principal debtor and the others merely sureties. Thus, as between the original parties to the bill the one who would prima facie be principal is in fact, the surety whether he be drawer, acceptor or indorser, that bill is an accommodation bill.

Rights to Duplicate Bill

Where the bill is not overdue but has been lost, the person who was holder of it may apply to the drawer, to give him another bill of the same tenor, giving security to the drawer if required, to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again. If the drawer refuses to give such duplicate bill may be compelled to do so by means of a suit. Holder is the person who can ask for a duplicate.

Bank Draft

A demand draft is a bill of exchange drawn by a bank on another bank, or by itself on its own branch, and is a negotiable instrument. It is like a cheque but differs in certain respects. First, it can be drawn only by a bank on another bank and not by a private individual as in the case of cheques. As against a cheque, it cannot be countermanded easily either by its purchaser or by the bank to which it is presented. Finally, it cannot be made payable to bearer. These days it is a popular mode of making payments. Banks charge a nominal amount of commission for this service.

Bill in Sets

Foreign bills are generally drawn in sets of three each. According to S. 132, bill of exchange may be drawn in parts, each part being numbered and containing a provision that it shall continue to be payable so long as the other part remains unpaid. All the parts together make a set but the whole set constitutes one bill and is extinguished when one of the parts, if a separate bill, would be extinguished.

The bills are drawn in sets, in foreign trade in order to facilitate prompt and easy presentation for acceptance and payment. It also reduces the risk of loss in course of transit.

HUNDI

As stated earlier in this chapter, the negotiable instrument act covers only three types of instruments, viz. promissory note, bill of exchange and cheque. Hundi is not given in the definition of a negotiable instrument in the act. Hundi is one of the oldest instrument prevalent in Indian business world. Hundis are governed by local usages or customs but where the act is contrary to the customs, the local usages or customs will apply. But in the absence of any usages or customs, the provisions of this act will apply.

The word Hundi is derived from the Sanskrit word 'Hund', which means to 'collect'. Hundi is generally drawn in a vernacular language according to Indian mercantile common law and customs. It is sometimes drawn as a promissory note.

Sometimes, a hundi is accompanied by ZIKRI CHIT. The zikri chit is written by the drawer or any other prior party and addressed to some respectable person requesting him to honour the hundi if it is dishonoured for non-payment or for any other reason. Thus it serves as a letter of protection.

Types of hundis

1. *Darshni Hundi* : It is payable at sight or on demand. No days of grace are allowed.
2. *Nam Jog Hundi*: It is payable to the person named in it or to his order. It is also called as 'farmanjog hundi'. It can be negotiated by endorsement and delivery alone like a bill of exchange.
3. *Muddati Hundi* : It is payable after the expiry of a fixed period. Days of grace are allowed as per local customs .
4. *Jawabi Hundi* : The person who has to remit the money writes a letter to the payee. The payee directs him to make the payment on his order. Once the payee has obtained payment after the arrival of the letter, he sends his reply (jawab) for the receipt of payment. Through this method money can be passed on from one place to another place. For example, Anand in Delhi owes Rs. 10,000 to Bihari in Kanpur, Ram in Meerut owes Rs. 10,000 to Anand in Delhi, Ram wants to make payment to Anand. Anand writes to Ram directing him to make payment to Bihari and send the 'javvab' intimating him the payment to Bihari. Similarly Bihari is also requested to send reply soon after he is paid by Ram.
5. *Shah Jog Hundi* : The word shah means a person of repute and wealth. This hundi is an instrument payable to bearer, negotiable by delivery alone and payable only to a shah. A shah Jog hundi passes from person to person by delivery only, since no endorsement is needed. The shah after making due enquiries regarding its validity will present it to drawee for final settlement. In case of any fraud, the shah is bound to refund the amount of hundi with interest.
6. *Dhanijog Hundi* : It is payable to the holder or to the bearer but the payer must ensure that its payment is being made to the real owner of hundi.
7. *Nishanjog Hundi* : Where the drawer does not write the name of the payee but simply puts a private code on the hundi which a drawee should decipher before making payment. This is payable only when the payee produces a person to the drawee who identifies the payee.

8. *Jokhmi Hundi* : It is drawn by the seller upon the buyer in lieu of the price of goods sold. The buyer accepts it for payment conditional upon the receipt of goods bought. It is some sort of combination of bill of exchange and insurance policy. Strictly speaking it can not be placed in the category of a negotiable instrument because it is conditional.
9. *Khoti Hundi* : It is a hundi whose genuineness is in doubt or which is a forged one.
10. *Khoka Hundi* : It is a hundi whose amount has been paid.

CHEQUES

A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand. It is like a bill of exchange always drawn on a bank payable on demand. Therefore, it must satisfy all the requirements of a bill (section 6).

It must be in writing and signed by the drawer. It should contain an unconditional order to a specified banker to pay a certain sum of money to a particular person or to his order or to the bearer on demand.

Distinction between Bills and Cheques

1. A cheque is always drawn on a banker, while a bill may be drawn on anyone, including a banker.
2. A cheque's payment is made when it has been demanded whereas in case of a bill its nature may be such that payment has to be made on demand or after the expiry of a certain period after date or sight.
3. In case of a cheque a bearer can get payment on demand but a bill's payment can not be demanded by the bearer.
4. Acceptance of bill is necessary for the demand of its payment, in case of cheque acceptance is not required and is aimed for quick payment.
5. In case of bills ordinarily a provision for grace days is made (which is generally of 3 days) whereas in case of cheques no such grace is allowed.
6. In the absence of presentment of a bill for payment the liability of bill's drawer ceases, whereas liability of cheque's drawer ceases when the delay caused in presentment for payment results in damages.
7. Notice must be served when the bill is dishonoured, but when a cheque is not honoured, no such notice is necessary.
8. A cheque being a revocable order the authority may be revoked by countermanding payment, and is determined by notice of the customer's death or insolvency. In case of a bill the position is different, it can not be revoked.
9. A cheque may be crossed to secure its payment, no such crossing can be done in case of a bill.

Liability of a Banker

A banker is one whose business is to honour cheques drawn upon him by persons and for whom he receives money on current accounts. If a person opens a current account by depositing certain money with the banker, a relationship of creditor and debtor emerges between the customer and the banker and the banker undertakes to honour the cheques drawn by the customer so long it has sufficient funds to the credit of the customer. If a banker without justification, fails to obey

his customer's mandate which is issued in the form of a cheque, he will be liable to compensate the drawer for any loss or damage suffered by him. But the payee or the holder of the cheque has no cause of action against the banker as the obligation to honour cheques is only towards the drawer.

The customer may, however, be awarded very heavy damages, if he proves loss of credit on account of the dishonour, and the rule is the smaller the amount of a cheque dishonoured the larger the amount the damages.

There are numerous cases in which the banker must refuse to honour his customer's cheques :

1. *When customer countermands payment.* When a customer after issuing a cheque, issues instructions not to honour a cheque, the banker must not pay it. If the bank pays it, he will be liable to make good the customer's loss.
2. *When banker receives notice of customer's death.* Notice of customer's death terminates banker's authority to honour cheques.
3. *When customer becomes insolvent.* When a customer has been adjudged an insolvent, all his assets vest in the Official Assignee or the Court, and the banker must thereafter refuse to pay his cheques.
4. *When banker receives notice of customer's insanity,* he must not honour his cheques.
5. *When the banker receives a garnishee order from the court relating to the customer's money,* the banker should not honour cheques drawn against the customer's account.
6. *The banker should not honour his customer's cheques after the customer has given notice of assignment of the credit balance of his account.*
7. *When the holder's title is defective, and banker comes to know of the defect.*
8. *When the banker comes to know that the customer is drawing cheques for unlawful purposes.*
9. *When the banker has received a notice from the customer for closing the account.*

When banker may refuse payment. In the following cases the banker may, if he likes, refuse to honour the cheques :

1. *Where the cheque is post-dated and is presented before the date noted on it.* The banker is required to pay the cheque on the date which the cheque bears and not before. In fact, payment before that date is made by the banker at his own risk, for if the customer countermands payment or issues another cheque bearing an earlier date, the banker cannot debit the customer's account with the amount of the post-dated cheque.
2. *Where the banker has not got sufficient funds of the drawer with him.*
3. *Where the funds in the hands of the banker are not properly applicable to the payment of the customer's cheque.* For example, the funds are held by the customer in trust, and the cheque is issued in breach of trust, the banker may refuse to pay.
4. *Where the cheque is of doubtful legality.* The banker may refuse to pay if the cheque is irregular or ambiguous, materially altered or drawn in a doubtful legality.
5. *Where the cheque is presented after office hours.*

6. Where the cheque is presented at a branch where the customer has no account or where his account is overdrawn.
7. Where some persons have joint account and the cheque is not signed by all jointly, or by the survivors of them. But if the cheques are payable to Either or survivor then the cheque signed by any of the two parties will be sufficient for payment.
8. Where the cheque has been allowed to become stale, i.e., it has not been presented for payment within a reasonable time after the date mentioned in it. In India, a cheque presented 6 months or more after the date is regarded as stale.

Crossing of Cheques

A cheque is either an “Open cheque” or a “crossed cheque”. An open cheque is uncrossed and can be presented by the payee to the banker on whom it is drawn and will be paid over the counter. An open cheque is, however, liable to great risk in course of circulation. It may be stolen or lost and the finder may get it cashed. In order to avoid the losses incurred by open cheques getting into the hands of wrong parties the custom of crossing was introduced.

A *Crossing* is a direction to the paying banker to pay the money generally to a banker or to a particular banker, as the case may be, and not to pay to the holder across the counter. A banker paying a crossed cheque over the counter will be liable to the customer if the holder turns out to be a person not entitled to get payment. The object of crossing is to secure payment to a banker so that it could be traced to the person receiving the amount of the cheque.

There are two types of crossing - *General* and *Special*. To these may be added another *type-Restrictive crossing*. A general crossing is one where a cheque bears across its face two transverse lines with or without the words “and company” or “& Co.” or two parallel transverse lines with or without the words “not negotiable”. If a cheque is crossed generally; the paying banker shall pay only to a banker.

A special crossing is defined thus: “Where a cheque bears across its face an addition of the name of a banker, either with or without the word “not negotiable” that addition shall be deemed a crossing and the cheque shall be deemed to be crossed specially and to be crossed to that banker.” In a general crossing the parallel transverse lines are necessary although in a special crossing they need not be there. But in the later case, the name of the banker is essential to whom or to whose collecting agent alone the payment will be made. *Restrictive crossing* have been adopted by commercial usage in order to obviate the risk of a their obtaining payment. They consist in addition to the general or special crossing the words ‘Account Payee’ only. Such crossing warn the collecting banker that the proceeds are to be credited only to the account of the payee, of the party named.

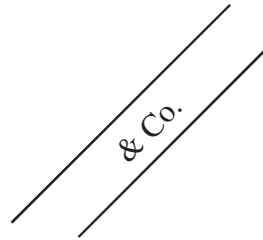
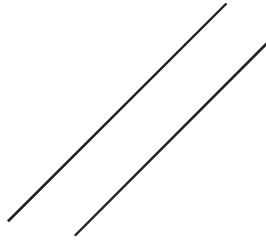
If a cheque is made payable to a payee and to him only, it becomes non-transferable in the strict sense. He is the only person who can get payment. But where a cheque is crossed and bears the word ‘not negotiable’ it is transferable, but it loses its special feature of negotiability. Such a cheque is like any goods, the transferee of which does not get a better title than that of the transferor, the transferee for value and in good faith is not a holder in due course.

A cheque may be crossed by the drawer or by the holder. The holder may add the words ‘not negotiable’ to a crossing. The word not negotiable represent the desire of the drawer that it should not be negotiated further.

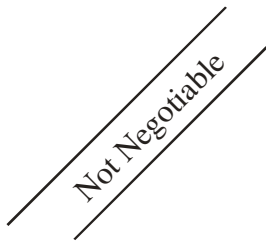
Examples of Crossing

A. General Crossing (Sec. 123)

- (i) Two parallel transverse lines with or without the words ‘& Co.’ across the face of a cheque.



- (ii) Two parallel transverse lines across the face of a cheque with the words ‘not negotiable’.



B. Special Crossing (Sec. 124)

Two parallel transverse lines across the face of a cheque with the name of a banker.



C. Restrictive Crossing

Addition of words ‘account payee only’ to the words general or special crossing.

Who can do crossing

According to Section 125 following persons can cross a cheque :

1. The drawer-generally or specially.
2. The holder who gets an uncrossed cheque can subsequently cross it. If he gets a generally crossed cheque, he may cross it specially. To generally or specially crossed cheques, he may add the words ‘not negotiable’.

3. Where a cheque is specially crossed to a banker the holder may again cross it specially to another bank or to his agent for collection.
4. Where a cheque is crossed specially the banker to whom it is crossed may again cross it specially to another bank or his agent, for collection.

