# BUSINESS REGULATORY FRAME WORK

## B.Com. First Year

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# UNIT– I & II

# INDIAN CONTRACT ACT

NOTES

***Structure***

1.0 Objectives

1.1 Nature of law

1.2 Nature of contract

1.3 Classification of contract

1.4 Offer and acceptance

1.5 Consideration

1.6 Quasi contract

1.7 Indemnity and Guarantee

1.8 Bailment

1.9 Pledge

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NOTES

## 1.0 OBJECTIVES

The objectives of this unit are to :

- Highlight the nature of contract
- Make classification of contract
- Give an idea about offer and acceptance.
- Consideration and its exceptions.
- Special contract
- Rules of Indemnity and guarantee.
- Bailment and pledge.

## 1.1 NATURE OF LAW

1. From a citizen point of view, law is a set of rules which he must obey. Violation of law is punishable.
2. From a lawyer point of view, it is his vocation and they practise it.
3. From a legislator point of view, it is something created by him in the state or legislative assembly. It is for the betterment of society.
4. From a judge point of view, it is the guiding principles to be applied in making decision.
5. From a social scientist, it is that medium which helps in reforming the society.

**Definition of law**

Law refers to all rules and regulations which regulate our relationship with other individual and with state recognized by state and enforceable.

Law denotes rules and regulations established by authority whether is the form of legislations or self-imposed customs applicable to people.

Simply law operates to regulate the action of persons with respect to one another and entire group or society and the state.

"Ignoratia Joris not excusat"

This means ignorance of law is not excuse. Although it is not possible for a layman to learn every branch of law, it is to the advantage of each member of the community to know something of rules and



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regulations by which he is governed and as such he must acquaint himself with general principles of law of the country.

There are many types of law such as mercantile law, civil law, tax law, criminal law, labour law.

**Sources of law**

(1) English Law : This is the most important source of Indian mercantile law

It includes

(a) Common law of England : It refers to a system of law based upon English custom, usages and traditions which are developed over countries by English court. First of all it is unwritten and its principles are applied whenever subsequent disputes of similar nature arises.

(b) Equity : It refers to that branch of English law which develops separation from common law. It is based upon concepts of justice developed by the judges whose decisions became precedent. It is also unwritten and it covers the deficiencies of common law.

(c) Statute law : the statute law refers to the law laid down in the Acts of parliament. It is superior to and over any rules of the common law of equity.

(2) Judicial decisions or the system of precedents : This is the source of law based upon previous judicial decisions which have to be followed in similar future cases. The system of precedents has been described as a system of law which applies in new combination of circumstances those rules which are derived from earlier judicial decisions.

(3) Customs and usages : Custom and usage established by long use and constantly put into practice become binding into the parties entering commercial transactions.

## 1.2 NATURE OF CONTRACT

**Definition of contract :**

According to section 2(h), "A contract is a legally binding agreement made between two or more persons, by which rights are

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acquired by one or more, to acts or forbearances on the part of other or others". According to section 2(h). Indian contract Act-1872, "An agreement enforceable at law is a contract".

If we analyse the definition of contract, we find that a contract consists of two elements :

(i) An agreement

(ii) Its enforceability by law.

**Agreement :**

According to section 2(e), an agreement is defined as, "Every promise and set of promises forming consideration of each other".

**Promise :**

According to section 2(b), "A proposal when accepted becomes a promise".

An agreement involves proposal or offer by one party and acceptance of the same by the other party. It requires existence of two or more persons i.e. plurality of person because one person cannot enter into an agreement with himself.

Agreement = offer + Acceptance

Example – When A offers B to come with him for a dinner, when B accepts it, it becomes an agreement.

**Enforceability by law :**

An agreement to become a contract must give rise to a legal obligation or duty. The term obligation is defined as, "A legal tie which imposes upon a definite person or persons the necessity of doing or abstaining or doing à definite act or acts. The common acceptance formed and communicated between the two parties must create lègal relation not the relation which are purely social or domestic nature.

Example : A promises to sell his car to B for Rs.10,000 received by him as the price of the ear. The agreement gives rise to an obligation on the part of A to deliver the car to B.

From this we conclude that all agreements are not contract only that agreement which is enforceable at law is a contract. So, contract is a broad term.

According to section (10) of I.C.A., "All agreements are contracts if they are made by free consent of parties, competent to contract, for



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a lawful consideration and with lawful object and aren't expressly declared to be void". So, to be enforceable by law, agreement must posses the essential elements of a valid contract.

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The essential elements of a valid contract are :

(i) Offer and acceptance : There must be two parties to an agreement i.e. one party making the offer and the other party accepting it. In order to create a valid contract, these must be a 'lawful offer' by one party and 'lawful acceptance' of the same by the other party. The acceptance must also be according to the mode prescribed and must be communicated to the offeror.

(ii) Intention to create legal relationship : When two parties enter into an agreement they must have intention to create legal relation between them. In case, there is no such intention on the part of parties, there is no contract. Agreement of social or domestic nature don't constitute legal relations.

Example : An agreement to have a launch at a friend's house, agreement between husband and wife, generally lack the intention to create legal relationship.

In commercial transaction an intention to create legal relation is prescribed. But the contract can not be valid, when the parties express, declare and resolve that their agreement is not intended to create legal relation.

(iii) Lawful consideration : Consideration means an advantage or benefit moving from one party to the other. In simple words, "consideration means something in return". Promise made for nothing are unenforceable under I.C.A. To make an agreement legally enforceable one must give something and get something in return. It may be in the form of money, goods, service. It may be past, present or future.

(iv) Capacity of parties : The parties to an agreement must be competent to a contract. According to section (11), "everyone is competent to a contract, who is of the age of majority according 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. According to this the following persons are incompetent to contract :



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(a) Minors

(b) Persons of unsound mind

(c) Persons disqualified by law.

(v) Free consent : The consent of the parties is said to be free when they are of the same mind on all the material terms of the contract. The parties are said to be of the same mind when they agree about the subject matter of the contract in the same sense and at the same time. This is called consensus in English law. Consent is said to be free when it is not caused by : (i) coercion (ii) undue influence (iii)fraud (iv)mis-representation (v)mistake.

(vi) Lawful object : The object of an agreement must be lawful. It means the purpose or design of the contract. The object must not be (a) illegal, (b) immoral (c) opposed to the public policy or against the public welfare.

Example : When one hires a house for use as a gambling house, the object of the contract is to run as gambling house.

(vii) Certainty of meaning : Agreement the meaning of which is not certain or capable of being made certain are void. So, the term of the contract must be precise and certain, not vague.

Example :A agrees to sell B, "10 litres of oil", There is nothing whatever to show which kind of oil was intended. The agreement is void.

(viii) Possibility of performance : If the act is impossible itself physically or legally, it can't be enforced at law. The act of the agreement must be all.

Example : A agrees with B to discover a treasure of magic.

(ix) Not declared to be void : The agreement must not have expressly declared void by any law in force in a country. Agreements mentioned in section (24) to (30) of the Act have been expressly declared to be void.

(x) Legal formalities : A contract may be made by words spoken or written. It is however in the interest of parties that the contract should be in writing. In some cases, the document in which the contract is incorporated is to be stamped. In some other cases a contract, besides being a written one has to be registered. So, all the required statutory formalities must be complied with.



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All the agreements must certify all the elements. Absence of anyone make the agreement void.

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## 1.3 CLASSIFICATION OF CONTACT

**A. Validity**

(i) Valid contract.

(ii) Void contract

(iii) Void agreement

(iv) Voidable contract

(v) Unenforceable contract.

(vi) Illegal agreement

**B. Formation**

(i) Express contract

(ii) Implied contract

(iii) Quasi contract

(iv) E-com. contract

**C. Performance**

(i) Executed contract

(ii) Executory contact – Unilateral and Bilateral.

**(A) (i) Valid contract :**

An agreement enforceable at law is valid contract. An agreement becomes a valid contract when all the elements given in section (10) are fulfilled.

Example : 'A' offers 'B' to sell his car at Rs.5 lakhs. B agrees to buy. It is a valid contract.

(ii) Void Agreement : According to section 2(g), "An agreement which is not enforceable at law by either of the parties is void". A void agreement doesnot create any legal right or obligation. It is void ab-initio i.e. from the very beginning.

Example : Agreement without consideration or with a minor.

(iii) Void contract :

An agreement which is legally enforceable when entered into but which has become void due to supervening



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impossibility of performance. A contract when entered into may be valid, but it may subsequently void. A contract may also lack any essential elements of a valid contract is said to be a void contract.

Example : The contract of importing goods from a country becomes void, when a war broke out with the concerned country.

(iv) Voidable contract :

According to section 2(i), "An agreement which is enforceable by law at the option of one or more of the parties but not at the option of other or others, is a voidable contract". When the consent of a party to a contract is not free, i.e. it is caused by coercion, undue influence, misrepresentation or fraud, the contract is voidable at his option. A voidable contract is valid and enforceable until it is repudiated by the party entitled to avoid it.

(v) Unenforceable contract :

It is a contract which is otherwise valid but cannot be enforced in the court of law because of some technical defect like absence of written form or absence of proper stamp. It will not be enforced by the court until and unless the defect is rectified.

Example : A promissory note being understamped i.e. a promissory note of Rs.10,000 has a one rupee stamp pasted on it.

(vi) Illegal agreement :

A contract which is either prohibilited by law or otherwise against the policy of law is an illegal agreement. It is void ab initio.

Example : Agreement with a pick-pocketor.

(B) (i) **Express contract :**

Where the proposal and acceptance is made in words spoken or written, it is an express contract. Where the offer or acceptance of any promise is made in words, the promise is said to be express. An express promise results an express contract.

(ii) Implied contract :

An implied contract is one which is inferred from the acts or conduct or behaviour of the parties or course of dealing



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between them and can be smelled out from the surrounding circumstances. According to section (9) , "Where the offer or acceptance of any promise is made otherwise than in words, the promise is said to be implied. An implied promise results in an implied contract.

Example : There are implied contract when one get into a public bus.

(iii) Quasi contract :

Strictly speaking quasi contract is not a contract at all. It is a contract in which there is no intention on either side to make a contract, but the law imposes a contract. It resembles a contract in that a legal obligation is imposed on a party who is required to perform it.

Example ; When certain books are delivered to a wrong person, the addressee is under an obligation to pay for them or return them.

(iv) E-Com Contract :

The contracts are entered into between the parties using internet. In electronic commerce, different parties or persons create networks which are linked to other networks through EDI (Electronic data interchange).

**(C) (i) Executed contract :**

Executed means that have already been done. An executed contract is one in which both the parties have performed their obligations or carried out the terms of contracts. In other words, it is a completed contact.

Example : A sells a TV set to B for Rs.20,000. B pays the price and A hands over TV set to B.

(ii) Executory contract :

Executory means that remains to be carried into effect when the contract is yet to be performed wholly or partially by one or both the parties have yet to perform their obligations, the contract is executory contract.

An executory contract may be :

(a) Unilateral

(b) Bilateral.

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(a) Unilateral : A unilateral contract is one in which at the time the contract is formed, only one party has to perform his obligation, the other party has already fulfilled his part of obligation.

(b) ...ateral contract ; These are the contracts where a promise on one side is exchanged for a promise on the part of other party. A bilateral lateral contract is also known as contract with executory consideration.

## 1.4 OFFER AND ACCEPTANCE

**Offer :**

According to section 2(a) of I.C.A-1872 an offer is defined as, "When one person signifies to another his willingness to do or to abstain from doing anything with a view to obtain the asset of that other to such act or abstinence".

***There are two parties in an offer :***

(i) Offeror/proposer/ promisor : The person making the offer.

(ii) Offeree/ proposee/ promisee : The person to whom offer is made.

***Types of offer***

(i) According to its mode

(a) Express offer : An offer may be made by express words spoken or written, it is known as express offer.

Example when A says to B, "will you purchase my house".

(b) Implied offer : An offer may also be implied from the conduct of the parties or the circumstances of the case, it is known as implied offer.

Example : When a transport company runs a bus on a particular route, it is an implied offer by the transport company and anyone who wants to go on this specific route can ride this bus.

(ii) According to its scope :

(a) General offer : when an offer is made to world at large, it is called as general offer.

(b) Specified offer : When an offer is made to a definite person, it is called as specified offer. It can be accepted only by the person to whom it is made.

Example : A offers B, "Will you purchase my bicycle".



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(iii) According to its approach :

(a) Positive offer : When an offer is made to do something it is called positive offer.

(b) Negative offer : When an offer is made not to do something it is called as negative offer.

(iv) According to its behaviour :

(a) Cross offer : When two parties make identical offers to each other, in ignorance of each others offer, these offers are called cross offer. In such a case the court will not construe one as the offer and the other as the acceptance and as such there can be no concluded contract.

Example : A offers B, "will you purchase my bicycle". At the same time B offers A ignorant of A's offers, "will you sell your bicycle".

(b) Counter offers : The counter offer is the rejection of original offer and making a new offer. The new offer is a counter offer. A person who makes a counter offer and subsequently discharges his mind and wishes to accept the first offer can't do so as the first offer lapses. Such as bargaining.

***Essential elements of a valid offer :***

(i) Offer must be capable of creating legal relationship : The offer must intend to create a legal relation. 'A' offers 'B' a dinner and 'B' accepts that on a certain date, but failed to turn up on the appointed date, now 'A' can't sue against 'B' for the breach of contract because a social invitation even accepted does not create legal relation because it is not so intended. An offer, therefore, must be such as, would result in a valid contract when it is accepted.

(ii) Offer must be certain, definite and not vague : No contract can come into existence if the terms of the offer are vague or loose or indefinite. Both the parties should be clear about legal consequences arising out of contract.

Example : 'A' says 'B', "I will sell you a car". 'A' owns three different cars. The offer is not definite.

(iii) The offer must be communicated to the offeree : An offer to be completed must be communicated to the person, to whom, it is made. Unless an offer is communicated to the offeree by the

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offeror or by his duly authorized agent, there is no acceptance of it.

Example : 'A' writes a letter to 'B' offering him to sell his watch for Rs.200, but does not post the letter and keeps it in his drawer, it is not an offer.

(iv) Offer must be made with a view to obtain the assent of the other party : The offer to do or not to do something must be made with a view to obtain the assent of the other party addressed. An offer must be distinguished from mere expression of intention.