Protection of Paying Banker

The paying banker is in a privileged position as regards the payment of his customer's cheques.-According to section 85 where a cheque payable to order signifies to be indorsed by or on behalf of the payee, the banker is discharged by payment in due course. He can debit the account of the customer with the amount even though the endorsement of the payee turns out subsequently to have been forged, or the agent of the payee without authority indorsed it on behalf of the payee. It would seem that the payee includes indorsers. This protection is granted because a banker cannot be expected to know the signatures of all persons in the world. He is only bound to know the signatures of his own customers. Therefore the forgery of drawer's signature will not ordinarily protect the banker, but even in this case, the banker may debit the customer's account, if he can show that the forgery was intimately connected with the negligence of the customer and was the proximate cause of loss. With regard to bearer cheques the rule is 'once a bearer cheque always a bearer cheque'. Therefore, where a cheque is originally expressed by the drawer himself to be payable to bearer. The banker may ignore any indorsements on the cheque. He will be discharged by payment in due course.

But a cheque that becomes bearer by a subsequent indorsement in the blank is not covered by this section (Section 85).

Collecting Banker: By Sec. 131, where a banker in good faith and without negligence receives payment on behalf of a customer of a cheque crossed generally or specially to himself and the customer has no title to the cheque, the banker is protected against the claims of true owner. The banker will be protected only if he proves that :

- (i) the cheque collected by him was crossed before it reached his hands,
- (ii) the cheque was presented by or on behalf of the customer and that he received payment for the customer.
- (iii) he acted in good faith and without negligence in collecting the money due on the cheque. Therefore, if he collects an uncrossed cheque or a crossed cheque for a non-customer, he gets no protection.

Instrument payable on demand— The following instruments are payable on demand :—

1. A cheque is always payable on demand.
2. A note or bill in which no time for payment is specified.
3. A note or bill expressed payable "on demand", or "at sight", or "on presentment".

Instrument which are not payable on demand are expressed to be payable at certain period 'after sight or 'after date', or after happening of 'an event' which is certain to happen. Thus, bill or note may be made payable 30 days after sight, 60 days after date, or 90 days after the death of A, and payment can be demanded on presenting it on its maturity.

Sometimes it may happen that an instrument is so worded that it can be interpreted either as a bill of exchange or as a promissory note. Such an instrument is called an Ambiguous Instrument and the holder may treat it either as a bill or a promissory note. A bill drawn by an

agent on his principal, or by one branch of a bank on another is an ambiguous instrument and the holder may treat it as a bill or a note.

Again, it may happen that a person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instrument, and either wholly blank or having written thereon an incomplete negotiable instrument, he is said to issue an Inchoate Instrument. He thereby gives authority to the holder of the instrument to make or complete up on it a negotiable instrument, for any amount not exceeding the amount covered by the stamp.

A signs a promissory note without stating the amount payable, puts a 25 paise stamp on it and hands it to his clerk B for making certain purchases and asks him to put the amount. B purchases goods worth Rs.400 but puts Rs.500 in the note. The note is negotiated to C, who takes in good faith and for value. C can recover Rs.500 from A,

Maturity of an Instrument- The maturity of a bill of exchange or a promissory note is the date on which it falls due. An instrument payable at a specified period after sight, or after date or after the happening of a certain event is entitled to three days of grace. Such a bill matures or falls due on the last day of grace, and must be presented for payment on that day. If it is dishonoured, a suit can be filed on the next day after maturity.

When a note or bill is expressed to be payable at a stated number of months after sight, or after date; or after certain event, the period of payment terminates on the day of the month which corresponds with the date of the instrument, or with the date of acceptance of the bill be accepted, or, presented for sight or noted or protested for non-acceptance. If the month in which the period would terminate has on corresponding day, the period shall be held to terminate on the last day of such month. If the date of maturity falls on a public holiday, the instrument is payable the preceding business day. Thus, if a bill is at maturity on a Sunday, it will be deemed due on Saturday and not on Monday.

The Instruments entitled to days of grace are :

- (a) A bill of exchange or promissory note payable at a specified day.
- (b) A bill or note payable after sight,
- (c) A bill or note payable at a certain period after date, and
- (d) A bill or note payable at a certain period after the happening of a certain event. The Instruments which are not entitled to days of grace :

- (a) A cheque,
- (b) A bill or note payable at sight or on presentment or on demand and
- (c) A bill or note in which no time is specified.

Parties to a Bill of Exchange

1. The Drawer: the person who draws the bill.
2. The Drawee: the person on whom the bill is drawn.
3. The Acceptor: the person who accepts the bill. Generally, the drawee accepts the bill, but stranger may accept on behalf of the drawee.
4. The Payee: one to whom the sum stated in the bill is payable. Either the drawer or any other person may be the payee.

5. The Holder is either the original payee or any other person to whom the payee has endorsed the bill. In case of the bearer bill, any bearer is the holder.
6. The Endorser: when the holder indorses the bill to anyone else he becomes the endorser.
7. The Endorsee is the person to whom the bill is endorsed.
8. Drawee in case of need: Besides the seven parties, another person called the drawee in case of need, may be introduced at the option of the drawer. The name of such a person is added to the bill so that when the bill is dishonoured either by non-acceptance or by non-payment, the bill may be accepted or paid.
9. Acceptor for Honour: a person who voluntarily becoitles a party to a bill as an acceptor to save the honour of the drawer at any indorser.

Parties to a Promissory Note ,

1. The Maker: the person who makes or executes the note promising to pay the amount stated therein (Debtor).
2. The Payee: one to whom the note is payable (Creditor).
3. The Holder: is either the payee or some to whom he may have endorsed the note. 4,5. The Endorser and Endorsees: Same as in the case of a bill.

Parties to a Cheque

1. The Drawer: the person who draws the cheque.
2. The Drawee is always the drawer's banker on whom the cheque is drawn.
- 3,4. The payee, Holder, Indorser and Indorsee: same as in the case of a bill of exchange 5&6 or promissory note.

Holder and Holder in due course

A holder of negotiable instrument is a person who is entitled to be legally in possession of the instrument and to recover or receive the amount due thereon from the parties to the instrument (Sec.8). A person who has obtained possession of the instrument by illegal means, e.g. by theft, or under a forged indorsement, is not a holder. He cannot recover amount from the parties thereto.

A holder in due course is a person who obtained possession of the instrument for valuable consideration before its maturity, (i.e. before the amount mentioned in it becomes payable), and had no cause to believe that any defect existed in the title of the person from whom he derived title (Sec.9)

It follows from the above that a person is a holder in due course if:

- (a) he has obtained the instrument for valuable consideration. Where the instrument is obtained by gift or by illegal means, the holder can not become a holder in due course.
- (b) he has obtained the instrument complete and regular in all respects.
- (c) he has become the holder before its maturity.
- (d) he has obtained the instrument in good faith. Good faith simply means that a person takes the instrument without sufficient cause to believe that any defect existed in the title of the person from whom it is received. So where an instrument was torn into

pieces and then pasted or the amount on the bill was erased, it should have aroused suspicion and the holder may not be called holder in due course.

Special Rights or Privileges of a Holder in due course

According to Sec.53 of the Act, once a negotiable instrument passes through the hands of a holder in due course, it gets cleansed of all defects, unless he himself was a party to fraud or illegality committed regarding the instrument.

The rights of a holder in due course can be summed up as follows :

1. He gets a good title to the instrument even though the title of the transferor is defective. Thus, he may get a better title than that of the transferor; e.g. if A steals a bill from B and endorses to C, a holder in due course, C can recover the amount from B, although A cannot recover from B.
2. Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.
3. A holder in due course can sue all the parties liable to pay in his own name.
4. The holder in due course gets a good title even though the instrument was originally and inchoate stamped instrument and the transferor completed the instrument for a sum greater than what was intended by the maker. He can recover the full amount provided the stamps affixed were sufficient to cover the amount.
5. Where a bill is drawn payable to drawer's order in fictitious name and endorsed by the same as drawer's signature, the acceptor cannot plead, by way of defence, that the bill is drawn in fictitious name.
6. In the eyes of the law, every holder is a holder in due course unless proved otherwise.
7. Even though between the immediate parties to an instrument it was caused by fraud etc., once the instrument passes through the hands of a holder in due course, it is purged of all defects, and any person acquiring it takes it free of all defects, unless he was himself a party to the fraud.
8. The maker of promissory note, the drawer of bill of exchange or cheque, and acceptor of a bill for the honour of the drawer, in a suit thereon by the holder in due course, is not permitted to deny the validity of the instrument as originally made or drawn. (A minor can plead minority).
9. The indorser of a negotiable instrument, in a suit thereon by the holder in due course, is not allowed to deny the signature or the capacity to contract of any prior party to the instrument.
10. In case of forged instrument, a holder in due course will get no title because it amounts to complete absence of title rather than a mere defect in title. (Sec.58).

Payment in due course

The payment of a negotiable instrument should be made to the right person by the paying banker or the acceptor of the bill, otherwise the latter shall be responsible for the same. The payment of a negotiable instrument is not without certain risks. Thus, the Negotiable Instrument Act provides protection to the paying banker or the drawee of a bill, provided the payment is made as required in the Act. Such payment is called as payment in due course.

According to Section 10 “payment in due course” is payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount mentioned therein.

A payment in due course has the following essential features :

1. The payment should be made according to the true intentions of the parties to the negotiable instrument, as is apparent from the document itself. Payment may be made either in cash or through a clearing house or by a draft. If the banker makes payment of a post-dated cheque before the date mentioned therein or pays a crossed cheque at the counter, then he acts against the true intentions of the drawer and hence the payment will not be treated as payment in due course.
2. The payment should be made in good faith and without negligence. The banker should made the payment in the good faith, i.e., honestly and not fraudulently. He should take all necessary precautions and act as a reasonable person will act in the particular circumstances of a case.
3. Payment must be made to the person in possession of the instrument in circumstances which do not arouse suspicion about his title to posses the instrument and receive payment thereof. The payment of the order cheque should be made to the right person after proper identification. Sometimes the appearance and behaviour of the person presenting the cheque at the counter may arouse a suspicion in the mind of the banker about the validity of the formers’ authority to receive payment.

Capacity of Parties (who can be parties to negotiable instrument)

The capacity to make draw, accept, negotiate and indorse a negotiable instrument depends upon the capacity to enter into contracts. Therefore, every person competent to contract may incur liability by becoming a party to a negotiable instrument. Thus, a minor , lunatic or a drunken person does not incur liability and can not become a party to the negotiable instrument, but he can acquire rights under it. So if a cheque is drawn in favour of a minor , i.e., he is a payee, he can recover the amount stated in the cheque. Also the absence of capacity of one or more of the parties to a negotiable instrument in no way diminishes the liability of the competent parties.

A draws a cheque in favour of B, a minor. B endorses it in favour of C, who in turn endorses it in favour of D. The cheque is dishonoured by the bank. D can recover from C and A, but not from B, the minor; and C can recover from A but not from B.

An insolvent person cannot draw, make, accept or indorse a negotiable instrument, although if he indorses it as payee to a holder in due course, the letter can recover from all parties, except the insolvent.

A corporation or company can incur liabilities under a negotiable instrument if it is so empowered by its memorandum of association. A trading company has, however an implied authority to execute a negotiable instrument, while a non-trading company has no such implied authority.

The Karta or manager of Joint Hindu Family can bind the Joint Family by executing a negotiable instrument, provided the transaction is for the benefit of the family or is for legal necessity.

Liability of Parties

1. The maker of a promissory note and the acceptor of a bill of exchange are primarily responsible for the payment due.
2. The drawer of a bill or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by, the drawer.

In consequence, the maker of a note, the drawer of a cheque, the drawer of a bill until acceptance, and the acceptor are respectively liable on the instrument as principal debtor. The other parties i.e., the intermediate indorsers and drawer of a bill after acceptance, are liable thereon as sureties for the maker, drawer or acceptor.

In between parties are liable as sureties, each prior party is also liable thereon as a principal debtor in respect of each subsequent endorsement.

A draws a bill payable to his own order on B, who accepts it. A afterwards indorses the bill to C, C to D and D to E. As between E and B, B is the principal debtor, and A, C and D are his securities. As between E and A, A is the principal debtor and C and D are his sureties. As between E and C, C is the principal debtor and D is his surety.

The maker of a note and the acceptor before maturity of a bill are bound to pay the amount at maturity to the holder. The acceptor of a bill at or after maturity must pay the amount to the holder on demand. The drawer of a cheque (i.e., the paying banker) must pay it when presented for payment if the drawer has sufficient funds to his credit with the banker.

NEGOTIATION

Negotiation of an instrument is the process by which the ownership of an instrument is transferred from one person to another. According to Section 14 of the Act, when a note, bill or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated.

A negotiable instrument can also be transferred (by a separate deed of assignment); but in that case, the privileges of negotiation will not be available to the assignee, i.e., he will not enjoy the rights of a holder in due course.

The object of negotiation of instruments and their assignment is the same, i.e., the transfer of ownership from one person to another but there are some points of distinction between the two which are as Under :

Negotiation and Assignment Distinguished

Negotiation

Assignment

- | | |
|--|--|
| <ol style="list-style-type: none"> 1. Mere delivery in case of bearer instrument and indorsement and delivery in case of an order instrument are sufficient to transfer title. 2. Notice of transfer is not required to debtor. 3. Consideration is presumed in case of negotiable instrument. 4. The transferee, as holder in due course may get a better title than his transferee. 5. The Negotiable instrument Act deal with transfer of instrument by negotiation. | <ol style="list-style-type: none"> 1. A separate deed of assignment is essential. 2. Notice of assignment must be given to the be the given to debtor. 3. Consideration must be proved by the assignee. 4. The assignee gets only the right of transferor, 5. The Negotiable instrument Act does not deal with transfer of negotiable instruments by negotiation. |
|--|--|

How Negotiation is Effected

A negotiable instrument payable to bearer can be negotiated by mere delivery i.e., by merely handing over the instrument to the transferee, and no writing is necessary. When a negotiable instrument is payable to order, it is negotiated by the holder by indorsement and delivery. Endorsement or Indorsement means signature of the holder made with the object of transferring the instrument. Endorsement may be made on the back or face of the instrument. If there is no space on the instrument the endorsement may be made on a slip of paper attached to it. Such a slip a called *Allonge*.