(v) An offer may be conditional : An offer is made subject to a condition. A conditional offer lapses when the condition is not accepted. If the offer contain certain conditions and the proposer has done everything required to take the condition into notice of the proposee, the person accepting the offer is presumed to have accepted it, with the condition so attached.

Example : When we sign the admit card, we are presumed to accept all the conditions mentioned back of the admit card.

(vi) Offer should not contain a term the non-compliance of which would amount to acceptance : One can't say while making an offer if the offer is not accepted before a certain date, it will be presumed to have been accepted.

Example : 'W' writes to 'X', "I offer to sell my bike for Rs.10,000. If I don't receive your reply by Sunday next, it will be presumed that you have accepted". There is no contract if 'X' does not reply.

(vii) Lapse of an offer : An offer lapses

(i) If either offeror or offeree dies before acceptance.

(ii) If it is not accepted within the specified time or a reasonable time if no time is prescribed.

(iii) If the offeree does not make a valid acceptance.

(iv) If the offeror withdraws the offer before acceptance.

(viii) An invitation to an offer is not an offer : An invitation to an offer is not an offer, if there is no such intention on the part of person sending out the invitation to obtain the assent of the other party. Though such one is the offer, it is not the offer in the eye of law.

Example : Offer scheme in shops, display of goods in shop, ads in news paper.

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The above examples are offers, but not in the eye of law.

Form the above rules, it is concluded that, the offer must fulfil and satisfy the above rules to be known as a valid and lawful offer.

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**Acceptance**

When a person to whom the proposal is made signifies his assent it is an acceptance to the proposal. Acceptance is an expression by the offeree of his willingness to be bound by the terms of the offeror.

Example : 'A' offers to sell his house for Rs.50,000. 'B' accepts the offer to purchase the house.

Acceptance may be express or Implied. Acceptance may be to a particular offer or a general offer.

***Essentials of a valid acceptance :***

(i) Acceptance must be absolute and unconditional : An acceptance must be unconditional and unqualified, in respect of all terms of offer, whether material or immaterial, major, or minor, in order to be binding. Accepting with condition, reservations amount to counter offer and rejection of the original offer. The acceptor must comply with all the terms of offer. A variation or alteration, however, small of the offer, will make the acceptance invalid.

(ii) Acceptance must be communicated to the offeror : To conclude a contract between the parties the acceptance must be communicated in some perceptible form. If the offeree remains silent and does nothing to show that he has accepted the offer, no contract is formed. The accepter should do something to signify his intention to accept. A communication to any other person is ineffectual as if no communication is made.

Example : 'A' tells 'B' that he intends to marry 'C', but tells 'C' nothing of his intention. There is no contract even if 'C' is willing to marry 'A'.

(iii) It must be according to the mode prescribed : Acceptance must be made in the manner prescribed or indicated by the offeror. Section (2) states that if the acceptance is not made – in the manner prescribed, the proposer may within a reasonable time after the acceptance is communicated to him, insist that the acceptance must be made in the manner prescribed. If he doesnot inform the offeree, he is deemed to have accepted the acceptance.



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Example : 'A' makes an offer to 'B' and says, "If you accept the offer, reply by telegram". 'B' sends by telephone. It will be a valid acceptance unless 'A' informs 'B' that the acceptance is not according to t' ~ mode prescribed.

(iv) The acceptor must be aware of the proposal at the time of the offer : Acceptance follows offer. The acceptor must have a clear knowledger of the offer. If he has not and he conveys his acceptance, no contract comes into being.

(v) Acceptance must be given before the offer lapses or revoked ; The acceptance must be given when the offer is inforce or before the lapsation or the revocation of the offerer.

(vi) Acceptance cannot be implied from silence : Acceptance can't be implied from the silence of the offeree or his failure to answer.

(vii) Acceptance can't precede an offer : If the acceptance precedes an offer, it is not valid acceptance and doesn't result in a contract.

Example : In a company shares were alloted to a person who hadn't applied for them. Subsequently when he applied for shares, he may unaware of the previous allotment. The allotment of shares previous to the application is invalid.

(viii) Acceptance must be made within a reasonable time : If any time limit is specified, the acceptance must be given within that time. If no time limit is given, then it must be within a reasonable time. Acceptance may be made any time till the offer is alive.

Example : A person applied for shares in a company in June, can't be bound by allotment made in November.

## 1.5 CONSIDERATION

### Meaning and Definition

The term consideration means something that a person gives in an agreement to the other party in return for such other parties promise e.g. if A promises to sell his property to B, the price that B pays is his consideration for A's promise.

Section 2(d) of the Indian contract Act states that "when at the desire of the promisor, the promiseee or any other person has done or abstained, does it or abstains or promises to do or abstain from doing



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something, such act or abstinence or promise is known as consideration for promise.

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From the definition it follows that consideration may be either a positive act like doing something, paying money etc or it can be negative act like not doing something, not filing a suit etc.

Section (10) states that lawful consideration shall be an essential element of a valid contract.

**Elements :**

1. Consideration must be given at the desire of promisor : It means whatever the promisee gives as consideration must be a benefit done to a promisor for the sacrifice made by him. If any promisee gets something from the promisor and promises in return to perform his existing legal duties he gives no consideration.

   Leading case – Durga Prasad Vs. Baldeo.

2. Consideration must be real : Though consideration need not be adequate yet it must be real and not illusory. Thus a promise to do that which a person is by law bound to do, doesnot amount to consideration. Consideration has also to be competent. If it is physically impossible, vague and legally impossible the contract can't be enforced.

3. Consideration need not be adequate : Inadequacy of consideration will be taken into account only when there is a complaint of absence of free consent. Now even under English law it is necessary that consideration must be valuable i.e. it must be capable of being expressed in terms of money.

4. Consideration must be given by promisee : In England consideration must be given by the promisee only and by no other person. Hence if A agrees to sell his goods to B and B agrees to buy them, Every other person like C, D, X, y will be called as a stranger to contract and also stranger to consideration. Such a person gets no right, not own liabilities under the contract.

In India consideration is how ever can be given by promisee or any other person. The term stranger to consideration has a different meaning. When in a contract consideration is given by a person other than the promisee, the promisee is called stranger to consideration.

Leading case – Chinayya Vs. Ramayya (1882)



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5. Consideration must be present, past and future : Present or executed consideration is given with the promise i.e. as soon as the contract is made. Future or executory consideration is given after the promise i.e. after the contract is made between the parties. If goods are purchased on credit the buyer gives future consideration.

Past consideration is that which is given before the promise i.e. before the contract is made. In England past consideration is not valid but in India it is valid.

e.g.-A saves B's property from destructor by force. This is purely voluntary act and there is no agreement between the parties. If B later promises to give A a reward for his good work, B's promise becomes a new agreement in which such voluntary act will be regarded as past consideration.

### NO CONSIDERATION NO CONTRACT

Section (10) of Indian contract Act makes consideration as an essential element of a valid contract.

Section 25 adds that an agreement without consideration shall be void.

### EXCEPTIONS

But there are certain exceptions and they are as follows :

1. Natural love and affection – [sec.25(1)] : It means parties must stand in near relation to each other. If a person out of natural love and affection for the other party to the agreement, who is his near relative makes a promise and has the promise written and registered. Such promise shall be enforceable without consideration.

   Leading case – Raj Lakhi Vs. Bhootnath (1900)

e.g. – The husband promises a property to the wife in order to make an arrangement after they have more serious difference and quarrels. The court held that since there was no natural love and affection between the parties the agreement could not come under this sub-section and it was void for absence of consideration.

2. Compensation for any voluntary act – [sec. 25(2)] : A promise to compensate for any voluntary act shall be enforceable without any consideration. If A helps B in some manner then B promises

to pay some money in return to A. The agreement is valid. And A doesnot give any consideration for B's promise. This is because in India A's good work will be treated as past consideration for B's promise.

3. Promise to pay time-barred debt – [sec-25(3)] : If a debtor personally or by an agent promises in writing to pay a time barred debt to the creditor, it becomes a promise. The creditor is not prepared to give any fresh consideration for the debtor's promise. A debt becomes time barred debt if creditor fails to institute a suit against a debtor for the debt within a certain period that is allowed by the limitation Act, 1963. However the debtor in writing promises to pay the same amount to the creditor it becomes a new promise and the new promise doesnot require any new consideration.

4. Completed gift- [Example. 1 to sec.25] : It explains that a completed gift cannot be avoided on ground of absence of consideration. Therefore if A promises to make a gift to B, the promise is void because B gives no consideration for it. But if A has already given the promised article to B we cannot any longer take it back because B gives no consideration.

5. Agency – [sec-185] : No consideration is required to create any agency. In other words in an agency agreement the agent promises to work for the principal and the principal should give some consideration to the agent. But if the principal gives nothing for the agents work even then agreement is taken as valid.

## STRANGER TO CONTRACT

According to the rule of privity of contract the terms and conditions of the contract are only known to the parties to the contract, A stranger who is an outsider doesnot come inside the contract. Neither he can sue any one of the parties to the contract nor any one of the parties can sue him.

## EXCEPTIONS TO THE RULE

1. Trust or charge – When a trust is created for the benefit of the





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third party, the third party even though he is a stranger can sue any fo the defaulting party who fails to contribute towards the trust.

2. ›iage or family settlement – In case of any family dispute or any marriage dispute where it has been settled by a third party fixing the terms and conditions of settlement, any party to the settlement if fails to fulfill the terms and conditions the third party who is a stranger can file a sue against the defaulting party.

3. Assignment of contract – When a contract is transferred to an outside, the outsider comes inside the contract.

4. Contract through agents – The contract entered by the agent will be fulfilled by the principal who is a stranger to the contract.

## 1.6 QUASI CONTRACT

| | | |
|---|---|---|
| English law | - | quasi-contract |
| | - | Constructive contract. |
| Indian law | - | Certain relations resembling from contract. |

"Quasi contract is not a contract at all". It is an obligation which the law creates in absence of any agreement. When the acts of the parties or others have placed in the possession of one person, money or its equivalent, under such circumstances that inequity and good conscience he ought not retain it and which in justice and fairness belongs to another. The basis of quasi contract is that no man should grow rich out of another person's loss.

Section 68 to 72 of the contract Act describe two cases which are to be deemed Quasi – contract.

(i) Supply of necessaries : U/S 68

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

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

Points should be noted :

(a) The goods supplied must be necessaries.



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(b) It is only the properties of the incapable person that shall be liable.

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(ii) Payment by an interested person : U/S 69

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

The essential requirement of Sec.69 :

(a) The person making the payment is interested in the payment of money i.e., the payment was made bonafide, for the protection of his own interest.

(b) The payment should not be a voluntary one.

(c) The payment must be to another person.

(d) The payment must be one which the other party was bound by law to pay.

(iii) Obligation to pay for non-gratitous Act U/S 70

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

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

**Conditions satisfied**

(a) The things must be done lawfully.

(b) The intention must be to do it non-gratituously.

(c) The person for whom the act is done must enjoy the benefit of it.

(iv) Responsibility of finder of good :

Ordinarily speaking, a person is not bound to take care of goods belonging to another, left on a road or the public place by accident or inadvertence, but if he makes them into his custody, an agreement is implied by law. Although, there is infact no agreement between the owner and the finder of the goods, the finder is for certain purpose, deemed in law to be a bailee and must take as much care of the goods as a man of ordinary prudence would take of similar goods of his own. The



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obligation is imposed on the basis of Quasi-contract S-71, which deals with this subject says, "A person who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a bailee".

(v) Mistake/ Coercion : U/s 72

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

Example : 'A' and 'B' jointly owe Rs.1,000 to 'C'. A alone pays the amount to 'C' and 'B', not knowing this fact, pays Rs.1,000 over again to 'C'. 'C' is bound to repay the amount to 'B'. it must be noticed that the term 'mistake' as used in (S-72) includes not only a mistake of fact, but also a mistake of law.

## 1.7 INDEMNITY AND GUARANTEE

**Indemnity :**

Indemnity simply means to make good of loss or compensation. U/S-124 "When one person promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of any person, it is called indemnity". The person who makes good of loss is called indemnifier. The person, whose loss is made good is called indemnified or indemnity holder.

***Essential elements of indemnity :***

(i) It must contain all the essential elements of a valid contract.

(ii) There are two parties.

(iii) The loss may be caused by the conduct of the promisor or any other person.

(iv) The contract may be express or implied.

Example : 'A' and 'B' go into a shop. 'B' says to the shopkeeper, "Let him (A) have the goods, I will see you paid". The contract is one of indemnity.

**Claim of indemnity-holder or rights of indemnity-holder when sued :**

Section-125 deals with rights of indemnity – holder when sued. According to it, an indemnity-holder is entitled to recover from the indemnifier;

(i) All the damages which he may be compelled to pay under the contract on any suit.



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(ii) All cost which he may be compelled to pay in bringing or defending the suit.

(iii) All sums which he may have paid under the terms of any compromise on such suits.

All these equal to total loss.

**Guarantee :** U/S-126, "Guarantee is a contract to perform the promise or to discharge the liability of a third person in case of defaults".

***Parties :***

(i) The person to whom, guarantee is given- creditor.

(ii) The persons of whom, guarantee is given-principal debtor.

(iii) The person who gives guarantee is called surety.

***Liability :***

(i) Liability of principal debtor – primary.

(ii) Liability of surety-secondary.

***Emergence of guarantee :***

(i) Guarantee for repayment of debt.

(ii) Guarantee for performance of promise.

(iii) Guarantee for good conduct and honest i.e. fidelity guarantee, given against conduct and honest.

***Agreements : (Three agreements)***

(i) Principal debtor and surety

(ii) Surety and creditor

(iii) Principal debtor and creditor

***Elements of guarantee :***

(i) It satisfies all the essentials of a valid contract.

(ii) There must be at least three parties

(iii) It presupposes the existence of a liability enforceable at law.

(iv) It may be oral or written

(v) It is an undertaking to perform the promise of other on his failure to do so. There should be no misrepresentation.

Example : 'S' and 'P' go into a shop. 'S' says to the shopkeeper, 'C', 'Let 'P', have the goods and if he does not pay, I will". This is a contract of guarantee.