It will be noticed that delivery of the instrument to the transferee or his agent is essential of both the bearer and order instruments. Thus, where A endorses a bill in favour of B and puts it in his desk-drawer, there is no negotiation as the bill has not been delivered to B. If A dies

and the bill is found by B in the drawer, B cannot sue on it, because the bill was never delivered by A to B.

Delivery of the instrument must be voluntary on the part of the holder and must be made with the intention of passing property in the instrument to the person to whom it is delivered. So that a thief cannot get a good title to the instrument, nor can a finder of a lost instrument.

A negotiable instrument can be negotiated till payment or satisfaction. After payment or satisfaction it cannot be negotiated.

ENDORSEMENT

When the maker or holder of a negotiable instrument signs the same otherwise than as such make for the purpose of negotiation, on the face or back thereof, or a slip of paper annexed thereto called allonge or so sign 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 as endorser. (Sec. 15).

Classes of Endorsement

An endorsement may be (i) General or blank, (ii) Special or Full (iii) Restrictive, (iv) Partial, or (v) Conditional or qualified.

1. An endorsement is blank or general where the endorser merely writes his signature on the back of the instrument, e.g., a bill payable to “Ram or order” and he writes on back of its back “Ram”, it is endorsement in blank and the bill has become payable to bearer.
2. An endorsement is *full* or *special* where the endorser mentions the name of the person to whom the money due on the instrument is to be paid. Where a bill is payable to “Ram or order” and Ram writes on the back of the instrument ‘Pay to Sham’ or ‘Pay to Sham or order’, and signs, it is a full endorsement.
3. An endorsement is *restrictive* if it restricts further negotiation of an instrument, e.g., ‘Pay Sham only’, or ‘Pay Sham for my use’ or ‘Pay Sham on account of Radha’.
4. An endorsement is *Partial* which purports to transfer to the indorsee a part only of the amount payable on the instrument; but a partial endorsement does not operate as a negotiation of the instrument; e.g. , A sells a bill for Rs.1000 endorses it thus: ‘Pay B or order Rs.500’ or ‘Pay Rs.500 to Band Rs.500 to C’, the endorsement is partial and invalid.
5. An endorsement is *conditional or qualified* which limits or negatives the liability of the endorser. For example, where the indorser makes it clear that he does not incur the liability of an endorser towards the indorsee or subsequent holders he makes a ‘Sans Recourse’ or ‘Without Recourse’ endorsement. He may endorse thus: ‘Pay Sham or order Sans Recourse’, or ‘Pay Sham or order without recourse to me’. In these cases, if the instrument is dishonoured he cannot be called upon to pay.

When the endorser by express words abandons some right or increase his liability under negotiable instrument is called Faculative : e.g., ‘Pay Sham or order. Notice of dishonour ‘uired’.

Requisites of valid endorsement

1. It should be done on the instrument or allonge.
2. It must be done by the maker/drawer/payee/holder/indorser of the instrument.

3. It must be signed.
4. Though no specific words are prescribed for endorsement yet the words used must clear the intention of the indorser to transfer the ownership of the instrument.
5. It must be completed by subsequent delivery of the instrument to the endorsee.

Legal provisions regarding endorsements

The Negotiable Instrument Act contains many provisions regarding endorsement :

1. *Effect of Endorsement.* The endorsement of a negotiable instrument followed by delivery, transfers to the endorsee the property therein with the rights of further negotiation. Thus the endorsee acquires property or interest in the instrument as the holder. He can also negotiate further if not restricted by a restricted endorsement by the endorser.
2. *Who can endorse.* According to section 51. 'Every sole maker, drawer, payee or endorsee or all of several joint makers, drawers, payees or endorsees, of negotiable instrument may endorse and negotiate the same'. Thus, in case the instrument is held jointly by a number of persons, endorsement by all of them is essential, one can not present the other.
3. *Time.* A negotiable instrument may be negotiated until its payment has been made' by the maker drawee or acceptor at or after maturity not after its payment.
4. Endorsement for a part of the amount. The instrument must be endorsed-for its entire amount: According to section 56 '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'. Thus an endorsement for a part of the amount of the instrument is invalid. But in cases where an instrument has been partly paid, it may be negotiated for the balance of the amount provided a note to that effect is given on the instrument. If the endorser intends to transfer the document to two or more endorsees separately, it will not constitute a valid endorsement.
5. The legal representative of a deceased person cannot negotiate by delivery only a promissory note, bill of exchange or cheque payable to order and endorsed by the deceased but not delivered. Thus if the endorser dies after endorsing the instrument payable to order but without delivering the same to the endorsee, the endorsement is not valid and his legal representative cannot complete the negotiation by mere delivery thereof.
6. Unless the contrary is proved it is presumed under section 118 that 'the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon'. It means that the endorsement which appears on the instrument first is presumed to have been made earlier to the second one.

Once a Bearer Cheque, Always a Bearer Cheque

If a negotiable instrument is endorsed in blank or is payable to bearer, it is bearer instrument. The holder may negotiate by mere delivery. But if the holder endorses it specially to a person and makes it payable to the order of such person, then the endorser in full cannot be sued by any person except the person in whose favour he endorsed it. But as regards all parties prior to the endorser in full, the instrument remains transferable by mere delivery.

A, the payee of a bill, endorses it in blank and delivers it to B who endorses specially to C, or order C without any endorsement transfers it to D. D as the bearer is entitled to receive payment. In case of dishonour D is entitled to sue the drawer and the acceptor of the bill and also A and all indorsers prior to A, if any. He cannot, however, sue B or C.

Where a cheque is originally drawn payable to bearer, the drawee (the paying banker) is discharged by payment in due course to the bearer, even if there are any subsequent endorsement. The rule is '*once a bearer cheque always a bearer cheque*' which means that if a cheque is originally drawn payable to bearer, it remains bearer, even though it is subsequently endorsed in full. This rule is not applicable if a cheque originally made payable to order becomes payable to bearer by blank endorsement.

Where a, bearer negotiates an instrument by mere delivery, and does not put his signature thereon, he is not liable to any party to the instrument in case it is dishonoured as he has not lent his credit to it.

Forged Instruments and Forged Endorsements

The general law is that forger, confers no title, so that the forged signature of the maker of a promissory note, or of the bill or of the cheque does not give to the forger any title whatever, as the forged instrument is a nullity from the very beginning. Nobody has any title to it and there is no holder in due course. A's signature is forged on a cheque as a *drawer*. A is not liable on the cheque, nor does ally party acquire any right under it.

If an instrument is payable to order or endorsed in full, it cannot be negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable, for the endorsee receives title only through his endorsement. Hence, if the signature of transferor is forged no person claiming through that forged signature gets any title, even if he obtained it for value and in good faith.

A is the payee of a bill. It is stolen by B, who forges A's signature and transfers the bill to C for value. C is not a holder in due course, even if he obtains the bill without notice of the forged endorsement, and cannot recover the amount on the bill. And if the acceptor of the bill pays to C on maturity, he is not discharged and A, as the holder in due course, can recover the amount from the acceptor.

ACCEPTANCE

After a bill has been issued, the holder should present it to the drawer for acceptance to find out whether the drawee is willing to carry out the order of the drawer. If the drawee agrees to obey the drawer order he is said to accept the bill, which he does by signing his name on the bill and writing the word "accepted".

Acceptance is defined as the indication by the drawee of his assent to the order of the drawer. After acceptance the drawee is known as the acceptor. The drawee becomes liable on the bill only after he has accepted it and delivered it over to the holder or has given notice of acceptance to him.

An acceptance may be either *General* or *Qualified*.

An acceptance is *general* when it is unconditional or unqualified. That is to say, when the drawee accepts liability to pay the amount of the bill in full without any condition or limitation.

An acceptance is said to be qualified when (1) acceptor attaches some conditions to the acceptance e.g., "accepted payable when in funds" or (2) it is partial i.e., for part only of the

amount of the bill e.g., a bill, drawn for Rs. 1,000 as “accepted for Rs.500 only”, or (3) is made local i.e., to pay at a particular place or (4) is qualified as to time, e.g., a bill is drawn payable 3 months after date is “accepted payable 6 months after date”. Acceptance for payments in installments or by some of the drawees only is also a qualified acceptance.

The holder of the bill may refuse to take a qualified acceptance and may treat the bill as dishonoured by non-acceptance, and sue the drawer for payment. If he accepts the “qualified, acceptance, it binds him and the acceptor, but the drawer and endorsees are not bound or are discharged unless they assent to it.

Who can accept a bill ?

1. The drawee of the bill.
2. All or some of the several drawees; but if all the drawees have to be liable all of them must accept it.
3. A drawee in case of need.
4. The agent of any of the persons named above.
5. An acceptor for honour i.e., person who accepts for the, honour of any party already liable on the bill. . . , .
6. The agent of the acceptor for honour.

An acceptor for honour: When a bill has been noted or protested for non-acceptance, any person who is not already a party to the bill, may with the consent of the holder, accept it for the honour of any party thereto.

An acceptor for honour enjoys a slightly better position than an ordinary-acceptor. His liability is conditional, because his acceptance is in the nature of a qualified acceptance. He undertakes to pay only when the bill has been duly presented at maturity to the drawee for payment and the drawee has refused to pay and the bill has been noted or protested for non payment.

On acceptance the rights and liabilities of the acceptor for honour are the same as those of the party for whose honour he accepts. He is liable to all parties subsequent to the party for whose honour he accepts to pay in case the drawee fails to pay. On paying the bill for honour he acquires all the rights of a holder for whom he pays and is entitled to all the remedies of the holder of the instrument. Those remedies are available only against the party for whose honour he pays and all parties prior to such persons and all parties subsequent to such person are discharged.

Presentment

Presentment is made for two purposes :

- (i) Presentment for acceptance and,
- (ii) Presentment for payment.

Only bill of exchange of certain kinds require presentment for acceptance. Bills payable demand or at sight need not be presented. But the following bills must be presented for acceptance, otherwise the parties to the bill will be liable on it.

1. A bill payable after sight. Presentment is necessary in order to fix maturity of the bill.
2. A bill in which there is an express stipulation that it shall be presented for acceptance before it is presented for payment.

But even in cases where presentment is optional, it is desirable to get it accepted as soon as possible. The bill must be presented for acceptance before the date of payment and within a reasonable time after it is drawn. The drawee can take 48 hours to accept it, but after **48** hours are over he must return the bill to the holder with or without acceptance. If the **holder** allows the drawee more than 48 hours to decide whether to accept or not, all prior parties to the bill are discharged from their liabilities under the bill.

If the drawee, after a reasonable search, cannot be found, the bill can be treated dishonoured.

If a bill is directed to the drawee at a particular place, it must be presented at that place.

If a bill, which **requires** acceptance, is not presented for acceptance; the drawer and all endorsees are discharged from their liability to the holder.

When presentment for acceptance not necessary

1. When after a reasonable search the drawee cannot be found.
2. When the bill is drawn on a fictitious person or on a person who is incapable of entering into contracts.
3. When the drawee is insolvent or dead.
4. Where, although the presentment is irregular, acceptance has been refused on some other ground.

Presentment for payment

The negotiable instrument must be presented for payment. The rule regarding presentment for payment are as follows :

1. Promissory notes, bills of exchange and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively, by or on behalf of the holder. If default in presentment is made no party other than the maker, acceptor or drawee will be liable to the holder.
2. A pronote, payable at a certain period after sight, must be presented to the maker by a person who is entitled to demand payment, within a reasonable time after it is made and during business hours on a business day. If presentment is not made, no party there to is liable on it to the person failing to present.
3. Where a pronote is payable on demand and is not payable at a specified place, no presentment is necessary.
4. A pronote or bill made payable at a specified period after date or sight, must be presented for payment at maturity.
5. A note or bill made, drawn or accepted payable at a specified place must be presented for payment at that place otherwise the maker or the drawer will be liable on it.
6. A note, bill or cheque made, accepted or drawn payable at "Specified place and not elsewhere" must be presented at that place, otherwise no party to it will be liable.
7. A pronote payable by instalments must be presented for payment on the third day after the date fixed for each installment.
8. A note or bill not made payable at a specified place must be presented for payment **at** the place of business, if any or at the usual residence, of the maker, drawee or acceptor thereof, as the case may be.

9. A cheque must be presented at the bank upon which it is drawn before the relation between the drawer and his banker has been altered to the prejudice of the drawer. If default is made the drawer be discharged from liability.
10. If the cheque is not presented to the banker for payment within a reasonable time, then all parties other than the drawer will be discharged.

Delay in presentment for acceptance or payment is excused, if it is caused by circumstances beyond the control of the holder.