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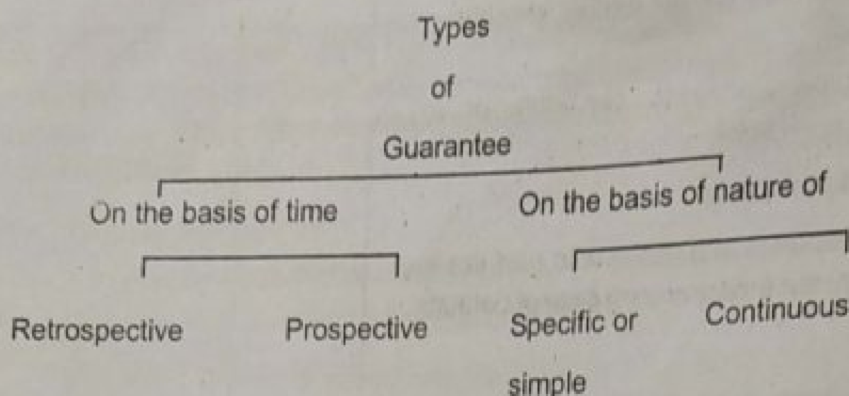


(i) Retrospective Guarantee : A guarantee given for an existing debt or obligation is called retrospective guarantee.

(ii) Prospective Guarantee : A guarantee given for future debt or obligation is called prospective guarantee.

(iii) Specific guarantee

- (a) Here guarantee is given for a single activity or transaction :
- (b) Once it is given, it is irrevocable.

(iv) Continuous guarantee :

- (a) It comprises several transactions.
- (b) It is not confined for a particular activity.
- (c) It is treated as a standing offer.

**Termination :**

(1) By notice of revocation by the surety : Section – 130 provides that where a guarantee is continuing it is open to the surety to terminate the same after due notice to the creditor in respect of any future transaction. In such a case the surety would not be responsible for future transactions which may be made by the principal debtor after the surety has revoked the contract of guarantee.

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

(2) By death of surety : According to section – 131, in the absence of a contract to the contrary, the death of surety operates as a revocation of a continuing guarantee for future transactions. But the liability of the surety for previous transactions however remains.



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(3) By novation :U/S-62 : When the parties agree to substitute a new contract for the old contract or rescind or alter the old contract of guarantee, it will amount to revocation.

(4) By variance of terms of contract : U/S – 133 : If any variation is made in the terms of the contract of guarantee between the creditor and principal debtor without knowledge or concurrence of the surety, the contract of guarantee is revoked.

(5) By release of discharge of principal debtor : U/S-134 : When the creditor discharge the principal debtor from the liability, the surety also get discharged.

(6) By creditor's act of omission : U/S – 139 : Any act of omission by the creditor which repairs the eventual remedy of the surety against the debtor amounts to revocation of contract of guarantee.

(7) By loss of security : U/S-141 : When a creditor losses security under the contract, the surety is discharged to the extent of value of that security.

| Basis | Indemnity | Guarantee |
|---|---|---|
| Parties | In contract of indemnity there are two parties. | In contract of guarantee there are three parties. |
| Nature of liability | In contract of indemnity the liability of indemnifier is primary. | In case of guarantee, the liability of surety is secondary and the liability of principal debtor is primary. |
| No. of contracts | Here there is only one contract. | Here there are three contracts. |
| Request | Indemnifier acts without any request. It is so moto. | Surety acts on the request of principal debtor. |
| Object | It is for reimbursement of loss. | It is for the security of the creditor for ensuring his payment. |
| Competent to contract | All the parties must be competent to contract | But if a minor is a principal debtor, the contract of guarantee is still valid. |
| Arising of liability | Here the liability arises on the happening of contingencies. | But the surety has a existing debt, the performance of which is guaranteed. |

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**Surety**

The person who gives guarantee is called surety. U/S-128, "the liability of the surety is co-extensive with that of the principal debtor, unless otherwise provided by the contract". The surety is liable for what the principal debtor is liable.

**Limitation of surety's liability**

The surety may limit his liability. There are two types of guarantee.

(i) Guarantee is only part of entire debt

(ii) Guarantee is for the entire debt subject to a limit.

Example : 'P' owes 'C' Rs.8,000 on a continuing guarantee given by 'S'. 'S' may have given this guarantee in either of the following two forms :

(a) I guarantee the payment of the debt of Rs.5,000 by 'P' to 'C'.

(iii) I guarantee the payment of any amount lent by 'C' to 'P' subject to a limit of Rs.5,000.

'P' becomes insolvent P's estate pay a dividend of 25 paisa in a rupee.

**In case – I :** 'C' will recover Rs.5,000 from S (i.e. full guaranteed amount) and Rs.750 (1/4th of the balance of Rs.3,000) from P's estate. S after making payment to 'C' will step into C's shoes and recover Rs. 1250 (being 1/4th of Rs.5,000) from P's estate.

**In case – II :** 'C' will recover Rs.5,000 from 'S' (i.e. upto the guaranteed limit) and Rs.2,000 (1/4 of the entire debt of Rs.8,000) from P's estate. He will, therefore, get Rs.7,000 in all. 'S' will not get any dividend from P's estate till the full amount of Rs.8,000 is Paid to 'C'.

Rights of surety

(a) Against creditor

(b) Against principal debtor

(c) Against co-surety

(d) Rights against creditor

(i) Before the payment of the guaranteed debt : A surety may, after the guaranteed debt has become due and before he is called upon to pay, required the creditor to sue the principal debtor.



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However, the surety will have to indemnify the creditor for any expenses or loss resulting thereof. In case of fidelity guarantee, the surety can ask the employer to dismiss the employee in the event of his proven dishonesty.

(ii) After the payment of guarantee- S-141 : The surety is subrogated to all the rights of the creditors and gets the right to demand from the creditor at due time of payment all the securities whether they have been received before, at or after, the creation of the guarantee. It is immaterial whether the surety has knowledge of those securities or not.

Example : On C's guarantee 'A' lent Rs.5,000 to 'B'. This debt is also secured by certain shares of a company. 'B' defaults in paying the debt and 'C' has to pay the debt. On paying off B's liability, 'C' is entitled to receive those shares from 'A'.

(iii) Right of subrogation – S-140 : Where a guaranteed debt has become due and the surety has paid all that he is liable for, he is invested with all the rights which the creditor had against the principal debtor. The surety steps into shoe of the creditor.

(iv) Right of "set-off" : On being sued by the creditor, the surety can rely on any set-off.

(b) Right against principal debtor :

(i) Right of indemnity : U/S-145

In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee. The surety can recover from the debtor not only the actual amount he has paid to the creditory but also interest thereon. The reason is that the surety is entitled to full indemnification.

Example : '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 he is compelled to pay the amount of debt with costs. He can recover from 'B' the amount paid by him for costs, as well as principal debt.

There are certain limitations as to what the surety can claim under this section :





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(i) He can't claim more than what he has actually paid to the creditor.

(ii) He can't claim amount which he paid due to his own negligence.

(iii) He can't claim amounts which he has paid wrongfully.

(ii) Right of subrogation – Section – 140 : Soon after making a payment and dischanging the liability of the principal debtor, the surety is clothed with all the right of the creditor which he can himself exercise against the principal debtor. This right of surety is called the right of subrogation. The surety steps into shoes of the creditor. The surety who pays off the debt is entitled to all the remedies which the creditor could have enforced not merely against the principal debtor but also against all person claiming under him.

Example : 'A' mortgages a house to 'B'. 'C' offers him self as a surety to 'B'. 'A' fails to pay. 'B' recovered the amount from 'C'. 'C' can get into the shoes of the creditor 'B' and enforce the mortgage itself against 'A'.

(c) Right against co-sureties : When a debt is guaranteed by two or more persons or sureties, they are called co-sureties. The co-sureties are liable to contribute, as agreed, towards the payment of guaranteed debt, when one of the sureties makes payment to the creditor, he has a right to claim contribution from other sureties. This doctrine of contribution applicable here is not found on contract but on equity i.e. there is equality of burden and benefit as between co-sureties. This rule is contained in section 146 and 147.

(i) Co-sureties liable to contribute equally : (U/S-146) where there are two or more co-sureties for the same debt or duty and the principal debtor makes a default, the co-sureties, in the absence of any contract to the contrary, are liable to contribute equally to the extent of the default.

Example : $S_1$, $S_2$, and $S_3$ are sureties to C for the sum of Rs.3,000 lent to P. P makes default in payment. $S_1$, $S_2$, and $S_3$ are liable between themselves to pay Rs.1,000 each.

(ii) Liability of co-sureties bound in different sums - U/S-147 : Where the co-sureties have agreed to guarantee different sums, they have to contribute equally subject to the maximum amount



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guaranteed by each one. As between co-sureties, the right of contribution arises only when a co-surety has paid more than he is liable to pay. And if a co-surety obtains from the creditor any security of the principal debtor, the other co-sureties have a right to share in proceeds of the security.

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Example : $S_1$, $S_2$, and $S_3$ as co-sureties for P, enter into three separate bonds each in different penalty, namely, $S_1$ in the penalty of Rs.10,000, $S_2$ in that of Rs.200,00 and $S_3$ in that of Rs.40,000, condition for P's duly accounting to 'C'. P makes default to the extent of (i)Rs.300,00 (ii) Rs.40,000 (iii)Rs.60,000.

**In case – I :** $S_1$, $S_2$, and $S_3$ are each liable to pay Rs.10,000.

**In case – II :** $S_1$, is liable to pay rs.10,000 and $S_2$, and $S_3$ are liable to pay Rs.15,000 each.

**In case – III** $S_1$, $S_2$, and $S_3$ are liable to pay Rs.10,000, Rs.20,000 and Rs.30,000 respectively.

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

**Discharge of surety**

A surety is said to be discharged when his liability comes to an end.

(i) By notice of revocation – U/S-130 : In case of continuing guarantee, a surety is discharged from liability when he gives due notice to the creditor in respect of any future transaction. In such a case the surety would not be responsible for the future transaction, but he will remain liable in respect of transactions already entered into.

(ii) By death of surety – U/S-131 : The death of the surety operates, in the absence of any contract to the contrary, as revocation of a continuing guarantee, so far as regards future transactions. The deceased surety's estate will not be liable for any transactions entered into between the creditor and principal debtor after the death of the surety, even if the creditor has no notice of his death. No effect on prior transaction.

(iii) By variance in the terms of the contract – U/S-133 : A surety is liable for what he has under taken in the contract. When the



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terms of the contract between the principal debtor and the creditor are varied without the surety's consent, the surety is discharged as to the transactions subsequent to the variance. But where the guarantee is for the performance of several distinct duties or obligations or for the payment of distinct debts, a variance in the nature of one of them will not discharge the surety as to the rest. When the guarantee is a subsequent one, any such variances will discharge the surety, as to the transaction subsequent to variance.

Example : 'A' becomes surety to 'C' for the payment of rent by 'B' under a lease. Afterwards, B and C contract, without A's consent that 'B' will pay rent at a higher rate. A is discharged from surety ship in respect of the arrears of rent accruing subsequent to such variance.

(iv) By release or discharge of principal debtor- U/S-134 : This section provides two kinds of discharges.

(a) if the creditor makes any contract with the principal debtor by which the latter is released, the surety is discharged. Release of the principal debtor is a release of the surety also. But if the principal debtor is discharged in insolvency this will not operate as a discharge of surety.

Example : 'A' contracts to build a house for 'B' and 'C' stands guarantee to 'B' for the due performance of the contract 'A'. There after if 'B' releases 'A' from the performance of the contract, the liability of surety 'C' shall come to an end.

(b) The surety is also discharged by any act or omission of the creditor, the legal consequence of which is the discharge of principal debtor.

Example : A contracts to build a house for 'B' on the condition that B will supply the necessary timber. C guarantees A's performance of the contract. B fails to supply the timber. It will discharge C as a surety.

(v) By arrangement of creditor with principal debtor – U/S-135 : This section provides three modes of discharge from liability.

(a) Composition with principal debtor.

(b) Promise to give time.

(c) Promise not to sue.



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(a) The liability of surety will be discharged where a creditor in composition with his principal debtor accepts a lesser amount in full satisfaction of the claim.

(b) A contract between the creditor and debtor by which the creditor promises to give time to principal debtor discharges the surety.

(c) When the creditor under an agreement with due principal debtor, promises not to sue him, the surety is discharged.

But in the following cases surety is not discharged

(a) Where a contract to give time to the principal debtor is made by the creditor with 3rd person, and not with the principal debtor, the surety is not discharged.

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

Example : Powes to C a debt guaranteed by S. The debt becomes payable. C does not sue P for a year after the debt has become payable. S is not discharged from his surety ship.

(c) Where there are co-sureties, a release by the creditor of one of them does not discharge the others, nor does it free the surety so released from his responsibility to other sureties.

(vi) By novation U/S-62 : Novation means substitution of a new contract of guarantee for an old one either between the same parties or between one of the old parties and a new party, the consideration for the new contract being the mutual discharge of the old contract. The original contract of guarantee in such a case comes to an end.

(vii) By loss of surety – U/S-141 : When the creditor losses or parts with the securities without the consent of the surety, the surety is discharged to the extent of value of securities.

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



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(viii) By misrepresentation – U/S-142 : Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material fact of the transaction, is invalid.

(ix) By concealment of fact- U/S-143 : Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Example : C engages P as a clerk to collect money for him. P fails to account for some of his receipts and C, in consequence, calls up on him to furnish security for his duly accounting. C does not acquaint S with P's previous conduct. P after wards makes default. The guarantee is invalid.

(x) By failure of co-sureties to join – U/S-144 : Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that person does not join.

Example : The defendant signed a guarantee which on the face of it was intended to be a joint and several guarantee of three persons with him. One of them did not sign. There being no agreement between the bank and the co-guarantors to dispense with his signatures the defendant was held not liable.

## 1.8 BAILMENT

The word 'Bailment' is derived from the French word "baillier" which it involves change of possession of goods from one person to another for some specific purpose. U/S-148 defines, the delivery of goods by one person to another person for some purpose, upon a contract, that they shall, when the purpose is accomplished, be returned or otherwise disposed off according to the direction of the person delivering them.

The person delivering the goods is called 'Bailor' and the person to whom they are delivered is called 'Bailee'.

Example : 'A' lends a book to 'B' to be returned after the examination. There is a contract of Bailment between 'A' and 'B'.

**Essentials/ Requisites of Bailment :**

(i) Contract : A bailment is usually created by agreement between the bailor and bailee, It may be express and implied.



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(ii) Delivery of goods : A bailment necessarily involves delivery of possession of goods by bailor to bailee. Mere custody without possession does not create bailment. Thus, a servant having custody of goods of his master, or a guest using goods of his host is not a bailee. Delivery of possession may be actual or constructive. Actual delivery is by physical handling Constructive delivery means something has been done which has effect of putting them in the possession of bailee. The delivery of railway receipt amounts to delivery of goods.

(iii) For some purpose : The delivery of goods from bailor to bailee must be for some purpose. If goods are delivered by mistake to a person there is no bailment.

1. Voluntary and involuntary bailment : Involuntary bailment is an outcome of an express contract between the parties. Voluntary bailment arises by the operation of law i.e. finder of goods.

2. Gratuitous and non-gratuitous bailment : In case of gratuitous bailment, consideration passes between bailor and bailee. For example : A lends a book to his friend B. In case of non-gratutious bailment consideration passes between bailor and bailee i.e. a motor car let out for hire.

3. According to the benefit derived :

   (a) Bailment for the exclusive benefit of the bailor-delivery of valuable to a neighbour.

   (b) Bailment for the exclusive benefit of the bailee-lending books of friend.

   (c) Bailment for mutual benefit – giving a watch for repair.

4. Movable goods : The bailment can only be of movable goods. Money is not included in movable goods.

5. Return of goods : It is agreed between the bailor and bailee that as soon the purpose is achieved, the goods shall be returned or disposed off according to the direction of the bailor. The goods may be returned either in original or altered form i.e. when a piece of cloth is given to a tailor for being stitched.

6. The transaction must be in between two persons.

**Rights of Bailee :**

(i) Enforcement of rights : The bailee can enforce his right against the bailor, by suing him, in case of default.



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(ii) Delivery of goods to one of the joint bailers –U/S-165 : if several joint owner of goods bail them, the bailee may deliver them back to, or according to the direction of, one joint owner, without the consent of all, in absence of any agreement to the contrary.

(iii) Right to claim damage – U/S – 150 : If the bailor has bailed without disclosing the defects in the goods, and the bailee has suffered some loss, the bailee has a right to sue the bailor for damage.

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

(iv) Right to claim reimbursement – U/S-158 : Unless otherwise agreed to, in case of gratuitous bailment, the bailee has right to recover from the bailor, all necessary expenses, which the bailee had incurred for achieving the purpose of bailment.

(v) Right to deliver the goods to the bailor even if his title is defective – U/S-166 : If the title of the bailor is defecive and the bailee, in good faith returns the goods to the abilor or delivers them according to the direction of the bailor, the bailee is not liable to the true owner in respect of such delivery.

(vi) Right of action against trespassers – U/S-180 : If a third person wrongfully deprives the bailee of the use or possession of the goods bailed to him, he has the right to bring an action against that party. The bailor also brings a suit in respect of the godos bailed.

(vii) Right to apply to court to stop delivery – U/S-167 ; If a person, other than the bailor, callings goods bailed, the bailee may apply to the court to stop the delivery of the goods to the bailor, and to decide to the title of the goods.

(viii) Enjoy the right of lien : Lien signifies the right of a person, who has possession of the goods, of another, to retain such possession until the debt due to him has been satisfied,

A lien may be (i) General lien.

(ii) Particular lien

(i) General lien : A general lien is a right to retain all the goods or



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any property of another until all the claims of the holder is satisfied. This is a right to retain the property of another for general balance of account. Section 171 refers to the general lien which bankers, factors, wharfingures, attorneys and policy brokers may claim on the goods bailed as security for the general balance of account. They retain the possession until their claims are fully satisfied.

(ii) Particular lien : A particular lien is a right of the bailee to retain the goods in his custody until he receives due remuneration for the services rendered in respect of them. U/S-170 of I.C.A. "where the bailee has in accordance with the purpose of bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the service he has rendered in respect of them.

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

Duties of Bailee :

(i) To take reasonable care of the goods bailed – U/S-151 : A bailee is under a duty to take as much care of the goods entrusted to him as a man of ordinary prudence would take of his own goods of similar bulk, quantities and value, bailee is not answerable for any act of God i.e. flood, fire, war etc. But he should take as much care as he can take for his own goods.

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

Example : A entered in a restaurant for dinning. His coat was taken by a waiter who hung it on a hood behind A. When A rose to leave, the coat was gone. Held, the proprietor of the restaurant was liable for the loss.

(ii) Not to make any unauthorized use of goods – U/S – 154 : Goods must be used by the bailee strictly for the purpose for which

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they have been bailed to him. An unauthorized use of goods would make the bailee absolute liable for any loss or damage in goods.

Example : X lends a horse to Y for his riding only. Y allows Z, a member of his family to ride the horse. Z rides the horse with care, but the horse accidentally falls and is injured. Y is liable to make compensation to X for the injury caused to the horse.

(iii) Not to mix the goods with own goods : If he mixes the bailor's goods with his own goods.

(a) With the consent of the bailors, both have to take proportionate share of their own. U/S-155.

(b) Without the bailors consent, and if the goods can be separated and divided, the cost of separation will be borne by the bailee. U/S-156.

(c) Without the bailor's consent, and the mixture is beyond separation, the bailor is compensated by the bailee for the loss of goods. U/S-157.

(iv) Not to set up any adverse title ; The bailee must hold the goods on behalf of and for the bailor. He can't deny the right of the bailor to bail the goods and receive them back. If he delivers the goods to another person, he has to prove that person has a better title.

(v) Return any accretion to the goods : In absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his direction any increase or profit which may have accrued from the goods bailed. U/S-163.

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

(vi) Return the goods : It is the duty of the bailee to return or deliver, according to the bailor's directions, the goods bailed, without demand, as soon as the time for which hey were bailed expired or the purpose for which they were bailed has been accomplished. U/S-160. If he fails to do so, he is responsible for the loss. U/S-160.



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### Right of Bailor :

(i) Enforcement of rights : The bailor can enforce by suit all the liabilities or duties of the bailee, as his rights. A bailor has the following rights against the bailee.

(ii) Right of termination – U/S-153 : The bailor can terminate the bailment if the bailee does, with regard to the goods bailed, any act which is inconsistent with the terms of bailment.

(iii) Right of goods lent gratuitously – U/S-159 : When the goods are lent gratuitously, the bailor can demand their return whenever he pleases even though he lends them for a specified time or purpose. But if the bailee suffered any loss exceeding the benefit actually derived by him from the use of goods because of premature return of goods, the bailor shall have to indemnify the bailee.

(iv) Compensation from a wrong doer – U/S-180 : if a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailor or bailee may bring a suit against the third person for such deprivation or injury.

### Duties of Bailor :

(i) Duty to disclose known fault – U/S-150 : It is the first and foremost duty of the bailor to disclose the known faults about the goods bailed to the bailee. If he does not make such disclosure, he is responsible for any damage caused.

Example : A lends a horse, which he knows to be vicious, to B. He doesnot disclose this fact. The horse runs away and B is thrown and is injured. A is responsible to B for damage sustained.

In case the goods are bailed for hire the duty of the bailor is still greater. He has to disclose the fault which is not known to him. But in case of gratuitous bailment, he is only responsible for non-disclose of known fact.

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

(ii) Duty to indemnify bailee – U/S-164 : A bailor is responsible to the bailee for any loss due to imperfect title in the goods bailed. As such the bailee has a right to be indemnified by the bailor.



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Example : A gives B's motorcycle to C for use. While riding B catches C and hands over to Police. C is entitled to recover all costs from A which he incurs to get out of the situation.

(iii) Duty to receive back the goods : The bailor is under duty to receive back the goods when they are returned by the bailee on the expiry of the term of bailment or on the fulfillment of the purpose of bailment.

(iv) Duty to bear extraordinary expenses – U/S-158 : When the bailment is gratuitous and the bailee is to receive no remuneration, the bailor shall pay all the necessary expenses incurred for the purpose of bailment.

Example : A lends his horse to B, a friend, for two days. The feeding charges are to be paid by B. But if the horse meets with an accident. A will have to repay B all medical expenses incurred by B.

(v) Duty to bear normal risks : It is the duty of the bailor to bear the risk of normal loss, deterioration and destruction of the things bailed if the bailee has taken reasonable care of the thing bailed.

(vi) To indemnify the bailee for loss in case of premature termination of gratuitous bailment – U/S-159 : Even though the gratuitous bailment can be terminated at any time, but if the bailee suffers from loss for such premature termination, the bailor shall indemnify the bailee.

Example : A lends an old discarded bicycle to B gratuitously for three months. B incurs Rs.120 on its repair. If A asks for the return of the bicycle after one month, he will have to compensate B for expenses incurred by B in excess of benefit derived by him.

## 1.9 PLEDGE

Pledge is a special kind of bailment. The bailment of goods as security for payment of a debt or performance of a promise is called "pledge". The bailor, in this case, called as 'pledgor' or 'pawnor' and the bailee is called as "Pledgee or Pawnee."

Example : A being in need of money, raises money from a money lender on the security of his furniture, the transaction is one of the pledge. The pledgee is bound to return the furniture on the satisfaction of debt.



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**Pledge by non-owners :**

The general rule is that it is the owners who can ordinarily create a valid pledge. This rule is based on the maxim that no man can pass a better title than he himself has. A pledge made by any other person is invalid. But section 178, 178-A and 179 provides the cases where a pledge of goods made by a person who is not the real owner is valid and binding.

(i) Pledge by mercantile agent : An agent is a connecting link between the principal and third party. Pledge by a mercantile agent, who is not authorized by the owner of the goods, will be valid if the following condition is fulfilled.

(d) The mercantile agent acts in the ordinary course of the business.

(e) The goods are in his possession.

(f) The buyer acts in good faith.

Example : A jewellery broker was entrusted with a diamond for sale. He pledged it for his own purpose. It was a valid pledge.

(ii) Pledge by seller or buyer in possession after sale : A seller who has got possession of goods even after sale can make a valid pledge provided the Pawnee acts in goods faith. U/S-30 of sale of goods Act-1930, "A seller left in possession of goods with the consent of the seller before sale, can create a valid pledge.

(iii) Pledge by co-owners in possession : When there are several joint owners of goods and goods are in the sole possession of one of the co-owners, such a co-owner may create a valid pledge of goods.

(iv) Pledge by a person having limited interest – U/S-179 : Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extend of that interest. A person having a lien over the goods or a finder of goods may pledge them to the extent of his interest.

Example : F finds a pen on a road and pledges it with P for Rs.20. P had however, incurred Rs.10 in getting the pen repaired. The owner can get the pen by paying Rs.10 to P.

(v) Pledge by the person under a voidable contract : Where a person obtains possession of goods under a voidable contract the pledge created by him is valid if the following conditions will be satisfied:

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(i) The contract hasn't been rescinded before the contract of pledge.

(ii) The Pawnee acts in good faith

(iii) The Pawnee has no notice of the Pawnor's defective title.

Examples : A gets an ornament by inducing the owner to sell it to him under influence. Before the contract is rescinded by the owner, he pawns it to B. B will get good title to the ornament provided he acted in good faith and was unaware of A's defective title.

**Rights of Pawnee :**

(i) Rights of retainer : The Pawnee has right to retain the goods till the payments are made (U/S-173). He can retain the goods for the following case.

(a) For the payment of the debt or performance of the promise.

(b) Interest on debt.

(c) For all necessary expenses incurred by him in respect of the possession or for the preservation of the pledged goods.

(ii) Right of particular lien : A Pawnee cannot retain the goods for any debt other than that for which the pledge was made. But in the absence of anything to the contrary he can retain the goods pledged for subsequent advances. (U/S-174)

(iii) Right for extraordinary expenses – U/S-175 : The Pawnee is entitled to receive from the Pawnor extraordinary expenses incurred by him for the preservation of the goods pledged. For such expenses he has no right to retain the goods, he can only sue to recover them.

(iv) Right in case of default of the Pawnar – U/S-176 : Where a Pawnar makes default in the payment of the debt or performance of the promise, at the stipulated time, section-176 provides following rights to the Pawnee :

(a) He may bring a suit against the Pawnor upon the debt or pomise and may retain the goods pledged as a collateral security.

(b) He may sell the property pledged after giving a reasonable notice of the sale.

(c) He can recover from the Pawnor any deficiency arising on the sale of goods by him. But he shall have to hand over the surplus if any realized on the sale of goods to the Pawnor.



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(v) Right against the owner – U/S-178-A : When the Pawnor has obtained possession of the goods pledged by him under a voidable contract, but the contract has not been rescinded at the time of the pledge, the Pawnee acquires a good title to the goods provided he acts in good faith and without notice of the Pawnor's defect of title.

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**Rights of Pawnor :**

(i) Right to get back the goods : The pownor has a right to claim back the security pledged on repayment of the debt with interest and other charges.

(ii) Preservation and maintenance of goods : If any loss is caused to the goods because of mishandling or negligence on the part of the pledgee or Pawnee, the pawnor has the right to claim the same.

## 1.10 SELF-ASSESSMENT QUESTIONS

1. Explain the essential elements of contract.
2. How contracts are classified.
3. Describe the legal rules regarding offer.
4. Explain the legal rules regarding acceptance.
5. "No consideration no contract". State its exceptions.
6. Explain the rights of surety.
7. How surety is discharged.
8. Write share notes on
   - (a) indemnity
   - (b) Guarantee
   - (c) Special contract,
   - (d) Continuing Guarantee.
9. Explain the rights and duties of Bailor.
10. Explain the rights and duties of Bailee.
11. Describe the rights and duties of pawner and Pawnee.

## 1.11 FURTHER READINGS

Kapoor N.D. – Elements of mercantile law (S.Chand)

Mahasweri S.N. – Business law.

Mitra and Sen – Commercial law

Garg and Chowla – Business regulatory frame work - Kalyani



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# UNIT – III SALE OF GOODS ACT

## OBJECTIVE OF THE STUDY

- ➢ ··oduction
- ➢ Contract of sale
- ➢ Sale and agreement to sale
- ➢ Conditions
- ➢ Warranties
- ➢ Transfer of ownership
- ➢ Performance of the contract
- ➢ Rights of Unpaid seller
- ➢ Key points to remember
- ➢ Questions

### An Introduction to sale of Goods Act 1930

Sale of Good Act 1930 deals with the law relating to sale of goods in India. Here the term 'goods' means every movable property, other than money and actionable claims. Before the sale of Goods Act 1930, the law relating to sale of goods was covered under the chapter VII of Indian contract Act, 1872, the provision of which were found to be inadequate. To overcome those difficulties a strong and independent goods act is required and it will give birth to the Sale of Goods Act 1930. Presently this Act has 66 sections and extends to whole of India except the state of Jammu and Kashmir with effect from 1st July, 1930.