Presentment for payment not necessary: Presentment for payment is not necessary in the following cases. In all such cases the instrument is deemed to be dishonoured at the due date so presentment for payment is not necessary:

1. If the maker, drawee or acceptor intentionally prevent presentment of the instrument.
2. If the instrument being payable at his place of business, he closes such place on a business day during the usual business hours.
3. If the instrument being payable at some other specified place, neither he nor any other person authorised to pay it attends at such place during the usual business hours.
4. If the instrument is not payable at & specified place and the drawer or acceptor, cannot, after due search, be found.
5. Where there is no promise to pay notwithstanding non-presentment.
6. Where the presentment is waived by the party entitled to presentment becomes impossible because of impossibility or illegality or performance.
7. Where the drawer could not possibly have suffered any damage by non-presentment.
8. Where the drawee is a fictitious person, or one incompetent to contract.
9. Where the bill has been dishonoured by non-acceptance.
10. Where the terms of agreement do not require any presentment for the instrument.

In all the above cases no presentment for payment is necessary and the instrument is deemed to be dishonoured at the due date.

DISHONOUR

A bill of exchange may be dishonoured either by non-acceptance or by non-payment. A promissory note or cheque is dishonoured by non-payment as acceptance is not required in their case.

When an instrument is dishonoured the holder must give notice of dishonour to the drawer or maker or his previous holders if he wants to make them liable.

Dishonour of a bill by non-acceptance (Sec.91) : A bill is said to be dishonoured by non-acceptance when :

1. the drawee does not accept it within 48 hours from the time of presentment for acceptance;
2. presentment for acceptance is excused and the bill remains unaccepted;
3. the drawee is incompetent to contract;
4. the drawee is a fictitious person;
5. the drawee, after a reasonable search, cannot be found; and
6. the acceptance is qualified and the holder opts to treat it as dishonoured.

Dishonour of an instrument by non-payment (Sec. 92) : A promissory note, a bill of exchange or cheque IS said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee banker of the cheque makes default in payment on being duly required to pay the same.

A negotiable instrument is also deemed to be dishonoured by non-payment when presentment for payment is excused and the instrument remains unpaid on maturity; and instrument when overdue, remains unpaid.

Effect of Dishonour : The drawer and all the endorsers of the bill are liable to the holder if the bill is dishonoured either by the non-acceptance or by the non-payments provided the he gives them notice of dishonour. The drawee is liable only when there is dishonour by non payment.

Consequence of failure to give notice: Any person to whom notice of dishonour is not given is discharged from his obligations under the instrument. He is not liable to pay and no suit can be filed against him.

When notice of dishonour is excused: It is not necessary to give notice of dishonour in the following cases and to the following parties :

1. To the maker of a dishonoured promissory note.
2. To the drawee or acceptor of a dishonoured bill or cheque.
3. When it is dispensed with by the party entitled to it.
4. In order to charge the drawer of a cheque when he has countermanded payment.
5. When the party charged could not suffer damage for want of notice.
6. When the party entitled to notice cannot be found.
7. To charge the drawer when the acceptor is also the drawer.
8. When the promissory note is not negotiable.
9. Where the party entitled to notice promises to pay the amount after the dishonour.
10. When the omission to give notice is caused by unavoidable circumstances.

Mode of giving Notice of dishonour

1. A notice of dishonour may be given to a duly authorised agent of the person to whom it is required to be given.
2. If the person on whom notice is to be served has died, it should be given to his legal representative, or if he has been declared insolvent, to his assignee.
3. The notice may be oral or written, if it is written it may be sent by post.
4. The notice may be in any form but the party to whom it is given must be informed, either in express terms or by reasonable intendment, that the instrument has been dishonoured and in what way and that he will be held liable thereon.
5. It must be given within a reasonable time after dishonour.
6. The notice of dishonour must be given at the place of business, or if the party has no place of business, at the residence of the party for whom it is intended.

7. If the notice is duly directed and sent by post but is miscarried, such miscarriage does not render the notice invalid.
8. When the party to whom notice of dishonour is despatched is dead but the sender is ignorant of his death, the notice given will be sufficient.
9. When the instrument is deposited with an agent for presentment, the agent is entitled to the same time to give notice to this principal as if he was the holder giving notice of dishonour and the principal is entitled to a further like period to give notice of dishonour.
10. Any party receiving notice of dishonour, in order to render any party liable to himself, should give notice of dishonour to such party within a reasonable time, unless such party otherwise receives due notice.

Noting (Sec. 99) : When a promissory note or a bill of exchange is dishonoured, the holder is entitled, after giving due notice of dishonour, to sue the drawer and the endorsers.

In order to have the fact of dishonour authenticated, the holder may get it recorded on the instrument, or on a paper attached to it, by a Notary Public. Such recording or notice must be done within a reasonable time after dishonour, and must contain the fact of the dishonour, the date of dishonour, the reason if any, assigned for such dishonour. If the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured should be noted as well as the notary's charges. Noting is optional. It is to the advantage of the holder to get the notice done because it is an evidence of dishonour.

Protest (Sec. 100) : When a promissory note or bill has been dishonoured, the holder may, within a reasonable time, cause such dishonour to be noted and certified by a notary public, such certificate is called a protest.

The difference between noting and protest is that noting is merely a record of the fact of dishonour. When the notary public issues a certificate stating the particulars regarding the dishonour, it is called a protest.

Noting and protest are not compulsory, in the case of an inland bill or note, but a foreign bill must be protested, if so required by the law of the place where it is drawn.

Protest for Better Security. When the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached, before the maturity of the bill, the holder may within a reasonable time, employ a notary public to demand better security of the acceptor and on its request, may cause facts to be noted and certified within a reasonable time. Such certificate is called a "Protest for better security".

Notary Public

The notary public is an officer appointed by the Government to exercise the functions of noting and protest, etc.

Discharge of Parties from Liabilities

The liability of a party to a negotiable instrument may be discharged or terminated in any one of the following ways -

1. By payment in due course of the amount due.
2. By the holder discharging or releasing the maker, acceptor or endorser.

3. By cancellation of a party's name by the holder.
4. By operation of law, e.g., by the insolvency of the debtor.
5. By the holder allowing the drawee more than 48 hours of accepting the bill.
6. By taking qualified acceptance all previous parties are discharged.
7. By non-presentment of a cheque for payment within a reasonable time of its issue, if the bank fails, the drawer is discharged.
8. By endorsement of an order cheque by payee the banker is discharged by payment in due course, even if the endorsement turns out to be a forgery. . ,
9. By material alteration. Any material alternation of a negotiable instrument renders the same void as against any one who is a party thereto at the time of alternation and does not consent thereto. Some examples of Material Alteration:

Alteration of (1) the date of the instruments or indorsements (2) the sum of payment, (3) the time of payment, (4) the place of payment, (5) the rate of interest, (6) the addition of a new party, (7) the tearing of the instrument in a material part, are material alteration.

A correction of a mistake, or an alteration made to carry out the common intention of the parties made before the instrument is issued or with the consent of the parties does not amount to a material alteration. It does not make the instrument void. When a person accepts an altered instrument; he can not afterwards raise objections to those alterations which existed at the time of accepting the instrument. Where any material alteration is made by an endorsee it discharges his endorser from all liability to him in respect of consideration thereof (Sec. 87).

THE PAYMENT OF WAGES ACT, 1936

— *Deepa Kakaria*

Structure of the lesson

Object and scope a

- Application of the Act
- Important Definitions
- Responsibility for the payment of wages
- Fixation of Wage period
- Time of payment of Wages
- Payment of wages to persons whose employment is terminated
- Exemption from compliance with the time limit for payment of wages
- Wages to be paid on a working day
- Modes of payment of wages
- Deductions from wages
- Fines
- Deductions for absence from duty
- Deductions for damage or loss
- Deductions for services rendered
- Deductions for recovery of advances
- Deductions for recovery of loans
- Deductions for payments to co-operative societies and insurance schemes
- Maintenance of Registers and Records

Object and scope of the Act

The main objects of the payment of wages Act are:

- To make sure, regular and timely payment of wages to the employeess,
- To check unlawful deductions being made from wages and illogical fines be imposed on the employed persons.

The scope of the Act extends to the whole of India.

Application of the Act

The act applies to the payment of wages to persons employed in any factory, to persons employed (otherwise than a factory) upon any railway by railway administration, or to persons employed in an industrial or other establishment specified under Section 2 of the Act.

The State Government may, after giving three months' notice of its intention of so doing, by notification in the Official Gazette, extend the provisions of this Act or any of them to the payment of wages to any class of persons employed in any establishment or class of establishments

specified by the Central Government or a State Government under section 2(ii) (h) provided that in relation to any such establishment owned by the Central Government no such notification shall be issued except with the concurrence of that government.

The Act shall be applicable if the wages for the wage period to an employed person do not exceed Rs. 6000 or such higher sum which the central government may stipulate.

Important Definitions

Section 2 : *Employed person*

Employed person includes the legal representative of a deceased employed person.-Section 2(i)

Employer

Employer includes the legal representative of a deceased employer. The liability of the employer's legal representative for the payment of wages due to the employed persons is limited to the extent of the value of the property inherited by him. Section 2(ia)

Factory

Factory means a factory as defined in section 2(m) of the Factories Act, 1948 and includes any place to which the provisions of that Act have been applied.

Industrial and other establishments

Industrial or other establishment means any—

- (a) tramway service , or motor transport service engaged in carrying passengers or goods or both by road for hire or reward;
- (b) air transport service other than such service belonging to, or exclusively employed in the military, naval or air forces of the Union or the Civil Aviation Department of the Government of India;
- (c) dock, wharf or jetty;
- (d) inland vessel, mechanically propelled;
- (e) mine, quarry or oil-field;
- (f) plantation;
- (g) workshop or other establishment in which articles are produced, adapted or manufactured, with a view to their use, transport or sale;
- (h) establishment in which any work relating to the construction, development or maintenance of buildings, roads, bridges or canals, or relating to operations connected with navigation, irrigation, or to the supply of water or relating to the generation, transmission and distribution of electricity or any other form of power is being carried on.
- (i) any other establishment or class of establishments which the Central Government or a State Government may, having regard to the nature thereof, the need for protection of persons employed therein and other relevant circumstances, specify, by notification in the Official Gazette.

Wages

Wages means all remuneration (whether by way of salary, allowances, or otherwise) expressed in terms of money or capable of being so expressed which would, if the terms of employment, express or implied, were fulfilled, be payable to a person employed in respect of his employment or of work done in such employment, and includes—

- (a) any remuneration payable under any award or settlement between the parties or order of a court;
- (b) any remuneration to which the person employed is entitled in respect of overtime work or holidays or any leave period; _
- (c) any additional remuneration payable under the terms of employment (whether called a bonus or by any other name);
- (d) any sum which by reason of the termination of employment of the person employed is payable under any law, contract or instrument which provides for the payment of such sum, whether with or without deductions, but does not provide for the time within which the payment is to be made;
- (e) any sum to which the person employed is entitled under any scheme framed under any law for the time being in force,

Wages does not include—

- (1) any *bonus* (whether under a scheme of profit sharing or otherwise) which does not form part of the remuneration payable under the terms of employment or which is not payable under any award or settlement between the parties or order of a court;
- (2) the value of any *house-accommodation*, or of the supply of light, water, medical attendance or other amenity or of any service excluded from the computation of wages by a general or special order of the State Government;
- (3) any *contribution* paid by the employer to any pension or provident fund, and the interest which may have accrued thereon;
- (4) any *travelling allowance* or the value of any travelling concession;
- (5) any sum paid to the employed person to defray *special expenses* entailed on him by the nature of his employment; or
- (6) any *gratuity* payable on the termination of employment in cases other than those specified in sub-clause (d).

Section 3 : Responsibility for payment of wages

Every employer shall be responsible for the payment to persons employed by him of all 'wages required to be paid under this Act.

The following persons shall also be responsible for the payment of wages;

- (a) in factories, if a person has been named as the manager of the factory of the Factories Act, 1948.
- (b) in industrial or other, establishments, if there is a person responsible to the employer for the supervision and control of the industrial or other establishments; and
- (c) upon railways (otherwise than in factories), if the employer is the railway administration and the railway administration has nominated a person in this behalf for the local area concerned.

Section 4 : Fixation of wage-periods

It is required under that:

- (1) Every person responsible for the payment of wages under section 3 shall fix periods in respect of which such wages shall be payable.
- (2) No wage-period shall exceed one month. Payment of wages can be made on daily, weekly, fortnightly or monthly basis.

Section 5 : Time of payment of wages

Specifies that the wages of every person employed upon or in:

- (a) any railway, factory or industrial or other establishment upon or in which less ifⁿ one thousand persons are employed, shall be paid before the expiry of the seventh day,
- (b) any other railway, factory or industrial or other establishment, shall be paid before the expiry of the tenth day, after the last day of the wage-period in respect of which the wages are payable.

Provided that in the case of persons employed on a dock, wharf or jetty or in a mine, the balance of wages found due on completion of the final tonnage account of the ship or wagons loaded or unloaded, as the case may be, shall be paid before the expiry of the seventh day from the day of such completion.

Section 5(2) *where the employment of any person is terminated* by or on behalf of the employer, the wages, earned by him shall be paid before the expiry of the second working day from the day on which his employment is terminated. Where the employment of any person in an establishment is terminated due to the closure of the establishment for any reason other than a weekly or other recognised holiday, the wages earned by him shall be paid before the expiry of the second day from the day on which his employment is so” terminated.