### The Contract of Sale

Section 4(i) of the Sale of Good Act defines a contract of sale as, 'A contract where by the seller transfers or agrees to transfer the property in goods to the buyer for a price.

A contract of sale consists of the following -

(i) Sale

(ii) Agreement to sale or conditional sale

(i) Sale or Absolute Sale

When the property or ownership in the goods is immediately



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transferred from the seller to the buyer and nothing is left on the part of the seller there is a sale or absolute sale.

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(ii) Agreement to sale or conditional sale

When the transfer of ownership in the goods take place in future or on the fulfillment of certain conditions, it shall be an agreement to sell or conditional sale.

## ESSENTIALS OF A CONTRACT OF SALE

To constitute a valid contract of sale, the following essentials must be present.

(1) ***A valid contract –***

A contract of sale must have all the essentials of a valid contract like offer, valid acceptance, free consent, competence of parties, consideration etc.

(2) ***Bilateral contract –***

There must be two distinct parties : the seller and the buyer and in the contract the property in goods has to pass from one party to another as a person can't buy his own goods

Example – A club supplies food and drinks to its member at fixed price. This was held to be not a sale as a member of the club pays to the members jointly (i.e. to the club) "members of a club are undivided joint owners and not part owners". [Graft V. Evans (1882)]

(3) ***Agreement for the transfer of ownership –***

To constitute a valid contract of sale there should be the transfer of ownership in goods from one party to another. A mere transfer of possession is not sale, it has to transfer ownership.

(4) ***Goods –***

The subject matter of the contract of sale must be the 'goods', Goods means every kind of movable property including stock and shares, growing crops, grass or things attached to land but agreed to be served from land before sale which can be transferred from one person to another. Immovable property can't be the subject matter of a contract of sale.



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(5) *Price –*

To constitute a valid contract of sale, considerations for transfer must be money paid or promised. Where goods are exchanged goods, it is barter not sale. However there is nothing to prevent the consideration from being partly on money and partly in goods or some other articles of value.

**Sale and agreement to sell**

Sec – 4(3) of sales of goods act 1930 clearly states that where in contract of sale the property in goods is transferred from the seller to buyer, the contract is called as sale, but where the transfer of property in goods is to take place at a future time or subject to some condition there after to be fulfilled, the contract is called an agreement to sell :

i.e. when the transfer of property takes place immediately it is a sale. But where the transfer of property is to take place at a future date or subject to fulfillment of some conditions the contract is called an agreement to sell. An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled.

**Example**

(a) A agrees to sell a T.V. to B on 1st December for Rs.1,000. B agrees to pay to price after one week. It is a sale.

(b) X on 3rd November agrees to sell a scooter to Y for Rs.3,000 after one week. Y agrees to pay for it on delivery. It is an agreement to sell.

An agreement to sell becomes a sale after the fulfillment of the conditions. It may be fulfilled by the buyer or the seller subject to which the property of goods is transferred.

Distinction between sale and agreement to sell

| | | Sale | Agreement to sell |
|---|---|---|---|
| 1. | Transfer of property | Transfer of property from seller to buyer takes place immediately. | Transfer of property is to take place at a future time or subject to the fulfillment of certain condition. |



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| | | | |
|---|---|---|---|
| 2. | Nature of contract performed | It is an executed contract, one which is immediately performed. | It is an executory contract which is to be in future. |
| 3. | Risk of loss | The buyer is responsible for any loss of destruction of goods even if the goods are in possession of the seller. | The seller is responsible for any loss or damage of goods, even if the goods are in possession of the buyer. |
| 4. | Consequence of the breach | If the buyer fails to take the goods, the seller may sue for price, even though the goods are still in his possession. | If the buyer fails to pay for accepted goods, the seller can only sue for damages, and not for payment of the price. |
| 5. | Breach by the seller. | In this case if the seller commits a breach, the buyer has not only a personal remedy against the seller, but also the remedies which an owner has in respect of goods such as a suit for conversion etc. | If the seller commits a breach, the buyer has only a personal remedy against the seller. |
| 6. | Insolvency of the buyer. | In this case, in the absence of a lien over the goods, the seller must deliver the goods to the official receiver or assignee of the buyer. | In this case the seller may refuse to deliver the goods to the official receiver. |
| 7. | Insolvency of the seller. | In case of sale, if the seller becomes insolvent the official receiver or assignee of the seller has to give goods to the buyer. Because buyer is the owner of the goods. | In an agreement to sell, if the buyer has already paid the price and the seller becomes insolvent, the buyer can claim only a rateable dividend and not the goods. |

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| 8. | Right of resale | The seller can't resale the goods even if he is in possession of the goods after sale. If he does so the new buyer doesn't get a good title & the first buyer can recover the goods. from him. | The seller may deal with the goods as the ownership is within. If he does so, he may become liable for breach of agreement and the original buyer can claim damages Buyer gets good title. |
|---|---|---|---|

**Sale and bailment**

Bailment is the delivery of goods by one person to another for some purpose upon a condition that they shall when the purpose is accomplished, returned to the person delivering them.

In case of sale, the property in goods is transferred from the seller to the buyer for a price.

**Sale and gift**

Where the goods are transferred by one person to another person without any price or consideration the transaction is called a gift. Sale is always for a consideration.

**Sale and hire purchase**

A hire-purchase agreement is an agreement under which the owner delivers his goods on hire basis to a buyer for his use. The buyer has the option to purchase the goods by paying the agreed amount in specified installments. A hire-purchase agreement gives the hirer the possession of goods only.

Where the hirer agrees to buy the goods though the price is to be paid by installments he not merely acquires an option to purchase them in future, then the contract is a contract of sale and not a contract of hire purchases.

**Sale and Contract for work and labour**

A contract of sale involves the delivery of goods whereas a contract for work and materials involves exercise of skill and labour by one party in respect of material supplied by another, the delivery of goods being subsidiary or incidental to the contract. To distinguish the



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sale and contract for work and labour is that if as a result of the contract property in an article is transferred to one who had no property therein, previously for a money consideration it is sale. Where the substance of the contract is the exercise of skill or labour, it is a contract for work and labour.

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**Mode and forms of contract of sale**

Sec-5 provides the formalities of the contract of sale as under :

A contract of sale is made by : an offer to sell or buy goods and acceptance of such offer.

(a) It may provide for delivery of goods immediately, simultaneously with payment of price, by installments or in future.

(b) It may provide for payment of price immediately simultaneously with delivery of goods by installments or in future.

Mode – The contract of sale may be express or implied i.e. it can be.

(i) In writing

(ii) By word of mouth

(iii) Partly in writing and partly oral

(iv) May be implied from the conduct of the parties or by the course of their business.

**Goods the subject matter of contract of sale**

The subject matter of the contract of sale must be 'goods' Sec-6 of the sale of Goods Act defines goods as every kind of movable property other than actionable claims and money, and includes stock and shares, growing crops, grass and things attached to or forming part of land which are agreed to be severed before sale or under the contract of sale.

**Classification of Goods**

The goods forming the subject matter of a contrast of sale may be divided into three types namely.



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

1) *Existing goods* – These are the goods which are in existence at the time of making the contract of sale with the seller. Existing goods can be further classified as under.

   (a) Specific goods. Good which are identified and separated from other goods at the time of contract of sale is made is called as specific goods. E.g. if A agrees to sell his horse to B, it is a sale of specific goods.

   (b) Ascertained goods. The goods which are ascertained or identified only after the formation of the contract of sale are known as ascertained goods. It can be misunderstood with specific goods. But the only difference is that it is identified after the formation of the contract of sale. The buyer is to select the goods. Keeping in mind the defective pieces only.

**Example**

If there is going to sell 25 chairs out of a lot of 100 chairs of same design and quality the goods are unascertained till 25 particular chairs are selected of good quality and no defect. When 25 chairs are selected out of the lots, the goods are said ascertained goods.

(iii) Unascertained goods

The goods which are not identified or ascertained at the time of sale are known as unascertained goods. When the buyer does not select the goods for the lots of goods, but are defined only by description these are unascertained goods e.g. If A has 100 chairs and he wants to sell 20 out of 100. It is unascertained goods as the 20 specific chairs are not separated.

2) *Future good.*- These are goods which are to be manufactured or acquired or produced by the seller after making the contract of sale. There can't be a sale of future goods but act as an agreement to sale. Because the ownership can't be transferred till the goods are not produced e.g. P agrees to sell to Q all the apples that will produce in his garden next year. This is an agreement for the sale of future goods.



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3) *Contingent goods* - These are type of future goods, the acquisition of which by the seller depends upon a contingency which may or may not happen. Such a contract is enforceable only when the event on happening of which the performance of the contract depends has happened. The non-happening of the event makes the contract void.

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**Example**

X agrees to sell Y a horse provided he can purchase it from its owner.

**Effect of destruction of subject matter (goods)**

Sec – 7 and 8 lay down the rules applicable to cases when the goods of a sale is destroyed before and after the contract.

(1) **Goods perishing before making of contract :**

Where in a contract of sale of specific goods, the goods without the knowledge of seller have perished or become so damaged as no longer to answer to their description in the contract at the time of making the contract, it is void.

**Example**

A agrees to sell to B, a specific cargo supposed to be or its way from England to Bombay. It turns out that, before the day of the bargain the ship carrying the cargo has been cast away and the goods lost. Neither party was aware of the facts. The agreement is void.

The contract is void under the following conditions.

(a) The goods must be specific goods and the contract of sale should be of specific goods.

(b) Goods must have perished before the contract is made and the seller should have knowledge about it.

If the seller was aware of the destruction and still entered into the contact he is stopped from disputing the contract. In that case he must either make his contract good or pay compensation for breach, except where the buyer also knows that the goods have perished. Here the term 'perished goods' is not described in this Act. It does not mean only the physically loss of goods but the goods which lose their



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commercial value like sugar is converted to subject and cement had lost due to moisture in it. Goods perishing after agreement to sell sec – 8 deals with the effect of perishing the goods before sale but after agreement to sell.

An agreement to sell specific goods becomes void if subsequently the goods without the fault of any party have perished or become so damaged as no longer to answer their description in agreement before the risk passes to the buyer.

However the contract can be avoided on this basis only when the following conditions are satisfied.

(a) the contract must be an agreement to sell

(b) The loss should relate to specific goods.

(c) The goods must have perished or damaged before the property or risk passes to buyer.

(d) The perishing or damage to goods must not be due to fault on the part of buyer or seller.

It is applied only to the sale of specific goods. If the sale is of unascertained goods, the perishing of the whole quality of such goods in the possession of the seller, will not relieve him of his obligation to deliver.

**Example : 1**

C agreed to sell to H 200 tons of potatoes to be grown on the land belonging to C. C sowed sufficient land to grow more than 200 tonnes, but without his fault, a disease attacked the crop, and he was able to deliver only 8 tones. The agreement was held to have become void.

[Howel Vs Coupland (1816 – IQBD 258)]

**Example – 2**

A agrees to sell to B 15 chairs out of 100 chairs in his shop. The shop had, at the time of contract, been destroyed by fire unknown to A. Here the contact is void and A must procure 15 chairs from elsewhere or pay damages for breach.



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## The Price

The term 'price' is defined by see – 2 (10) of sales of Goods Act as "price means the money consideration for a sale of goods". Price is the most essential element for sale. No valid sale can takes place without price. Price may be money actually paid or promised to pay depending upon whether the agreement is for cash or credit sales.

**Modes of fixing the price :**

Section 9 provides the following modes of the determination of the price :

(1) Price may be fixed by the contract. The price in a contract of sale may be fixed by the contract itself. The parties are free to fix any price for it and the court will not interfere on it.

(2) Price may be fixed in the manner provided in the contact of sale. The contract itself may provide the manner in which the price is to be fixed. The buyer may pay the price as others or it would be fixed by a third person appointed by the consent of both parties.

(3) The price may be determined by the course of dealing between the parties – A practice to deduct discount in determining the price may be implied from a course of dealing Similarly a usage to pay the price at the rate prevailing in the market on the date of delivery may be implied from the course of dealings.

(4) Reasonable price – reasonable price is a question of fact depending upon the circumstances. On this provision the buyer shall pay the seller a reasonable price.

(5) Price fixation by third parties – with the consent of both the parties the price of the goods is fixed by the third party. If such third party fails to make valuation, the contract becomes void. If one party may wrongfully prevents the valuation from taking place, the party not in fault may claim damages from other party. Mode of payment of price : By common consent or in accordance with an established course of dealing, the seller may accept the payment (a) by a cheque or draft, (b) by a bank guarantee (c) by a letter of credit (d) by any other mode.

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## CONDITION AND WARRANTIES

When there is negotiation for making a contract of sale, parties exchange many statements regarding the goods. All the statements said during this stage may not be a part of the contract. Some of them constitute the hardcore of the contract the terms of the contract which form a part of the contract may be either conditions or warranties. It has legal consequences.

### Condition and warranties [sec-12(i)]

A stipulation in a contract of sale with reference to goods which are subject matter there of, may be a condition or a warranty.

All stipulations in a contract of sale are not of equal importance. Some of them are essential to the main purpose of the contract which are called 'condition's and some are collateral to the main purpose of the contract which are called 'warranties'

### 1. Conditions [Sec.12(2)

"A condition is a stipulation essential to the main purpose of the contract breach of which gives rise to a right to treat the contract as repudiated".

*Essentials of a condition –*

(1) It is essential to the main purpose of the contract.

(2) The non fulfillment of condition causes irreparable damage to the injured party which would defeat the very purpose for which the contract is made.

(3) The breach of a condition gives a right to the aggrieved party to rescind the contract and recover the damages for breach of condition.

### 2. Warranties [Sec -12(3)]

A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim of damages but not to a right to reject the goods and treat the contract as repudiated.

**Essentials of a warranty**

(1) It is collateral to the main purpose of the contract



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(2) The breach of warranty causes damage to the aggrieved party and doesn't defeat the main purpose of the contract.

(3) The aggrieved party can only claim the damages for breach of warranty but can repudiate the contract.

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Thus a condition in contract of sale is a stipulation of fundamental nature the breach of which gives the opposite party a right to treat the contract repudiated. Buyer can also claim the refund of the price. However a warranty is subsidiary to main purpose of the contract. The breach of warranty only gives rise to a right to claim damages for any loss which may rise.

**Illustrations –**

(a) Suppose A at the time of selling his lorry to B tells him that it is capable of making a speed of 40 miles per hour. Subsequently, if it turns out after B has purchased the lorry that it can keep up hardly 25 miles per hour, the breach to the representation by the seller amounts to a breach of warranty. But where B tells A that he wants to buy a lorry which is capable of making a speed of 40 miles per hour, B can repudiate the contract, return the lorry to A and get back the price.

*Example of the concept of warranty*

H bought two small ships from K relying upon the particulars furnished by K that the capacity of each ship was 460 tons. Actually the capacity was 360 tons only. H wanted to reject the ships. It was held that the representation of capacity was a warranty for which H could only sue for damages.

So a stipulation in a contract is a condition or a warranty depends in each case the construction of the contract. No special word is necessary for it, a stipulation may be a condition though called a warranty in the contract.

**Example**

(a) X sold certain balls of cotton to Y to be paid for on delivery. Y failed to pay for the goods after part delivery. X stopped further delivery. It was held that delivery was subject to the condition of payment and the condition being broken, X was entitled to bring an action for the recovery of goods.



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(b) There was contract for sale of goods. Delivery was to be given in October. Owing to a strike in the port of loading the goods were not shipped until November. It was held that the buyer could refuse to take delivery of goods.

[J.Aron & Co. C. Comptoir Wegimont (1921) 3 K.B. 435]

| | | Condition | Warranty |
|---|---|---|---|
| 1. | Relation to the main purpose | It is essential to the main purpose of the contract. | It is a stipulation which is collateral to the main purpose of the contract. |
| 2. | Importance | It has vital importance for completion of the contract. | It has no vital importance |
| 3. | Consequences of breach | Breach of condition gives the buyer a right to put an end to the contract and claim damage for the loss suffered. | Breach of warranty gives the buyer a right to claim damage only from the seller. |
| 4. | Treatment | A breach of condition can be treated as a breach of warranty as an option on the part of the aggrieved party. | A breach of warranty can never be treated as breach of condition. |

**When condition to be treated as warranty**

A buyer can treat the breach of condition as a breach of warranty under Sec-13(1) of the Act in the following circumstances :

(1) Voluntary Waiver – In a contract of sale, although on a breach of condition by a seller, the buyer has a right to treat the contract as repudiated and he can reject the goods, but he is not bound to do so. Instead he can elect to waive the condition i.e. to treat the breach of condition as breach of warranty and accept the goods and sue the seller for damages for breach of warranty.

**Example**

X agrees to sell Y, 100 bags of particular quality of basmati rice @ Rs.4500 per bag. But he supplied second quality Basmati rice @



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Rs.3500 per bag. It is breach of condition and he can refuse to accept the delivery by rejecting the goods. But if the buyer elects to treat the breach of condition as breach of warranty, he can accept the second quality basmati rice and claim the damages @ Rs.1000 per bag.

(2) Treating the breach of condition as breach of warranty.

When a contract of sale is subject to any condition to be fulfilled by the seller and the seller commits a breach of the condition, the buyer can treat the condition as repudiated and refuse to accept the goods. But he is not bound to do this and may accept the goods by treating the conditions as warranty. He may sue the seller for damages.

(3) Acceptance of goods by buyer

When a contract of sale is of non severable nature and the buyer has accepted the goods or part thereof, the breach of any condition by the seller can only be treated as a breach of warranty. Here the buyer would be deprived of his right of rejecting the goods and treating the contract as repudiated, unless there is a term in the contract express or implied to that effect.

Where the contract is divisible and buyer has accepted a part of it, he can result the goods which is not law full in case of an invisible contract.

Express and implied conditions and warranties

The condition and warranties which are agreed upon between the parties in express words either spoken or written are called express conditions and warranties.

Implied condition and warranties are those which are implied by the operation of the law. The condition and warranties mayn't form a part of contract of sale at the time of contract between parties but comes into existence by operation of law.

**Example**

There was a sale of pigs with all faults in a market. The pigs were suffering from typhoid fever and infected other pigs belonging to the buyer and caused him heavy loss. It was held that as it was expressly agreed that the seller was giving no warranty, the buyer was left without any remedy.



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**Implied condition**

The implied conditions laid down under the Act are as follows :

*(i) Condition as to title (Sec. 14)*

In presence of contrary intention, there is an implied condition on the part of the seller that he has the right to sell in case of sale and in case of agreement to sell, he will have the right to sell the goods of the time when the property is to pass. This is called "condition as to title". Where the seller has no right to sale and buyer has to return the goods, he can recover the price from the seller.

The law states that the seller has the right to sell. If it was found that the sellers title is defective the buyer can result the goods as in sale the transfer of ownership occurs from seller to buyer. It will happen in two cases (i) seller must be the owner of goods sold. (ii) seller may be the owner yet due to certain reason he mayn't have right to sell".

**Example**

Rowland Vs. Divall (1923)

Point decided is : there is no sale when seller has no right to sell R brought a motor car from D and used it for four months. Then it was seized by the police as it was a stolen one. Here D had broken the condition as to title and R can recover the amount from D.

The expression right to sell 'in this section doesn't only mean the right to give ownership, but also a right to sell the thing as it was. Accordingly a sale which would be a breach of patent, copyright or trade mark may be repudiated by the buyer.

**Example :**

In Niblets Vs confectioners materials co (1921)

**Point decided is :**

Right to sell means not mere possession soon of defect free title to goods. It also means that the seller should not infringe on the trade mark of other seller.

**Example**

C sold to N 3000 tins of condensed milk. On their arrival in London from U.S.A., it was found that 1000 tins were labeled with the brand



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which another manufacturer of condensed milk claimed that it was an infringement of their trademark. As a result N had to remove all the labels in order to obtain the goods from custom authorities. After that the goods were sold at a reduced price and the buyer claimed damages. It was held that the seller had broken the implied condition that they had the right to sell the goods.

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### 2) Sale by description (Sec.-15)

It was stated that where there is a sale of goods by description, there is implied condition that the goods shall correspond with description. The purchaser has not seen the goods but rely on the description alone. In a sale by description one sells a described thing. And a buyer is not bound to accept and pay for goods which are not in accordance with the description of the goods he bargained for. If it happens the buyer can reject the goods and claim the refund of the price for it. The word 'description' means anything said as to quality, fitness, brand, place of origin, mode of packaging etc. The condition as to description must be strictly fulfilled. It includes many situations. First is where the buyer never sent the goods and buys it on the description given by the seller.

**Example**

A sold to B a car which B had never seen describing a new one. But on delivery B found that the car is unused one. He can return the car and claim the damage.

Secondly where the buyer has seen the goods, it may be a sale by description if he relies not on what he has seen but what was stated to him.

**Example**

There was an auction sale of a set of napkins and table cloths described as 'dating from the seventeenth century. X who was a dealer in antiques saw the set and purchased it. He subsequently found it to be an eighteenth century set. It was held that X could reject it [Nicholson and Venn Vs. Smith Marrit (1947) 177 LT 189]

Thirdly packaging of goods also form a part of description.

**Example**

Dagreed to sell to P apples in boxes containing 100 apples in one box. But D supplied boxes containing 95 apples. Here occurs breach of condition as to description and P rejects the goods.



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### 3) Sale by sample as well as by description (Sec-15)

If the sale is by description as well as sample, It is not sufficient that the bulk of the goods corresponds with the sample. If the goods do ... respond with the description. i.e there is an implied condition that the goods shall correspond both with the sample as well as with the description.

**Example**

N agreed to sell to a some parcels of "foreign refined rape oil, warranted only equal to sample". N delivered equal to the quality of samples but which was not foreign refined rape oil. It was held that G could refuse to accept it.

[Nichol Vs. Godts (1854) 10 Example 191]

### 4. Condition as to sample (Sec-17)

"A condition of sale is a contract of sale by sample where there is a term in the contract, express or implied to that effect. When a sample is shown it means that the goods should be of the kind and quality as the sample is. In case of a contract for sale by sample there is an implied condition that –

(a) The bulk shall correspond with the sample in quality.

(b) The buyer shall have a reasonable opportunity of comparing the bulk with the sample.

(c) The goods shall be free from any defect which render them un-merchantable, after examination.

**Example**

(a) A agrees to sell by sample two parcels of wheat to B, one containing 700 bags and the other 1400. The buyer was allowed to inspect the smaller parcel but was refused to inspect the larger one. It was held that the buyer is entitled to refuse to take any of the wheat.

(b) A ordered B to supply worsted coating which were to be in quality and weight equal to samples previously shown. As purpose was to sell the cloth to clothiers and tailors. The coating supplied agreed with the sample but was not discoverable by due diligence



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upon sale of cloths. It was held that the defect makes the goods un-merchantable. [Drummond and sons Vs. van Inyen (1887) 12 App. (as 284).

5) **Condition as to quality and fitness**

There is no implied condition as to the quality and fitness for any goods supplied under a contract of sale under this Act. But the buyer can expressly or impliedly makes known to the seller the particular purpose for which the goods are required and seller has to supply that goods which are fit for the particular purpose.

The implied condition as to quality or fitness will operate if the following conditions are satisfied-

(a) The buyer requires the goods for a particular purpose.

(b) The buyer makes known to the seller that particular purpose.

(c) The buyer relies on the seller's skill or judgement.

(d) The seller is to sell the goods whether he is the actual producer or not.

Where it was found that the article is not for the purpose and turn out to unsuitable when used, in this case the condition is broken. But where an article is suitable for a number of purposes, the buyer must notify the specific purpose in his mind and if this is not shown, the buyer will have no remedy merely because it is unfit for that purpose.

**Example**

(a) P, a doctor purchased from a retailer two woolen under parts manufactured by D. Next day after wearing one of them he became ill. His illness was caused by a chemical irritant which was negligently omitted to remove in the process of manufacture. It was held that the implied condition of fitness for the buyer's purpose was broken. [Grant Vs. Australian Khitting 1936)

(b) A sold a refrigerator to B. It performed all other acts which a refrigerator usually does but failed to make ice. It was held that this tends to a breach of implied condition.

(c) 'P' purchased a hot water bottle from a chemist 'L'. P said the chemist if it can withstand boiling water. Chemist told him that the bottle was meant to hold hot water. When the bottle was being

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used by P's wife it burst and injured her. It was held that P could claim damages from L because the purpose was clear from the nature of goods.

6) Condition as to merchantability

There is always an implied condition in a contract of sale that the goods purchased should be of a merchantable quality. For this two requirements must be fulfilled.

(a) The goods should be brought by description

(b) The seller should be a dealer in goods of that description.

The merchantable quality means that the article is of such quality that a reasonable man, acting reasonably would accept it under the circumstances of the case whether uses it for his own or to sell again.

Goods may be un-merchantable under the following circumstances –

(a) Where they infringe a trade mark,

(b) The use of them is dangerous or injurious in a way not to be expected from goods of that kind or

(c) They are unfit for use.

**Example**

(a) M purchased a bottle of stone's Ginger wine. When he was opening the bottle the neck of the bottle broke off and M's hand was injured. It was held that there was breach of condition as to merchantable quality and M was entitled to damages. [More Vs. Fitch and Gibbons (1928) 2 KB 636]

(b) A purchased finned Salmon from D's bakery. The Salmon was poisonous and A and his wife who ate it felt ill. His wife died from the poison. A filled a suit for damages. It was held that A was entitled to get damage because the condition of wholesomeness was violated by the seller.

**Implied warranties**

The implied warranties in a contract of sale is as follows –



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### (1) *Warranty as to quiet possession*

Sec-14(6) provides that there is an implied warranty that the buyer shall have and enjoy quiet possession of goods. "It is an implied assurance to the buyer that he shall have the possession and enjoyment of the goods sold to him without disturbance by the seller or any other person. If there is breach of the warranty, the buyer is entitled to hold the seller liable for breach of this warranty.

**Example**

R purchased a motor car from D. The car turned out to be a stolen one and R had to restore it to the true owner. R was held entitled to recover the whole of the price paid in spite of the fact that he had used the car for some months. [Rowland Vs Divall(1923) 2 RB 500].

### (2) *Warranty as to freedom from encumbrances Sec.14(c).*

There is an implied warranty on the part of the seller that the goods are free from any charge or encumbrance. A breach of this warranty will occur when the buyer discharges the amount of encumbrances. If the goods are found to be subject to a charge in favour of a third party the seller is liable to the buyer to pay damages. This warranty is not applied if the charge or encumbrances over the goods is made known to the buyer when the contract is made or he has notice of them.

**Example**

A pledged some goods with 'B'. Later on A took the goods back from B under some pretense and sold them to C. Goods being subject to an encumbrance, there was a breach of warranty. The buyer could recover compensation if his possession was disturbed.

### (3) *Warranty to disclose dangerous nature of goods*

If the goods are inherently dangerous or likely to be dangerous and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If the seller fails to do so the buyer is entitled to claim from him compensation for any injury suffered by him (buyer).

**Example**

C purchased a packet of disinfectant powder from B who knew



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that while opening the packet special care has to be taken neither it might be dangerous. B knew that C was ignorant about it but did not warn him. His wife opened the packet and her eyes were injured from it. In this case C was held to be entitled to compensation of the injury suffered by his wife.

(4) Warranties implied by custom or usage of trade : A warranty as to quality of fitness for a particular purpose may be annexed by the usage of trade.

**CAVEAT EMPTOR**

The term caveat emptor is a latin word which means 'let the buyer beaware'. This principle states that it is the duty of the buyer to satisfy himself that the goods which he is purchasing are of the quality which he requires. The same principle is contained in sec – 16 which proves that;

"Subject to the provision of this Act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale". In simple words it is the duty of the buyer to purchase the goods which are suitable for a particular purpose of the buyer not the seller to give the goods to the buyer. The buyer purchases the goods at his own risk. He must take proper care while purchasing an article. If he makes a wrong selection he can't blame the seller if the goods turn out to be defective or do not serve his purpose.