Section 5(3) The State Government may, by general or special order, *exempt*, to such extent and subject to such conditions as may be specified in the order, the person responsible for the payment of wages to persons employed upon any railway (otherwise than in a factory) or to persons employed as daily-rated workers in the Public Works Department of the Central Government or the State Government from the operation of this section in respect of wages of any such persons or class of such persons .But in the case of persons employed as daily-rated workers as above stated, no such order shall be made except in consultation with the Central Government.

Section 5(4) All payments of wages shall be made on a *vjorking* day.

Section 6 : Wages to be paid in current coin or currency notes

All wages shall be paid in current coin or currency notes or in both.

The employer may, after obtaining the written authorisation of the employed person, pay him the wages either by *cheque* or by crediting the wages in his bank account.

Section 7 : Deductions which may be made from wages

The wages of an employed person shall be paid to him without deductions of any kind except those authorised by or under this Act. Every payment made by the employed person to the employer or his agent shall, for the purposes of this Act, be deemed to be a *deduction from wages*.

Any loss of wages resulting from the imposition, for good and sufficient cause, upon a person employed of any of the following penalties, namely:-

- (i) the withholding of increment or promotion (including the stoppage of increment at an efficiency bar);
- (ii) the reduction to a lower post or time scale or to a lower stage in a time scale; or
- (iii) suspension;

shall not be deemed to be a deduction from wages in any case where the rules framed by the employer for the imposition of any such penalty are in conformity with the requirements, if any, which may be specified in this behalf by the State Government by notification in the Official Gazette.

Section 7(2) Deductions from the wages of an employed person shall be made only in accordance with the provisions of this Act and any other deduction is unauthorized. The Authorised deductions may be of the following kinds only, namely:

- (a) fines;
- (b) deductions for absence from duty;
- (c) deductions for damage to or loss of goods expressly entrusted to the employed person for custody, or for loss of money for which he is required to account, where such damage or loss is directly attributable to his neglect or default;
- (d) deductions for house-accommodation supplied by the employer or by government or any housing board set up under any law for the time being in force (whether the government or the board is the employer or not) or any other authority engaged in the business of subsidising house-accommodation which may be specified in this behalf by the State Government by notification in the Official Gazette.
- (e) deductions for such amenities and services supplied by the employer as the State Government or any officer specified by it in this behalf may, by general or special order, authorise. The word "services" here does not include the supply of tools and raw materials required for the purposes of employment;
- (f) deductions for recovery of advances of whatever nature (including advances for travelling allowance or conveyance allowance), and the interest due in respect thereof, or for adjustment of over-payments of wages;
- (ff) deductions for recovery of loans made from any fund constituted for the welfare of labour in accordance with the rules approved by the,State Government, and the interest due in respect thereof;
- (fff)deductions for recovery of loans granted for house-building or other purposes approved by the State Government and the interest due in respect thereof;
- (g) deductions of income-tax payable by the employed person;
- (h) deductions required to be made by order of a court or other authority competent to make such order;
- (i) deductions for subscriptions to, and for repayment of advances from any provident fund to which the Provident Funds Act ,1925, applies or any recognised provident

- fund as defined in section 58A of the Indian Income Tax Act, 1922, or any provident fund approved in this behalf by the State Government, during the continuance of such approval;
- (j) deductions for payments to co-operative societies approved by the State Government or any officer specified by it in this behalf or to a scheme of insurance maintained by the Indian Post Office,
 - (k) deductions, made with the written authorisation of the person employed for payment of any premium on his life insurance policy to the Life Insurance Corporation Act of India established under the Life Insurance Corporation Act, 1956, or for the purchase of securities of the Government of India or of any State Government or for being deposited in any Post Office Savings Bank in furtherance of any savings scheme of any such government.
 - (kk) deductions, made with the written authorisation of the employed person, for the payment of his contribution to any fund constituted by the employer or a trade union registered under the Trade Union Act, 1926, for the welfare of the employed persons or the members of their families, or both, and approved by the State Government or any officer specified by it in this behalf, during the continuance of such approval;
 - (kkk) deductions, made with the written authorisation of the employed person, for payment of the fees payable by him for the membership of any trade union registered under the Trade Union Act, 1926.
 - (l) deductions, for payment of insurance premia on Fidelity Guarantee Bonds;
 - (m) deductions for recovery of losses sustained by a railway administration on account of acceptance by the employed person of counterfeit or base coins or mutilated or forged currency notes;
 - (n) deductions for recovery of losses sustained by a railway administration on account of the failure of the employed person to invoice, to bill, to collect or to account for the appropriate charges due to that administration whether in respect of fares, freight, demurrage, wharfage or in respect of sale of food in catering establishments or in respect of sale of commodities in grain shops or otherwise;
 - (o) deductions for recovery of losses sustained by a railway administration on account of any rebates or refunds incorrectly granted by the employed person where such loss is directly attributable to his neglect or default;
 - (p) deductions, made with the written authorisation of the employed person, for contribution to the Prime Minister's National Relief Fund or to such other Fund as the Central Government may, by notification in the Official Gazette, specify;
 - (q) deductions for contributions to any insurance scheme framed by the Central Government for the benefit of its employees.

The list of deductions given by section 7(2) is exhaustive. If an employer makes any deduction, the burden to prove that the deduction does fall under the several clauses of Section 7(2), lies upon the employer.

Section 7(3) Notwithstanding anything contained in this Act, the *total amount of deductions* which may be made under sub-section (2) in any wage-period from the wages of any employed person shall not exceed-

- (i) in cases where such deductions are wholly or partly made for payments to co-operative societies under section 7(2)(j), seventy-five per cent of such wages, and
- (ii) in any other case, fifty percent of such wages.

Provided that where the total deductions authorised under sub-section (2) exceed seventy five per cent or, as the case may be, fifty per cent of the wages, the excess may be recovered in such manner as may be prescribed.

Section 7(4) Nothing contained in this section shall be construed as precluding the employer from recovering from the wages of the employed person or otherwise any amount payable by such person under any law for the time being in force other than the Indian Railways Act, 1890.

Section 8 : Fines

- (1) No fine shall be imposed on any employed person save in respect of such acts and omissions on his part as the employer, with the previous approval of the State Government or of the prescribed authority, may have specified by notice under sub-section (2).
- (2) A notice specifying such acts and omissions shall be exhibited in the prescribed manner on the premises in which the employment is carried on or in the case of persons employed upon a railway (otherwise than in a factory), at the prescribed place or places.
- (3) No fine shall be imposed on any employed person until he has been given an opportunity of showing cause against the fine, or otherwise than in accordance with such procedure as may be prescribed for the imposition of fines.
- (4) The total amount of fine which may be imposed in any one wage-period on any employed person shall not exceed an amount equal to three per cent of the wages payable to him in respect of that wage-period.
- (5) No fine shall be imposed on any employed person who is under the age of fifteen years.
- (6) No fine imposed on any employed person shall be recovered from him by instalments or after the expiry of sixty days from the day on which it was imposed.
- (7) Every fine shall be deemed to have been imposed on the day of the act or omission in respect of which it was imposed.
- (8) All fines and all realisations thereof shall be recorded in a register to be kept by the person responsible for the payment of wages under section 3 in such form as may be prescribed; and all such realisations shall be applied only to such purposes beneficial to the persons employed in the factory or establishment as are approved by the prescribed authority.

When the persons employed upon or in any railway, factory or industrial or other establishment are part of a staff employed under the same management, all such realisations may be credited to a common fund maintained for the staff as a whole, provided that the fund shall be applied only to such purposes as are approved by the prescribed authority.

Section 9 : Deductions for absence from duty

- (1) Deductions may be made under section 7(2)(b) only on account of the absence of an employed person from the place or places where, by the terms of his employment, he

is required to work, such absence being for the whole or any part of the period during which he is so required to work.

- (2) The amount of such deduction shall in no case bear to the wages payable to the employed person in respect of the wage-period for which the deduction is made in a larger proportion than the period for which he was absent bears to the total period, within such wage-period, during which by the terms of his employment, he was required to work. Provided that, subject to any rules made in this behalf by the State Government, if ten or more employed persons acting in concert absent themselves without due notice (that is to say without giving the notice which is required under the terms of their contracts of employment) and without reasonable cause, such deduction from any such person may include such amount not exceeding his wages for eight days as may by any such terms be due to the employer in lieu of due notice.

For the purposes of this section, an employed person shall be deemed to be absent from the place where he is required to work if, although present in such place, he refuses, in pursuance of a stay-in strike or for any other cause which is not reasonable in the circumstances, to carry out his work.

Section 10 : Deductions for damage or loss

- (1) A deduction under clause (c) or clause (o).of sub-section (2) of section 7 shall not exceed the amount of the damage or loss caused to the employer by the neglect or default of the employed person.
- (1A) A deduction shall not *be* made under clause (c) or clause (m) or clause (n) or clause (o) of sub-section (2) of section 7 until the employed person has been given an opportunity of showing cause against the deduction or otherwise than in accordance with such procedure as may be prescribed for the making of such deduction.
- (2) All such deduction and all realisations thereof shall be recorded in a register to be kept by the person responsible for the payment of wages under section 3 in such form as may be prescribed.

Section 11 : Deductions for services rendered

A deduction under clause (d) or clause (e) of sub-section (2) of section 7 shall not be made from the wages of an employed person, unless the house-accommodation amenity or service has been accepted by, him, as a term of employment or otherwise, and such deduction shall not exceed an amount equivalent to the value of the house-accommodation amenity or service supplied and, in the case of deduction under the said clause (e), shall be subject to such conditions as the State Government may impose.

Section 12 : Deductions for recovery of advances

Deductions under clause (f) of sub-section (2) of section 7 shall be subject to the following conditions, namely:

- (a) recovery of an advance of money given before employment began shall be made from the first payment of wages in respect of a complete wage-period, but no recovery shall be made of such advances given for travelling-expenses;
- (aa) recovery of an advance of money given after employment began shall be subject to such conditions as the State Government may impose;

- (b) recovery of advances of wages not already earned shall be subject to any rules made by the State Government regulating the extent to which such advances may be given and the instalments by which they may be recovered.

Section 12-A : Deductions for recovery of loans

Deductions for recovery of loans granted under clause (fff) of sub-section (2) of section 7 shall be subject to any rules made by the State Government regulating the extent to which such loans may be granted and the rate of interest payable thereon.

Section 13 : Deductions for payments to co-operative societies and insurance schemes

Deductions under clause (j) [and clause (K)j of sub-section (2) of section 7 shall be subject to such conditions as the State Government may impose.

Section 13-A : Maintenance of registers and records

- (1) Every employer shall maintain such registers and records giving such particulars of persons employed by him, the work performed by them, the wages paid to them, the deductions made from their wages, the receipts given by them and such other particulars and in such form as may be prescribed.
- (2) Every register and record required to be maintained under this section shall, for the purposes of this Act, be preserved for a period of three years after the date of the last entry made therein.

THE PAYMENT OF BONUS ACT, 1965

— Deepa Kakaria

Structure of the lesson :

- Application of the Act
- Definitions
- Calculation of the Amount of Bonus
- Eligibility for bonus
- Disqualification for Bonus
- Payment of Minimum and maximum bonus
- Calculation of number of working days
- Set on and set off of allocable surplus.
- Adjustment of customary or interim bonus against bonus payable
- Deduction of certain amounts from bonus payable under the Act
- Time limit for the payment of bonus
- Application of Act to establishments in public sector in certain cases.
- Recovery of Bonus From the Employer
- Act not to apply to certain classes of Employees.

Bonus is defined as something given in addition what is ordinarily received by or due to the recipient. The main object of the payment of Bonus Act is to provide for the payment of bonus to persons employed in certain establishments on the basis of profits or on the basis of production or productivity and for matters connected therewith.

Application of the Act

This Act may be called the Payment of Bonus Act, 1965. It extends to the whole of India. Save as otherwise provided in this Act, it shall apply to -

- (a) every factory; and
- (b) every other establishment in which twenty or more persons are employed on any day during an accounting year.

Provided that the appropriate Government may, after giving not less than two months' notice of its intention so to do, by notification in the Official Gazette, apply the provisions of this Act with effect from; such accounting year as may be specified in the notification, to any establishment or class of establishment including an establishment being a factory within the meaning of section 2(m)(ii) of the Factories Act, 1948 employing such number of persons less

than twenty as may be specified in the notification; so, however, that the number of persons so specified shall in no case be less than ten.

Save as otherwise provided in this Act, the provisions of this Act shall, in relation to a factory or other establishment to which this Act applies, have effect in respect of the accounting year commencing on any day in the year 1964 and in respect of every subsequent accounting year.

Provided that in relation to the State of Jammu and Kashmir, the reference to the accounting year commencing on any day in the year 1964 and every subsequent accounting year shall be construed as reference to the accounting year commencing on any day in the 1968 and every subsequent accounting year.

Provided further that when the provisions of this Act have been made applicable to any establishment or class of establishments by the issue of a notification under the proviso to sub-section (3), the reference to the accounting year commencing on any day in the year 1964 and every subsequent accounting year or, as the case may be the reference to the accounting year commencing on any day in the year 1968 and every subsequent accounting year, shall, in relation to such establishment or class of establishments, be construed as a reference to the accounting year specified in such notification and every subsequent accounting year.

An establishment to which this Act applies shall continue to be governed by this Act notwithstanding that the number of person employed therein falls below twenty or, as the case may be, the number specified in the notification issued under the proviso to sub-section (3).

Definitions

(1) Accounting year [(Section 2(1))]

Accounting year means

- (i) in relation to a corporation, the year ending on the day on which the books and accounts of the corporation are to be closed and balanced.
- (ii) in relation to a company, the period in respect of which any profit and loss account of the company laid before it in annual general meeting is made up, whether that period is a year or not;
- (iii) in any other case —
 - (a) the year commencing on the 1st day of April; or
 - (b) if the accounts of an establishment maintained by the employer thereof are closed and balanced 6th any day other than the 31st day of March, then, at the option of the employer, the year ending on the day on which us accounts are so closed and balanced.

Provided that an option once exercised by the employer under paragraph (b) of this sub-clause shall not again be exercised except with the previous permission in writing of the prescribed authority and upon such conditions as that authority may think fit.

(2) Allocable surplus [(Section 2(4))]

Allocable surplus means—

- (a) in relation to an employer, being a company (other than a banking company) which has not made the arrangements prescribed under the Income-tax Act for the declaration and payment within India of the dividends payable out of its profits in accordance with the provisions of section 194 of that Act, sixty-seven per cent of the available surplus in an accounting year;
- (b) in any other case, sixty per cent of such available surplus;

(3) Appropriate Government [(Section 2(5))]

Appropriate Government means—

- (i) in relation to an establishment in respect of which the appropriate Government under the Industrial Disputes Act, 1947 is the Central Government, the Central Government;
- (ii) in relation to any other establishment, the Government of the State in which that other establishment is situated.

(4) Available surplus [(Section 2(6))]

Available Surplus means the available surplus computed under section 5.

(5) Award [(Section 2(7))]

“Award” means an interim or a final determination of any industrial dispute or of any question relating thereto by any Labour Court, Industrial Tribunal or National Tribunal constituted under the Industrial Disputes Act, 1947 or by any other authority constituted under any corresponding law relating to investigation and settlement of industrial disputes in force in a State and includes an arbitration award made under section 10A of that Act or under that law.

(6) Company [(Section 2(9))]

“Company” means any company as defined in section 3 of the Companies Act, 1956 and includes a foreign company within the meaning of section 591 of that Act.

(7) Corporation [(Section 2(11))]

“Corporation” means any body corporate established by or under any Central, Provincial or State Act but does not include a company or a co-operative society.

(8) Employee [(Section 2(13))]

“Employee” means any person (other than an apprentice) employed on a salary or wage not exceeding [three thousand and five hundred rupees] per month in any industry to do any skilled or unskilled manual, supervisory, managerial, administrative, technical or clerical work for hire or reward, whether the terms of employment be express or implied.

(9) Employer [(Section 2(14))]

“Employer includes—

- (i) in relation to an establishment which is a factory, the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased

owner or occupier and where a person has been named as a manager of the factory under clause (f) of sub-section (1) of section 7 of the Factories Act, 1948, the person so named; and

- (ii) in relation to any other establishment, 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.

(10) Establishment in the Private Sector [(Section 2(15))]

“Establishment in private sector” means any establishment other than an establishment in public sector.

(11) Establishment in the public Sector [(Section 2(16))]

“Establishment in public sector” means an establishment owned, controlled or managed by-

- (a) a Government company as defined in section 617 of the Companies Act, 1956 ;
- (b) a corporation in which not less than forty per cent of its capital is held (whether singly or taken together) by—
 - (i) the Government; or
 - (ii) the Reserve Bank of India; or
 - (iii) a corporation owned by the Government or the Reserve Bank of India.

(12) Salary or Wage [(Section 2(21))]

“Salary or Wage” means all remuneration (other than remuneration in respect of over-time work) capable of being expressed in terms of money, which would, if the terms of employment, express or implied, were fulfilled, be payable to an employee in respect of his employment or of work done in such employment and includes 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), but does not include-

- (i) any other allowance which the employee is for the time being entitled to;
- (ii) the value of any house accommodation or supply of light, water, medical attendance or other amenity or of any service or of any concessional supply of food grains or other articles;
- (iii) any traveling concession;
- (iv) any bonus (including incentive, production and attendance bonus);
- (v) any contribution paid or payable by the employer to any pension fund or provident fund or for the benefit of the employee under any law for the time being in force;
- (vi) any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex-gratia payment made to him;
- (vii) any commission payable to the employee.

Where an employee is given in lieu of the whole or part of the salary or wage payable to him, free food allowance or free food by his employer, such food allowance or the value of such food shall, for the purpose of this clause, be deemed to form part of the salary or wage of such employee.'

(13) Establishments [(Section 3)]

Where an establishment consists of different department or undertakings or has branches, whether situated in the same place or in different places, all; such departments or undertakings or branches shall be treated as parts of the same establishment for the purpose of computation of bonus under this Act.

Provided that where for any accounting year a separate balance-sheet and profit and loss account are prepared and maintained in respect of any such department or undertaking or branch, then such department or undertaking or branch shall be treated as a separate establishment for the purpose of computation of bonus, under this Act for that year, unless such department or undertaking or branch was, immediately before the commencement of that accounting year treated as part of the establishment for the purpose of computation of bonus.

Calculation of the Amount of Bonus

Section 4 : Computation of gross profits.

The gross profits derived by an employer from an establishment in respect of the accounting year shall—

- (a) in the case of a banking company, be calculated in the manner specified in the First Schedule;
- (b) in any other case, be calculated in the manner specified in the Second Schedule.

Section 5 : Computation of available surplus.

The available surplus in respect of any accounting year shall be the gross profits for that year after deducting therefrom the sums referred to in section 6;

Provided that the available surplus in respect of the accounting year commencing on any day 1968 and in respect of every subsequent accounting year shall be the aggregate of —

- (a) the gross profits for that accounting year after deducting therefrom the sums referred to in section 6; and
- (b) an amount equal to the difference between —
 - (i) the direct tax, calculated in accordance with the provisions of section 7, in respect of an amount equal to the gross profits of the employer for the immediately preceding accounting year; and
 - (ii) the direct tax, calculated in accordance with the provisions of section 7, in respect of an amount equal to the gross profits of the employer for such preceding accounting year after deducting therefrom the amount of bonus which the employer has paid or is liable to pay to his employees in accordance with the provisions of this Act for that year.

Section 6 : Sums deductible from gross profits.

The following sums shall be deducted from the gross profits as prior charges, namely:—

- (a) any amount by way of depreciation admissible in accordance with the provisions of sub-section (1) of section 32 of the Income-tax Act, or in accordance with the provisions of the agricultural income-tax law, as the case may be.

Provided that where an employer has been paying bonus to his employees under a settlement or an award or agreement made before the 29th May, 1965, and subsisting on that date after deducting from the gross profits notional normal depreciation, then, the amount of depreciation to be deducted under this clause shall, at the option of such employer (such option to be exercised once and within one year from the date) continue to be such notional normal depreciation;

- (b) any amount by way of development rebate or investment allowance or development allowance which the employer is entitled to deduct from his income under the income-tax Act;
- (c) subject to the provisions of section 7, any direct tax which the employer is liable to pay for the accounting year in respect of his income, profits and gains during that year;
- (d) such further sums as are specified in respect of the employer in the Third Schedule.

Section 7 : Calculation of direct tax payable by the employer.

Any direct tax payable by the employer for any accounting year shall, subject to the following provisions, be calculated at the rates applicable to the income of the employer for that year, namely:—

- (a) in calculating such tax no account shall be taken of —
 - (i) any loss incurred by the employer in respect of any previous accounting year and carried forward under any law for the time being in force relating to direct taxes;
 - (ii) any arrears of depreciation which the employer is entitled to add to the amount of the allowance for depreciation for any following accounting year or years under sub-section (2) of section 32 of the Income-tax Act;
 - (iii) any exemption conferred on the employer under section 84 of the Income-tax Act or of any deduction to which he is entitled under sub-section (1) of section, 101 of that Act, as in force immediately before the commencement of the Finance Act, 1965;
- (b) where the employer is a religious or a charitable institution to which the provisions of section 32 do not apply and the whole or any part of its Income is exempt from tax under the Income-tax Act, then, with respect to the income so exempted, such Institution shall be treated as if It were a company in which the public are substantially interested within the meaning of that Act;
- (c) where the employer is Individual or a Hindu Undivided Family, the tax payable by such employer under the Income-tax Act shall be calculated on the basis that the income derived by him from the establishment is his only income;

- (d) where the income of any employer includes any profits and gains derived from the export of any goods or merchandise out of India and any rebate on such income is allowed under any law for the time being in force relating to direct taxes, then, no account shall be taken of such rebate;
- (e) no account shall be taken of any rebate other than development rebate or investment allowance or development allowance or credit or relief or deduction (not herein before mentioned in this section) in the payment of any direct tax allowed under any law for the time being in force relating to direct taxes or under the relevant annual Finance Act, for the development of any industry.

Section 8 : Eligibility for bonus.

Every employee shall be entitled to be paid by his employer in an accounting year, bonus, in accordance with the provisions of this Act, provided he has worked in the establishment for not less than thirty working days in that year.

Section 9 : Disqualification for bonus.

An employee shall be disqualified from receiving bonus under this Act, if he is dismissed from service for —

- (a) fraud; or
- (b) riotous or violent behaviour while on the premises of the establishment; or
- (c) theft, misappropriation or sabotage of any property of the establishment.

Section 10 : Payment of minimum bonus

Subject to the other provisions of this Act, every employer shall be bound to pay to every employee in respect of the accounting year commencing on any day in the year 1979 and in respect of every subsequent accounting year, a minimum bonus which shall be 8.33 per cent of the salary or wage earned by the employee during the accounting year or one hundred rupees, whichever is higher, whether or not the employer has any allocable surplus in the accounting year:

Provided that where an employee has not completed fifteen years of age at the beginning of the accounting year, the provisions of this section shall have effecting relation to such employee as if for the words “one hundred rupees”, the words “sixty rupees” were substituted.

Section 11 : Payment of maximum bonus.

- (1) Where in respect of any accounting year referred to in section 10, the allocable surplus exceeds the amount of minimum bonus payable to the employees under that section, the employer shall, in lieu of such minimum bonus, be bound to pay to every employee in respect of that accounting year bonus which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year subject to a maximum of twenty per cent, of such salary or wage.
- (2) In computing the allocable surplus under this section, the amount set on or the amount set off under the provisions of section 15 shall be taken into account in accordance with the provisions of that section.

Section 12 : Calculation of bonus with respect to certain employees.

Where the salary or wage of an employee exceeds [two thousand and five hundred rupees] per month, the bonus payable to such employee under section 10 or, as the case may be, under section 11, shall be calculated as if his salary or wage were [two thousand and five hundred rupees] per month.

Section'13 : Proportionate reduction in bonus in certain cases.

Where an employee has not worked for all the working days in an accounting year, the minimum bonus of one hundred rupees or, as the case may be, of sixty rupees, if such bonus is higher than 8.33 per cent, of his salary or wage for the days he has worked in that accounting year, shall be proportionately reduced.

Section 14 : Computation of number of working days.

For the purposes of section 13, an employee shall be deemed to have worked in an establishment in any accounting year also on the days on which—

- (a) he has been laid off under an agreement or as permitted by standing orders under the Industrial Employment (Standing Orders) Act, 1946 (20 of 1946), or under the Industrial Disputes Act, 1947 (14 of 1947), or under any other law applicable to the establishment;
- (b) he has been on leave with salary or wage;
- (c) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and
- (d) the employee has been on maternity leave with salary or wage, during the accounting year.

Section 15 : Set on and set off of allocable surplus.

- (1) Where for any accounting year, the allocable surplus exceeds the amount of maximum bonus payable to the employees in the establishment under section 11, then, the excess shall, subject to a limit of twenty per cent, of the total salary or wage of the employees employed in the establishment in that accounting year, be carried forward for being set on in the succeeding accounting year z, d so on up to and inclusive of the fourth accounting year to be utilized for the purpose of payment of bonus in the manner illustrated in the Fourth Schedule.

THE FOURTH SCHEDULE

(See section 15 and 16)

In the Schedule, the total amount of bonus equal to 8.33 per cent of the annual salary or wage payable to all the employees is assumed to be Rs. 1,04,167. Accordingly, the maximum bonus to which all the employees are entitled to the paid (twenty per cent of the annual salary or wage of all the employees) would be Rs. 2,50,000.