Exception to the doctrine of caveat emptor –

Section – 16 lays down the following exceptions to the rule of caveat emptor.

*(1)* ***Where the buyer relies on the skill and judgement of the seller –***

The doctrine of caveat emptor will not apply and the seller will be held liable for breach of implied condition as to quality or fitness of the goods, if the buyer makes known to the seller the particular purpose for which he requires the goods and the buyer has relied on the skill and judgment of the seller, who deals in such goods.

There is however no such implied condition where a specific article is sold and its patent or trade name.

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**Example**

B purchased timber from C and the fact was made known to the seller that the timber was to be used for railway sleepers. It was held that B could reject the timber as it was not fit for the purpose. [Bombay Burmah Trading co. Vs. Ayha Mohammad. (1911) 39 34 Mad. 453 (Pc)].

**(2) *Merchantable quality of goods.***

The 2nd exception to caveat emptor is that "where goods are bought by description from a seller who deals in goods of that description there is an implied condition that the goods shall be of merchantable quality. However this exception is not applied if the buyer has examined the goods as regards the defects which could have been revealed by such examination of the goods by the buyer.

**(3) *Consent by fraud***

Where the consent of the buyer is obtained by fraud by the seller or where the seller knowingly conceals a defect so that it could not be discoursed on a reasonable examination the doctrine of caveat emptor doesn't apply. A seller, who is guilty of fraud, shall have no protection of the doctrine of caveat emptor.

**(4) *Usage of trade***

An implied condition as to quality or fitness for a particular purpose may be annexed by the usage of trade. This is so because the parties contract with reference to those known usages.

**TRANSFER OF OWNERSHIP**

There are two stages in a contract of sale. Vis. (a) the transfer of possession of goods. & (b) the transfer of ownership of goods. Or property in goods.

The transfer of possession is different from transfer of ownership. The transfer of possession of goods doesn't necessarily mean that property in goods has also been transferred. Similarly, the transfer of property in goods doesn't essentially amount to transfer of possession of goods from the seller to the buyer. There can be case that a buyer



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is having the ownership of the goods but the seller is in possession of the goods even after sale of those goods and a buyer may have the possession of the goods but the ownership still lying with the seller.

The following rights and obligations of the partners are linked with passing of property –

1. Risk of loss : The risk of loss also passes with the ownership of the goods from the seller to the buyer. In this case the owner who suffers.
2. Only owner can sue : Where the goods are destroyed or damaged by the action of a third party, it is only the owner which possesses the ownership in goods, who can sue or take legal action.
3. Suit for price : the seller can sue for the price unless otherwise agreed, only if the goods have become the property of the buyer.

**Rules regarding transfer of property**

Sec – 18 to 24 of the sale of Goods Act deal with rules regarding transfer of ownership goods.

Sec – 18 provides that no property in goods is transferred to the buyer unless the goods are ascertained. In case of unascertained goods, property in the goods is transferred to the buyer unless and until the goods are ascertained. A contract to sell unascertained goods isn't complete sale, but an agreement to sell.

The fundamental rule is that the property shall pass when the parties intend it to pass, but in many cases the intention of the parties can't be judged. Sec. 20 to 24 determines as to when property will pass from the seller to the buyer. These rules are as under.

***(1) Specific goods in deliverable state (sec. 20)***

In a contract of sale of specific goods in a deliverable state the property in goods passes to the buyer, when the contract is made. This rule is applicable in case of the following conditions –

(i) The contract of sale must be unconditional

(ii) It must relate to specific goods &

(iii) The goods must be in a deliverable state.



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The goods are said to be in a 'deliverable state' when they are in such a state that the buyer would under the contract be bound to take delivery of them.

**Example**

B offers A his horse for Rs.1000/- on a month's credit. A accepts the offer. The horse becomes B's property as soon as the offer is accepted.

There was a sale of a fixed condensing engine. It was to be severed and delivered free on rail at a specified place. It was damaged in transit before it reached the railway. The property didn't pass as when it reached the railway it was not in a deliverable state.

**(2) *Specific goods not in a deliverable state (sec. 21).***

Where there is a contract for the sale of specific goods which is not in a deliverable state and the seller has to do something to the goods to bring it to deliverable state, the property doesn't pass until it is done. Here something means any act like collecting goods, severing the goods, or packing, loading, filling them in the container etc.

**Example**

The contents of a tank of a oil were sold, the oil was to be filled into drums by the seller and then the drums were to be taken away by the buyer. Some of the drums were filled in the presence of the buyer and before the remainder could be filled a fire broke out and entire quantity of oil was destroyed. The buyer must bear the loss of the oil which was put into drums and the rest was borne by the seller. [Mauny Paw Vs. Mauny Saw, 12.1 (.805)].

(b) There was a contract for the sale of machinery weighing 30 tons and embedded in a concrete floor. A part of the machine was destroyed while being removed. It was held that the buyer was entitled to refuse to take the machine as it was not in a deliverable state.

**(3) *When goods have to be measured, tested etc. (sec-22)***

Where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, test, measure

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or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property doesn't pass until such act or thing is done and the buyer has notice thereof.

**Example**

T sold to B a heap of fireclay at a certain price per ton. B was to load the clay in his carts and take it away at his own expenses. The clay was to be coughed of a certain weighing machine, which the carts were to pass on their way from the ground to B's place. It was held that ownership of clay passed to B on completion of the bargain and nothing remained to be done by T. [Turely Vs. abates 91863) 2H and C174]

***(4) Unascertained goods and its appropriation 9Sec.230***

In case of sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained. Where the contract is for sale of unascertained goods or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the, contract, the property in goods thereupon passes to the buyer. The appropriation can be either by the seller with the assent of the buyer or by the buyer with the assent of the seller. The assent to the appropriation may be given before or after appropriation is made.

The world 'appropriation' hasn't been defined in the Act. It means an overt act showing an intention to identify and determine the specific goods as those to which the bargain of the parties shall apply. It is generally made by the seller by putting the goods into boxes, gunny bags or in case of fluids into bottles or other suitable containers with the assent of the buyer. If may be expressed or implied.

**Example**

In a sale of twenty bags of sugar, out of a bulk of sugar four bags were filled and taken away by the buyers. The remaining sixteen bags were subsequently filled and informed to the buyer. Buyer promised to take them away but before he could do so the goods were lost, it was held that by the appropriation of the seller and assent by buyer, sugar became the property of buyer at the time of loss.





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**Delivery to carrier Sec. 23 (2)**

Where in pursuance of the contact the seller delivers the goods to buyer or to carrier or other bailee 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. It means where in pursuance of contract the seller delivers the goods to a carrier for the purpose of transmission to the buyer this operates as an unconditional appropriation by these seller. Here the property in goods passes to the buyer at the time of delivery and the seller should not reserve the right of disposal.

But where the goods are already in transits and the whole lot is sold that amount to an appropriation.

**Example**

A entered into a contract with B for the sale of 814 tins of kerosene which was on its way for delivery to A. A endorsed the railway receipt received by him in favour of B. Six days later the oil was destroyed by fire while still in transit. It was held that the loss fell upon the buyer as the property in goods had passed to him on the date of sale. [Shankar Das Jyoti Prasad Vs. Bhauma ram (AIR 1926 P(38)]

(5) Goods sent on approval or 'on sale or return' (Sec.24)

In case of delivery of goods on approval or on sale or return basis or other similar terms, the property in goods passes to the buyer.

(i) When the buyer signifies his approval or acceptance to the seller, or

(ii) Does any other act adopting the transaction; e.g. sells the goods to a third party or pledges the goods with a third party.

(iii) Where the buyer doesn't signify his approval or acceptance but retains the goods without giving notice of rejection in such a case,

(a) If a time has been fixed for return, on the expiry of such time

(b) If no time has been fixed on the expiry of a reasonable time.

**Example**

'G' delivered certain diamonds to 'W' on sale on return basis. W



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delivered them to X and X delivered them to Y on the same terms i.e. sale or return basis. The diamonds were lost while in possession of Y. G remained unpaid. 1st was held that 'W' is responsible to G for the payment of price as by reselling them he had deprived himself of the right to return the goods. [Genn V. winked (1911) 28 TLR 483].

**Passing of Risk (Sec-26)**

Subject to a contract of sale goods remain at the seller's risk until property there in has passed to the buyer. Once the property in goods is transferred to the buyer, the goods are at the buyers risk, whether delivery has been made or not.

**Example**

A bids for Rs.1000/- for a picture at a sale by auction. After the bid, the picture is damaged by an accident. If the accident happens before the hammer falls, the loss falls on the seller, if afterwards on A.

The general rule of passing of risk with property has the following exceptions –

(i) If the parties have come to some agreement to the contrary, it has no app$^n$. Means if the seller agrees to be responsible for the goods even after the ownership has passed to the buyer.

(ii) Where delivery has been delayed through the fault of either buyer or seller. In such case the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

**Example**

A ordered 30 tins of kerosene from B and B after packing informed A for delivery. But with A's request B delayed the delivery for 3 months and due to fire all the tins were lost. It was held that the loss fell upon the buyer.

(iii) The rule doesn't affect the rights and liabilities of the seller or buyer as bailee of goods for the other even when the risk is passed.

**Example**

Furs are delivered on approval with invoice. They are stolen by burglars. By the custom of the fur trade, goods were at the risk of the



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person ordering them on approval. The sender it was held could recover the invoice price from the person to whom he delivered them. [Bevingtov Vs Dale 91902) 7 Com. Cas. 112].

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## SALE BY NON-OWNERS

It is assumed that the seller is a full owner of the goods and on transfer the buyer also becomes an absolute owner of the goods. But where the seller is not an absolute owner of the goods, the buyer will not get a better title than what the seller himself has. As a general rule 'no man can sell goods and give a good title unless he is the owner. This is expressed by the maxim 'Nemo Dat Quod Non Habet" which means no one can pass a better title than he himself has. If a person transfers articles not belonging to him the transference in good faith and may have paid for the goods. The real owner can recover the goods from any innocent buyer.

### Example

A found a ring in a garden and after making reasonable effects to discover the owner sold it to B. B bought it without knowledge that A was merely a finder. Held the true owner could recover the ring from B.

The rule 'Nemo Dat Quod Non Habet' is incorporated in Sec.27 of the Act. It is meant to protect the true owner and save the bonafide purchaser from the non-owner.

### Exceptions to the rule

(a) ***Sale by a mercantile agent (Sec.27)***

A mercantile agent means an agent having in the customary course of business has such authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods or to raise money on the security of goods. Here the seller has no authority to sell but the buyer can acquire a good title to the goods in the following conditions –

(i) The sale must be by a mercantile agent.

(ii) The mercantile agent must be in possession of the goods or of documents or title to the goods.

(iii) Such possession must be with the consent of the owner.



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(iv) He must sell the goods while acting in the ordinary course of business as mercantile agent.

(v) The buyer must act in good faith and

(vi) Buyer shouldn't have at the time of contract of sale any notice that the agent has no authority to sell.

**Example**

P, the owner of a motor car, delivered it to a mercantile agent to sale on commission subject to a reserve price. The agent sold it to s a bonafide purchaser below the reserve price subsequently S sold the car to D. P can't recover the car from D, as the property has passed to D. [ Folves V. Kiny (1923), IK. B. 282 (A.)].

**(b) *Title by estoppel (sec. 27)***

Under certain circumstances the true owner may be prevented by his conduct from denying the seller's authority to sell. Thus the owner by his words or conduct causes the buyer to believe that the seller was the owner of the goods and induce him to buy it with that belief. The owner may be stopped when the sale was effected, or by having assisted at the sale, or by permitting goods to go into the possession of another.

**Example**

A the owner of a horse, allowed B his employee to sell it. B sold it to C who acquires a good title of the horse as A is estopped from denying B's authority to sell.

***(c) Sale by one of joint owners (Sec.28)***

Where one person has the sole possession of the goods by the permission of the co-owners can transfer the property in goods to any person who buys them from such joint owners with good faith and without notice that the seller had no authority to sell. This exception holds good in the following conditions-

*(i)* The sale is done by one of several joint owners of goods.

*(ii)* The goods are in his sole possession with the permission of his co-owners.

*(iii)* The buyer acts in good faith and has no notice of the time of the contract of sale that the seller has no authority to sell.





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### Example

A, B and C are joint owners of certain cattle B and C leave the cow in possession of A which A sells to D. D makes the purchase in good faith. The property is transferred to D.

(d) ***Sale by a person in possession of goods under voidable contract (Sec. 29).***

It provides that a person in possession of goods under voidable contract which hasn't been rescinded can transfer a good title to the buyers who buys the goods in good faith and without notice of the seller's defect of title. The exception is limited to contract voidable under sec. 19 and 19A of contract Act. i.e voidable under coercion, fraud, misrepresentation and undue influence.

### Example

A by misrepresentation induces B to sell and deliver to him a horse. A sells the horse to C before B has rescinded the contract. The property in horse is transferred to C.

(e) ***Sale by seller in possession after sale (sec 30(1)***

Sometimes the seller continues to be in possession of goods or document of title of goods after sale. In such cases, the delivery or transfer of goods or documents of title under any sale or pledge by such person or his agent shall give a valid title to a bonafide purchaser.

### Example

A sold certain goods to B but continued to remain in possession there of with the consent of the buyer. A subsequently resold the goods to another person. It was held that the second purchaser had acquired a good title.

(f) ***Sale by buyer in possession after sale (sec 30(2)***

Where a buyer obtains possession of goods with the consent of the seller or of documents of title to the goods before the property in them has passed to him, sells to a bonafide person, the third person takes the delivery in good faith and he will get a good title to them without notice of any lien or other right of the original seller.



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**Example**

Furniture was delivered to X under an agreement that the price was to be paid on two instalments. X sold the furniture before second instalment was paid. It was held that the buyer acquired a good title.

But it is necessary that the original seller has the right to sale.

**(g) *Sale by an unpaid seller sec 54(3)***

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

**(h) *Exception under other Acts***

Under certain Acts a person although he isn't the owner the goods may sell the goods and pass a better title than he himself has. These are discussed below.

(i) Sale by a finder of goods – If a finder can't trace the true owner, or if owner refuses to pay the lawful charges of the finder, the finder can resell when the thing is perishable or when his lawful charges for finding the owner amount to 2/3rd of the value of goods.

(ii) Sec-176 of contract Act - A Pawnee of goods has the power to sell the goods pawned under certain conditions and he passes a better title than he herself has.