Year	Amount equal to sixty per cent. or sixty seven per cent, as the case may be, or available surplus allocable as bonus	Amount payable as bonus	Set on or set off of the year carried forward	Total set on or set off Carried forward
(1)	(2)	(3)	(4)	(5)
	Rs.	Rs.	Rs.	Rs. of (year)
1.	1,04,167	1,04,167**	Nil	Nil
2.	6,35,000	2,50,000*	Set on 2,50,000*	Set on 2,50,000* (2)
3.	2,20,000	2,50,000* (inclusive of 30,000 from year-2)	Nil	Set on 2,20,000 (2)
4.	3,75,000	2,50,000*	Set on 1,25,000*	Set on 2,20,000 (2) 1,25,000 (4)
5.	1,40,000	2,50,000* (inclusive of 1,10,000 from year-2)	Nil	Set on 1,10,000 (2) 1,25,000 (4)
6.	3,10,000	2,50,000*	Set on 60,000	Set on Nil+ (2) 1,25,000 (4) 60,000 (6)
7.	1,00,000	2,50,000* (inclusive of 1,25,000 from year-4 and 25,000 from year-6)	Nil	Set on 35,000 (6)
8.	Nil (due to loss)	1,04,167** (inclusive of 35,000 from year -6)	Set off 69,167	Set off 69,167 (8)
9.	10,000	1,04,167**	Set off 94,167	Set off 69,167 (8) 94,167 (9)
10.	2,15,000	1,04,167** (after setting of 69,167 from year-8 and 41,666 from year-9)	Nil	Set off 52,501 (9)

Notes—*Maximum + The balance of Rs. 1,10,000 set on from year-2 lapses.** Minimum

- (2) Where for any accounting year, there is no available surplus or the allocable surplus in respect of that year falls short of the amount of minimum bonus payable to the employees in the establishment under section 10, and there is no amount of sufficient amount carried forward and set on under sub-section (1) which could be utilized for the purpose of payment of the minimum bonus, then, such minimum amount or the deficiency, as the case may be, shall be carried forward for being set off in the succeeding accounting year and so on up to and inclusive of the fourth accounting year in the manner illustrated in the Fourth Schedule.
- (3) The principle of set on and set off as illustrated in the Fourth Schedule shall apply to all other cases not covered by sub-section (1) or sub-section (2) for the purpose of payment of bonus under this Act.
- (4) Where in any accounting year any amount has been carried forward and set on or set off under this section, then, in calculating bonus for the succeeding accounting year, the amount of set on or set off carried forward from the earliest accounting year shall first be taken into account.

Section 17 : Adjustment of customary or interim bonus against bonus payable under the Act.

Whether in any accounting year —

- (a) an employer has paid any puja bonus or other customary bonus to aji employee; or
- (b) an employer has paid a part of the bonus payable under this Act to an employee before the date on which such bonus becomes payable.

then, the employer shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year and the employee shall be entitled to receive only the balance.

Section 18 : Deduction of certain amounts from bonus payable under the Act.

Where in any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, then, it shall be lawful for the employer to deduct the amount of loss from the amount of bonus payable by him to the employee under this Act in respect of that accounting year only and the employee shall be entitled to receive the balance, if any.

Section 19 : Time-limit for payment of bonus.

All amounts payable to an employee by way of bonus under this Act shall be paid in cash by his employer —

- (a) where there is a dispute regarding payment of bonus pending before any authority under section 22, within a month from the date on which the award becomes enforceable or the settlement comes into operation, in respect of such dispute;
- (b) in any other case, within a period of eight months from the close of the accounting year:

Provided that the appropriate Government or such authority as the appropriate Government may specify in this behalf may, upon an application made to it by the employer and for sufficient reasons, by order, extended the said period of eight months to such further period or periods as it thinks fit; so, however, that the total period so extended shall not in any case exceed two years.

Section 20 : Application of Act to establishments in public sector in certain cases.

If in any accounting year an establishment in public sector sells any goods produced or manufactured by it or renders any services, in competition with an establishment in private sector, and the income from such sale or services or both less than twenty per cent of the gross income of the establishment in public sector for that year, then, the provision of this Act shall apply in relation to such establishment in public sector as they apply in relation to a like establishment in private sector.

Section 21 : Recovery of bonus due from an employer.

Where any money is due to an employee by way of bonus from his employer under a settlement or an award or agreement, the employee himself or any other person authorised by him in writing in this behalf, or in the case of the death of the employee/ his assignee or heirs may, without prejudice to any other mode of recovery, make an application to the appropriate Government or such authority as the appropriate Government may specify in this behalf is satisfied that any money is so due, it shall issue a certificate for that amount to the Collector who shall proceed to recover the same in the same manner as an arrears of land revenue.

Provided that every such application shall be made within one year from the date on which the money became due to the employee from the employer,

Provided further that any such application may be entertained after the expiry of the said period of one year, if the appropriate Government is satisfied that the applicant had sufficient cause for not making the application within the said period.

Explanation— In this section “employee” includes a person who is entitled to the payment of bonus under this Act but who is no longer in employment.

Section 32 : Act not to apply to certain classes of employees.

The Act shall not apply to —

- (i) employees employed by any insurer carrying on general insurance business and the employees employed by the Life Insurance Corporation of India;
- (ii) seamen as defined in clause (42) of section 3 of the Merchant Shipping Act, 1958;
- (iii) employees registered or listed under any scheme made under the Dock Workers (Regulation of Employment) Act, 1948 and employed by registered or listed employers;
- (iv) employees employed by an establishment engaged in any industry carried on by or under the authority of any department of the Central Government or a State Government or a Local authority;
- (v) employees employed by —
 - (a) the Indian Red Cross Society or any other institution of a like nature (including its branches);
 - (b) universities and other educational institutions;
 - (c) institutions (including hospitals, chambers of commerce and social welfare institutions) established not for purposes of profit;
- (vi) employees employed through contractor on building operations;
- (viii) employees employed by the Reserve Bank of India;

- (ix) employees employed by —
 - (a) the Industrial Finance Corporation of India;
 - (b) any Financial Corporation established under section 3, or any Joint Financial Corporation established under section 3A, of the State Financial Corporations Act, 1951;
 - (c) the Deposit Insurance Corporation;
 - (d) the National Bank for Agriculture and Rural Development;
 - (e) the Unit Trust of India;
 - (f) the Industrial Development Bank of India;
 - (g) the Small Industries Development Bank of India; (h) the National Housing Bank;
- (i) any other financial institution [(other than a banking company)], being an establishment in public sector, which the Central Government may, by notification in the Official Gazette, specify, having regard to —
 - (i) its capital structure;
 - (ii) its objectives and the nature of its activities;
 - (iii) the nature and extent of financial assistance or any concession given to it by the Government; and
 - (iv) any other relevant factor;
- (xi) employees employed by inland water transport establishment operating on routes passing through any other country.

THE PAYMENT OF GRATUITY ACT, 1972

— *Deepa Kakaria*

Structure of the lesson

- Application of the Act
- Definitions
- Continuous service
- Controlling authority
- Payment of gratuity
- Forfeiture of gratuity
- Compulsory insurance
- Power to exempt
- Nomination
- Determination of the amount of gratuity
- Recovery of gratuity
- Penalties
- Protection of gratuity
- Act to override other enactments etc.

Gratuity is the lump sum payment to an employee made by an employer as the retrieval reward for his past service when his employment is terminated. Gratuity compensates the affected employee and enables him to meet the situation of reduced earnings after retirement. It also provides the financial aid to the surviving members of the family of deceased employee. The Act provides for a scheme for the payment of gratuity to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, shops or other establishments and for matters connected therewith or incidental thereto.

Application of the Act

The Payment of Gratuity Act, 1972 extends to the whole of India. It shall, however, not extend to the state of Jammu and Kashmir in so far as it relates to plantations or ports.

According to Section 1(3) the Act shall apply to—

- (a) every factory, mine, oilfield, plantation, port and railway company,
- (b) every shop or establishment within the meaning of any law for the time being in force in relation to shops and establishments in a State, in which ten or more persons are employed, or were employed, on any day of the preceding twelve months;
- (c) such other establishments or class of establishments, in which ten or more employees are employed, or were employed, on any day of the preceding twelve months, as the Central Government may, by notification, specify in this behalf.

A shop or establishment to which this Act has become applicable shall continue to be governed by this Act notwithstanding that the number of persons employed therein at any time after it has become so applicable falls below ten.

Definitions

1. Appropriate Government

Appropriate Government means—

- (i) in relation to an establishment—
 - (a) belonging to, or under the control of, the Central Government,
 - (b) having branches in more than one State,
 - (c) of a factory belonging to, or under the control of, the Central Government;
 - (d) of a major port, mine, oil field or railway company, the Central Government;
- (ii) in any other case, the State Government;

2. Employee

Employee means any person (other than an apprentice) employed on wages, in any establishment, factory, mine, oilfield, plantation, port, railway company or shop to do any skilled, semi-skilled, or unskilled, manual, supervisory, technical or clerical work, whether the terms of such employment are express or implied, and whether or not such person is employed in a managerial or administrative capacity, but does not include any such person who holds a post under the Central Government or a State Government and is governed by any other Act or by any rules providing for payment of gratuity.

3. Employer

Employer means, in relation to any establishment, factory, mine, oilfield, plantation, port, Railway Company or shop—

- (i) belonging to, or under the control of, the Central Government or a State Government a person or authority appointed by the appropriate Government for the supervision and control of employees, or where no person or authority has been so appointed, the head of the Ministry or Department concerned,
- (ii) belonging to, or under the control of, any local authority, the person appointed by such authority for the supervision and control of employees or where no person has been so appointed, the chief executive officer of the local authority,
- (iii) in any other case, the person, who, or the authority which, has the ultimate control over the affairs of the establishment, factory, mine, oilfield, plantation, port, railway company or shop, and where the said affairs are entrusted to any person, whether called a manager, managing director or by any other name, such person.

4. Factory

Factory has the meaning assigned to it in clause (m) of section 2 of the Factories Act, 1948.

5. Family

Family in relation to an employee, shall be deemed to consist of—

- (i) in the case of a male employee, himself, his wife, his children, whether married or unmarried, his dependent parents and the dependent parents of his wife and the widow and children of his predeceased son, if any,

- (ii) in the case of a female employee, herself, her husband, her children, whether married or unmarried, her dependent parents and the dependent parents of her husband and the widow and children of her predeceased son, if any.

Where the personal law of an employee permits the adoption by him of a child, any child lawfully adopted by him shall be deemed to be included in his family, where a child of an employee has been adopted by another person and such adoption is, under the personal law of the person making such adoption, lawful, such child shall be deemed to be excluded from the family of the employee;

6. *Retirement*

Retirement means termination of the service of an employee otherwise than on superannuation.

7. *Superannuation*

Superannuation, in relation to an employee, means the attainment by the employee of such age as is fixed in the contract or conditions of service as the age on the attainment of which the employer shall vacate the employment.

8. *Wages*

Wages means all emoluments which are earned by an employee while on duty or on leave in accordance with the terms and conditions of his employment and which are paid or are payable to him in cash and includes dearness allowance but does not include any bonus, commission, house rent allowance, overtime wages and any other allowance.

Section 2(b): Completed year of Service - means Continuous services for one year.

Section 2A : Continuous service. - For the purposes of this Act,—

- (1) an employee shall be said to be in continuous service for a period if he has, for that period, been in uninterrupted service, including service which may be interrupted on account of sickness, accident, leave, absence from duty without leave (not being absence in respect of which an order treating the absence as break in service has been passed in accordance with the standing orders, rules or regulations governing the employees of the establishment), lay-off, strike or a lock-out or cessation of work not due to any fault of the employee, whether such uninterrupted or interrupted service was rendered before or after the commencement of this Act;
- (2) where an employee (not being an employee employed in a seasonal establishment) is not in continuous service within the meaning of clause (1), for any period of one year or six months, he shall be deemed to be in continuous service under the employer—
 - (a) for the period of one year, if employee during the period of twelve calendar months preceding the date with reference to which calculation is to be made, has actually worked under the employer for not less than—
 - (i) one hundred and ninety days, in the case of any employee employed below the ground in a mine or in an establishment which works for less than six days in a week; and
 - (ii) appropriate Government two hundred and forty days, in any other case;

- (b) for the said period of six months, if the employee during the period of six calendar months preceding the date with reference to which the calculation is to be made, has actually worked under the employer for not less than-
- (i) ninety-five days, in the case of an employees employed below the ground in a mine or in an establishment which works for less than six days in a week; and
 - (ii) one hundred and twenty days, in any 'other case.

For the purpose of clause (2) the number of days on which an employee has actually worked under an employer shall include the days on which.-

- (i) he has been laid-off under an agreement or as permitted by standing orders made under the Industrial Employment (Standing Orders) Act, 1946 or under the Industrial Disputes Act, 1947 or under any other law applicable to the establishment;
 - (ii) he has been on leave with full wages, earned in the previous year;
 - (iii) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and
 - (iv) in the case of a female, she has been on maternity leave; so, however, that the total period of such maternity leave dose not exceed twelve weeks.
- (3) Where an employee, employed in a seasonal establishment, is not in continuous service within the meaning of clause (1), for any period of an year or six, months, he shall be deemed to be in continuous service under the employer for such period if he has actually worked for not less than seventy-five per cent. Of the number of days on which the establishment was in operation during such period.

Section 3 : Controlling authority.

The Appropriate Government may, by notification, appoint any officer to be a controlling authority, who shall be responsible for the administration of this Act and different authorities may be appointed for different areas.

Section 4 : Payment of gratuity.

- (1) Gratuity shall be payable to an employee on the termination of his employment of his employment after he has rendered continuous service for not than five years,-
- (a) on his superannuation, or
 - (b) on his retirement of resignation, or
 - (c) on his death or disablement due to accident or disease:

The completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement:

For the purposes of this section, disablement means such disablement as incapacitates an employee for the work which he was capable of performing before the accident or disease resulting in such disablement.

The *amount of Gratuity is payable to* the employee himself. In the case of death of the employee, gratuity payable to him shall be paid to his nominee or, if no nomination has been made, to his heirs, and where any such nominees or heirs is a minor, the share of such minor, shall be deposited with the controlling authority who shall invest the same for the benefit of such

minor in such bank or other financial institution, as may be prescribed, until such minor attains majority.

- (2) Every completed year of service or part thereof in excess of six months, the employer shall pay gratuity to an employee at the rate of fifteen days' wages based on the rate of wages last drawn by the employee concerned.

In the case of a piece-rated employee, daily wages shall be computed on the average of the total wages received by him for a period of three months immediately preceding the termination of his employment, and, for this purpose, the wages paid for any overtime work shall not be taken into account. Further in the case of an employee who is employed in a seasonal establishment and who is not so employed throughout the year, the employer shall pay the gratuity at the rate of seven days' wages for each season. In the case of a monthly rated employee, the fifteen days' wages shall be calculated by dividing the monthly rate of wages last drawn by him by twenty-six and multiplying the quotient by fifteen.

- (3) The amount of gratuity payable to an employee shall not exceed three lakhs and fifty thousand rupees.
- (4) For the purpose of computing the gratuity payable to an employee who is employed, after his disablement, on reduced wages, his wages for the period preceding his disablement shall be taken to be the wages received by him during that period, and his wages for the period subsequent to his disablement shall be taken to be the wages as so reduced.
- (5) Nothing in this section shall affect the right of an employee to receive better terms of gratuity under any award or agreement or contract with the employer.

Section 4(6): Forfeiture of Gratuity.

- (a) The gratuity of an employee, whose services have been terminated for any act, willful omission or negligence causing any damage or loss to, or destruction of, property belonging to the employer' shall be forfeited to the extent of damage or loss so caused;
- (b) The gratuity payable to an employee may be wholly or partially forfeited—
 - (i) if the services of such employee have been terminated for his riotous or disorderly conduct or any other act of violence on his part, or
 - (ii) if the services of such employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

Section 4A : Compulsory Insurance.

Every employer, other than an employer or an establishment belonging to, or under the control of, the Central Government or a State Government, shall obtain an insurance in the manner prescribed, for his liability for payment towards the gratuity under this Act, from the Life Insurance Corporation of India established under the Life Insurance Corporation of India Act, 1956 or any other prescribed insurer.

Section 5 : Power to exempt.

The appropriate Government may, by notification, and subject to such conditions as may be specified in the notification, exempt any establishment, factory, mine, oilfield, plantation, port, railway company or shop to which this Act applies from the operation of the provisions of this

Act if, in the opinion of the appropriate Government, the employees in such establishment, factory, mine, oilfield, plantation, port, railway company or shop are in receipt of gratuity or pensionary benefits not less favorable than the benefits conferred under this Act.

Section 6: Nomination.

- (1) Each employee, who has completed one year of service, shall make, within such time, in such form and in such manner, as may be prescribed, nomination for the purpose of the second proviso to sub-section (1) of section 4.

Section 7 : Duty to Pay Gratuity (Determination of the amount of gratuity)

- (1) A person who is eligible for payment of gratuity under this Act or any person authorised, in writing to act on his behalf shall send a written application to the employer, within such time and in such form, as may be prescribed, for payment of such gratuity.
- (2) As soon as gratuity becomes payable, the employer shall, determine the amount of gratuity and give notice in writing to the person to whom the gratuity is payable and also to the controlling authority specifying the amount of gratuity so determined.
- (3) The employer shall arrange to pay the amount of gratuity within thirty days from the date it becomes payable to the person to whom the gratuity is payable.
- (4) If the amount of gratuity payable is not paid by the employer within the period of 30 days, the employer shall pay, from the date on which the gratuity becomes payable to the date on which it is paid, simple interest at such rate, not exceeding the rate notified by the Central Government from time to time for repayment of long-term deposits.

However no such interest shall be payable if the delay in the payment is due to the fault of the employee and the employer has obtained permission in writing from the controlling authority for the delayed payment on this ground.

- (6) If there is any dispute to the amount of gratuity payable to an employee under this Act or as to the admissibility of any claim of, or in relation to, an employee for payment of gratuity, or as to the person entitled to receive the gratuity, the employer shall deposit with the controlling authority such amount as he admits to be payable by him as gratuity.

Where there is a dispute the employer or employee or any other person raising the dispute may make an application to the controlling authority for deciding the dispute. The controlling authority shall, after due inquiry and after giving the parties to the dispute a reasonable opportunity of being heard, determine the matter or matters in dispute and if, as a result of such inquiry any amount is found to be payable to the employee, the controlling authority shall direct the employer to pay such amount or, as the case may be, such amount as reduced by the amount already deposited by the employer.

The controlling authority shall pay the amount deposited, including the excess amount, if any, deposited by the employer, to the person entitled thereto.

As soon as may be after a deposit is made the controlling authority shall pay the amount of the deposit—

- (i) to the applicant where he is the employee; or
- (ii) where the applicant is not the employee, to the nominee or, as the case may be, the guardian of such nominee or heir of the employee if the controlling authority is satisfied

that there is no dispute as to the right of the application to receive the amount of gratuity.

Section 8 : Recovery of gratuity.

If the amount of gratuity payable under this Act is not paid by the employer, within the prescribed time, to the person entitled thereto, the controlling authority shall, on an application made to it in this behalf by the aggrieved person, issue a certificate for that amount to the Collector who shall recover the same, together with compound interest thereon at such rate as the Central Government may, by notification, specify, from the date of expiry of the prescribed time as arrears of land revenue and pay the same to the person entitled thereto.

Provided that the controlling authority shall, before issuing a certificate under this section, give the employer a reasonable opportunity of showing cause against the issue of such certificate.

Provided further that the amount of interest payable under this section shall, in no case exceed the amount of gratuity payable under this Act.

Section 9 : Penalties.

- (1) Whoever, for the purpose of avoiding any payment to be made by himself under this Act or of enabling any other person to avoid such payment, knowingly makes or causes to be made any false statement or false representation shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to ten thousand rupees or with both.
- (2) An employer who contravenes, or makes default in complying with, any of the provisions of this Act or any rule or order made thereunder shall be punishable with imprisonment for a term which shall not be less than three months but which may extend to one year, or with fine which shall not be less than ten thousand rupees but which may extend to twenty thousand rupees, or with both.

Section 13 : Protection of gratuity.

No gratuity payable under this Act to an employee shall be liable to attachment in execution of any decree or order of any civil, revenue or criminal court.

Section 14 : Act to override other enactments, etc.

The provisions of this Act or any rule made thereunder shall have effect notwithstanding anything inconsistent therewith contained in any enactment other than this Act or in any instrument or contract having effect by virtue of any enactment other than this Act.

This question paper contains 4+2 printed pages]

Your Roll No.

आपका अनुक्रमांक.....

5351

B.Com./I/NS HI

Paper III—BUSINESS AND INDUSTRIAL LAWS

(NC-Admission of 2006 onwards)

Time : 3 Hours

Maximum Marks : 75

समय : 3 घण्टे

पूर्णांक : 75

(Write your Roll No. on the top immediately on receipt of this question paper.)

(इस प्रश्न-पत्र के मिलते ही ऊपर दिए गए निर्धारित स्थान पर अपना अनुक्रमांक लिखिए।)

Note :—Answers may be written either in English or in Hindi;

but the same medium should be used throughout the paper.

इस प्रश्न-पत्र का उत्तर अंग्रेजी या हिन्दी किसी एक भाषा में दीजिए; लेकिन सभी उत्तरों का माध्यम एक ही होना चाहिए।

Attempt All questions.

Each question carries equal marks.

सभी प्रश्नों के उत्तर दीजिये।

प्रत्येक प्रश्न के अंक समान हैं।

1. Define the term 'offer' and 'acceptance'. Explain the rules regarding a valid offer.

6.9

‘प्रस्ताव’ तथा ‘स्वीकृति’ शब्दों की परिभाषा लिखिये। एक वैध प्रस्ताव से सम्बन्धित नियमों की व्याख्या कीजिए।

Or

(अथवा)

Define Consideration. How far is it necessary for the validity of a contract ? State the exception to the rule—
'No Consideration, no Contract'. 5,5,5

प्रतिफल की परिभाषा कीजिये। एक वैध अनुबन्ध के लिए प्रतिफल की आवश्यकता क्योंकर है ? 'बिना प्रतिफल अनुबन्ध नहीं' कथन के अपवादों को लिखिये।

2. Explain various modes in which a contract may be discharged. 15

उन विभिन्न ढंगों की व्याख्या कीजिये जिनके द्वारा एक संधि की पूर्ति की जा सकती है।

Or

(अथवा)

"The liability of surety is co-extensive with that of the principal debtor." Explain. State the rights of surety against the creditor, the principal debtor and co-sureties. 5,10

“एक जमानतदार की जिम्मेवारी मुख्य देनदार के समकालीन होती है। व्याख्या कीजिए। एक जमानतदार के ऋणदाता मुख्य ऋणी और सहजमानतियों के प्रति अधिकारों की व्याख्या कीजिए।

3. (a) Who is Holder-in-due course ? Describe the privileges of a Holder-in-due course. 10
- (b) Explain the circumstances under which the court can order the dissolution of a partnership firm. 5
- (अ) यथाविधि-धारक कौन होता है ? यथाविधि-धारक के विशेषाधिकारों की व्याख्या कीजिए।
- (ब) न्यायालय किन आधारों पर साझेदारी फर्म के विघटन का आदेश दे सकता है ? व्याख्या कीजिए।

Or

(अथवा)

- (a) Explain the concept of an 'Implied Authority' of a partner. 10
- (b) Explain the characteristics of a Negotiable Instruments. 5
- (अ) 'साझेदार के गर्भित अधिकार' अवधारणा की व्याख्या कीजिए।
- (ब) परक्राम्य लिखत की विशेषताएँ स्पष्ट कीजिए।

P.T.O.

4. (a) Define 'Wages' and industrial establishment' under the Payment of Wages Act, 1936. 5
- (b) Does the Payment of Bonus Act, 1965 impose any obligation on an employer to pay a minimum bonus ? What is the quantum of maximum bonus. 10

- (अ) 'मजदूरी' और 'औद्योगिक संस्था' को मजदूरी भुगतान अधिनियम, 1936 के अंतर्गत परिभाषित कीजिए।
- (ब) क्या बोनस भुगतान अधिनियम, 1965 के अन्तर्गत नियोक्ता को न्यूनतम बोनस के लिए बाध्य करता है ? अधिकतम बोनस की राशि कितनी हो सकती है, लिखिये।

Or

(अथवा)

- (a) When is an employee disqualified from receiving bonus. 10
- (b) State the provisions of the Payment of Wages Act, 1936 with regard to deduction from wages. Is there any limit on deductions. 8,2

- (अ) एक कर्मचारी किन परिस्थितियों में असामान्य (बोनस) देयक राशि से वंचित हो सकता है ?
- (ब) मजदूरी भुगतान अधिनियम, 1936 के अंतर्गत मजदूरी से की जाने वाली कटौतियों से सम्बन्धित प्रावधानों को लिखिये। क्या इन कटौतियों को कोई सीमा भी है, लिखिये।
5. (a) Define the following terms as used in Payment of Gratuity Act, 1972 :
- (i) Appropriate Government;
- (ii) Continuous services. 6(3+3)
- (b) What are the certain categories of employees to whom the Payment of Bonus Act shall not apply ?
- 9
- (अ) ग्रेच्युटी भुगतान अधिनियम, 1972 के अंतर्गत प्रयोग किये जाने वाले निम्नलिखित शब्दों को परिभाषित कीजिए :
- (i) उपयुक्त गवर्नमेंट;
- (ii) सतत् नौकरी।
- (ब) ऐसे किस तरह के कर्मचारी हैं जिन पर बोनस असामान्य देयक राशि अधिनियम लागू नहीं होता ?

P.T.O.

Or
(अथवा)

- (a) State the circumstances in which gratuity becomes payable to an employee and when does an employee forfeit his right to gratuity. 6(3+3)
- (b) On whom does the responsibility for payment of wages lie. State the rules regarding the time of the payment of wages.
- (अ) उन परिस्थितियों का वर्णन कीजिए जब कर्मचारी को पारितोष (ग्रेच्युटी) का भुगतान देय हो जाता है और किन परिस्थितियों में वह इस अधिकार से वंचित हो जाता है ?
- (ब) मजदूरी के भुगतान की जिम्मेदारी किसकी है ? मजदूरी के भुगतान के समय सम्बन्धित नियमों को लिखिये।

Paper - III
BUSINESS AND INDUSTRIAL LAWS
Contents

Unit I : The Indian Contract Act, 1872

1. Contract: Its Essential
2. Contingent And Quasi Contracts
3. Discharge of Contracts
4. Contracts of Indemnity guarantee and Bailment
5. Agency

Unit II : Indian Partnership Act. 1932

6. Definition. Nature of Partnership and its Formation. Relation of Partner-Implied Authority of a Partner. Dissolution of Firm

Unit III : The Sale of Goods Act. 1930

7. Contract of Sale of Goods-Sale and Agreement to Sell
Conditions and Warranties-Implied Conditions and Warranties
8. Transfer of Property-Passing of Risk
Transfer of Title by Non-owners
9. Performance of the Contract of Sale
Rights of an Unpaid Seller

Unit IV : The Negotiable Instruments Act. 1881

10. Introduction. Promissory Note, Bill of exchange, Hundi, Cheque-Crossing, Parties to Negotiable Instruments.
11. Negotiation

Unit V 12. The Payment of Wages Act. 1936

Unit VI 13. The Payment of Bouns Act. 1965

Unit VII 14. The Payment of Gratuity Act. 1972

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