(iii) Sale by official receiver or assignee – In case of insolvency of an individual his official receiver or any liquidator of a company can confer a good title on the buyer.

(iv) Execution sales – Under order 21 of civil procedure code officers of court can sell goods and convey title to the buyer.

## PERFORMACE OF THE CONTRACT

After the formation of a valid contract of sale, the next is its performance. It has given in to the sale of goods Act certain special rules for performance of a contract of sale. Sec-31 of the sale of goods Act provides that "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 and other wise agreed, delivery of goods





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and payment of the price are concurrent condition i.e. the seller should be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer should be ready and willing to pay the price in exchange for possession of the goods. In the absence of a contract, there is an implied promise on the part of the seller to deliver the goods without delay and an undertaking on the part of the buyer to accept the goods and pay for the price.

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**Delivery of Goods**

Delivery means voluntary transfer of possession from one person to another. It is a bilateral act and two parties are required. The essential elements of delivery are

(i) A person has possession

(ii) He transfers that possession to another person

(iii) He does so voluntarily.

**Mode of delivery**

Delivery of goods may be made in any of the following ways –

(a) Physical or actual delivery – In this case the goods are physically handed over by the seller or his agent to the buyer.

(b) Symbolic delivery – symbolic delivery occurs by doing some act which has the effect of putting the goods in possession of the buyer. Where the goods are bulky and heavier and incapable of actual delivery, symbolic delivery occurs by delivery of the keys of the godown or transfer of a document of title of the goods.

(c) Constructive delivery. A delivery is constructive when it is made without any charge in the actual possession of the goods. There is only acknowledgement by the person in possession that he holds them on behalf of another. It may take place in the following ways (i) where the seller who is in possession of goods holds them as the bailee of the buyer after sale. (ii) where the goods may be in possession of the buyer before sale, but after sale may hold them on his own account as bailee of the owner and (iii) where a third party like a warehouse man, who was holding the goods as a bailee of the seller agrees after a sale to hold them as bailee of the buyer.



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**Rules regarding delivery**

The rules with regard to delivery of goods are discussed below :

(1) *Mode of delivery*

Delivery of goods sold may be made by any of the three modes discussed previously (a) actuals, (b) symbolic and (c) constructive (sec.33)

(2) *Delivery and payment are concurrent*

It means the seller should be ready and willing to pay the price (sec. 32)

(3) *Effect of part delivery*

A delivery of part of the goods, in progress of the whole, has the same effect, as a delivery of the whole for the purpose of passing the property in goods. But a delivery of the part of the goods with an intention of severing it from the whole does not operate as a delivery of the remainder. Here the intention of the parties in any case is to be determined with regard to all the circumstances. (sec. 34).

**Example**

(a) Some goods lying at a wharf, were sold and the seller instructed the wharfinger to give delivery to the buyer. The buyer weighed the goods and took away a part of them. This is a delivery of the whole. [Hammond Vs. Anderson91803) R.R. 763]

(b) X sold 5 bales of certain goods to Y. Y received and paid for one bale and refused to accept the others. This amounts to part delivery.

(4) *Buyer to apply for delivery (sec-35)*

In the absence of an express contract, the seller is not bound to deliver the goods unless the buyer applies for delivery. Where goods are subsequently acquired by the seller he should intimated this to the buyer and the buyer should then apply for delivery. The buyer has no cause of action against the seller if he does not apply for delivery.

(5) *Place of delivery (Sec 36(1)*

The place of delivery of goods should be governed by an



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agreement between the parties. In the absence of any agreement, the goods sold are to be delivered at the place at with they are at the time of sale. Same is the case of goods agreed to be sold i.e the place where it is at the time of agreement. And goods which are not in existence i.e. future good at the place at which they are to be produced or manufactured.

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(6) *Time of delivery (Sec 36(2)*

Delivery of goods must be made within a reasonable time, if time is not fixed by the contract. The buyer can't demand the delivery before the expiry of that reasonable time and seller is bound to send the goods within that time.

(7) *Goods in possession of a third party Sec-36(3).*

Where at the time of sale, goods are in the possession of a third party, there is no delivery by seller unless and until such person acknowledges to the buyer that he holds goods on his behalf. The issue or transfer of any document or title to goods operates as delivery even goods are in possession of third party.

(8) *Expenses of delivery (sec-36(5))*

Unless otherwise agreed the expenses of and incidental to putting the goods in a deliverable state shall be borne by the seller.

(9) *Delivery of wrong quantity (sec-37)*

Delivery of goods must be of the exact quantity ordered. A defective delivery entitles the buyer to reject the goods. Sec-37 provides three cases of defective delivery as follows.

(a) Short delivery - where the seller delivers to the buyer a quantity less than he contracted to sell, the buyer may reject them. But if he accepts the goods so delivered, he shall pay for them at the contract rate.

**Example**

A agrees to sell and deliver to B 500 mounds of rice. But only 420 mounds are delivered. B accepts the quantity sent. B must pay for 420 mounds at the contract rate. B is entitled to sue for damages on the grounds of short delivery.



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(b) Excess delivery – where the seller delivers a quantity larger than the ordered or contracted for, the buyer has the option.

  (i) To accept the whole, and if he does so, he becomes liable for the price of all the goods at the contract rate or

  (ii) To accept the goods mentioned in the contract and reject the excess and

  (iii) To reject the whole

**Example**

A agreed to supply 50 dozen bottles of wine to B. A sent 60 dozen bottles. B may either reject the whole or accept the whole or accept 50 dozen and reject 10 dozen.

(c) Mixed delivery – where the seller delivers to the buyer the goods he contracted to sell mixed with other goods of a different description not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the rest or reject the whole.

**Example**

A contracts with B to sell 100 bags of cane sugar. A delivers 75 bags of cane sugar and 25 bags of beet sugar. A may accept 75 bags and reject the rest or reject the whole.

However the provisions of sec-37 are subject to any usage of trade, special agreement or course of dealing between the parties.

*(10) Instalment delivery (sec.38)*

In the absence of an agreement to the contrary the buyer is not bound to accept delivery by instalments. It means that instalment delivery can be made or demanded if there is special agreement between the parties.

In a contract where goods are to be delivered by instalments which are to be separately paid for, the failure of a party to deliver or accept and pay for one or more instalemnt doesn't put an end to the contract but treated as breach of contract. The breach may entitle the other party to put an end to the contract or be a severable breach giving rise to a claim for compensation, but not to a right to cancel the contract.





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**Example**

Sale of 1100 pieces of blue gum wood to be delivered in two instalments, the first instalment of 7500 pieces was of very inferior quality and the buyer refused to accept it. The seller tendered the 2nd instalment. It was held that the buyer was under no obligation to accept it. [Millars Ran and Farrah Co.Vs Weddle (1908) 100 L.T.R. 8].

(11) *Delivery to carrier or wharfinger (sec. 39)*

Where in a contract of sale, the seller is authorized or required to send the goods to the buyer, delivery of the goods to a carrier for the purpose of transmission to the buyer or delivery to a wharfinger for safe custody, is prima facie deemed to be a delivery of goods to the buyer. Here the risk is with the buyer. But in addition, the seller may make reasonable contract with the carrier or wharfinger on behalf of the buyer without which he (seller) becomes responsible for any damage or loss. In case the goods will be sent by searoute, the seller should give notice to the buyer enabling him to insure the goods. If he fails to do so, the goods shall be at his risk during the sea transit.

**Example**

The buyer directed the seller to ship the goods by any ship to Orissa. The ship sailed on 25th August and was lost the next day. The buyer received the notice of shipment on 29th. The buyer was to pay for goods as he had sufficient information to enable him to insure.

(13) *Examining the goods on delivery (sec. 41)*

Where goods are delivered to the buyer without previous examination, he is not bound to accept it until and unless he had a reasonable opportunity of examining them, so as to see if they correspond with the contract.

Unless otherwise agreed, when the seller tenders delivery of goods to buyer, he is bound on request to afford reasonable opportunity to the buyer of examining the goods for the purpose of ascertaining whether they are in accordance with the contract or not.

(14) *When acceptance is complete on delivery (sec – 42).*

It states that the buyer is deemed to have accepted the goods when.



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(a) He intimates to the seller that he has accepted the goods.

(b) The goods have been delivered to him and he does any act in relation to them which is in consistent with the ownership of the seller.

(c) Where the buyer retains the goods beyond reasonable time without intimation of rejection to the seller.

**Example**

A took the delivery of wheat from B and sold a part of it and afterwards found that the wheat is not of the contracted quality, it was held that A had lost the right of rejection as he had accepted the wheat by a dealing inconsistent with the rights of the seller in so far as he had sold out a portion of it.

*(15) Buyer not bound to return rejected goods (sec – 43)*

Unless otherwise agreed, where goods are delivered to the buyer and he refuses to accept them, having the right to do so, he is not bound to return them to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them. The seller should take the goods back at his own expenses.

*(16) Liability of buyer for neglecting or refusing delivery of goods (sec. 44)*

When the seller is ready and willing to deliver the goods and requests the buyer to take delivery and the buyer doesn't within a reasonable time after such request takes delivery of goods, he is liable to the seller for any loss occasioned by his neglect or refusal to take delivery and a reasonable charge for the care and custody of the goods.

This section further provides that the seller shall be entitled to exercise the above rights even though the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract.

**Example**

If C agrees to sell a car to S and he tenders the car to S, who refuses to take delivery. Now later on if C sells car to some body else and incurs a loss. He is entitled to claim damages from S in lieu of breach of contract. [Charter Vs. Sullivan (1957) I. AU. E.R. 809].





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## UNPAID SELLER AND HIS RIGHTS

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**Who is an unpaid seller ?**

Sec 45 defines unpaid seller as – "a seller is unpaid (a) when the whole of the price has not been paid or tendered, and (b) when a negotiable instrument or a bill of exchange has been received as conditional payment and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise".

When the seller doesn't get the payment of whole or part of the price he remains unpaid. Where the whole of the price tendered and seller refuses to accept it, he ceases to be unpaid seller and loses all his rights against the goods.

The unpaid seller's right can be exercised by an agent of the seller to whom the bill of lading has been endorsed, or a consignee or an agent who has himself paid, or is directly responsible for the price.

**Rights of an unpaid seller**

The sale of goods Act has expressly given two kinds of right to an unpaid seller.

(A) Right against the goods

(B) Right against the buyer personally.

(A) Right against the goods –

It is further subdivided as

(a) When the property in goods has passed

(i) Right of lien,

(ii) Right of stoppage of goods in transit

(iii) Right of re-sale.

(b) When the property in goods hasn't passed.

(i) Right of withholding delivery.

(a) Right of unpaid seller when the property in goods has passed

(i) Right of lien (Sec – 47-49)



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Lien means the right to retain possession of goods until payment in respect of them is paid. This right is available when the property in goods has been transferred to the buyer. An unpaid seller can get rights of lien in the following cases as –

(i) Where the goods has been sold without stipulation as to credit.

(ii) Where the buyer becomes insolvent.

The right of lien holds when the goods are in possession of the seller. Once the possession is lost, lien is also lost. The lien of the unpaid seller is only for the price of goods and not other charges like storage etc.

Right of lien is indivisible in nature and so the buyer is not entitled to claim delivery of a portion of goods on payment of a proportionate price. This right is available in case of part delivery also, unless such part delivery is made under such circumstances as to show an agreement to waive the lien (sec. 48).

**Termination of lien (Sec – 49)**

Right of lien is exercised with the possession of goods and it is lost with lost of possession. Unpaid seller loses his right of lien in following cases-

***(1) By delivery to carrier***

The delivery of goods to a carrier for the purpose of transmission to the buyer operates as a delivery to the buyer himself and this delivery to the carrier puts an end to the right of lien. But if the seller regains possession of the goods from the carrier by exercising his right of stoppage in transit, his lien revives, if he takes back the goods for any other purpose, the right of lien does not revive.

***(2) By delivery to buyer***

The right of lien is lost when the goods are delivered to the buyer or his agent. In case the buyer obtains possession of goods without the consent of the seller, lien is not lost. But where goods are delivered to the seller for a specific purpose like repair etc. the seller doesn't have right of lien.

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(3) **By Waiver –**

When the seller has waived the right of lien, the right of lien is terminated. The Waive is of express or implied. Express Waiver occurs where the contract itself provides that the seller shall not be entitled to retain possession of the goods even if the buyer doesn't pay the price of the goods. A Waiver is implied where ; the seller sells the goods on credit or grants fresh term of credit.

(4) **By tender of price –**

When the buyer tenders price for the goods, the seller looses the right of lien.

(ii) *Right of stoppage in transit (sec. 50-52)*

It is the second right enjoyed by the unpaid seller. The right to stoppage means the right to stop the further transit of the goods, to resume possession there of and to rètain the same till the price is paid. But in order to avail this right three conditions must be satisfied.

(a) the seller must be unpaid

(b) the buyer must be insolvent

(c) the seller must have parted with the possession of goods and the buyer must not have acquired it i.e., goods are in transit.

This right is available only when the goods are neither in the possession of the seller nor the buyer but by a middleman for the purpose of transmission to the buyer. If the middleman holds goods on be half of the seller, it is in seller's lien. But if he is an agent of the buyer then the lien is lost because the buyer has acquired the possession.

**Duration of transit**

The right of stoppage is valid only during the transit. So the duration of transit has a great role on it. Goods are said to be in transit.

(1) Whey they are delivered to a carrier or other buyer and the buyer or his agent has not taken the delivery.

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(2) If the goods are rejected by the buyer and the carrier continues in possession of them.

(3) When part delivery has been made and the remainder may be stopped in the transit.

(4) When the carrier holds the goods as an independent contract.

The transit comes to an end in following cases –

(a) If the buyer or his agent obtains delivery of goods before its arrival at the destination.

(b) If after arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on his behalf.

(c) In case the carrier or bailee refuses to deliver the goods to the buyer.

But the transit does not come to an end if the goods are rejected by the buyer and they are in possession of the carrier.

**Effect of Stoppage in transit :**

The unpaid seller can exercise the right or stoppage in transit either –

(1) by actually taking possession of the goods or

(2) by giving notice of his claim to the carrier or other bailee in whose possession the goods are. Such notice must be given to the carrier or his principal with sufficient time to communicate to his for preventing delivery to buyer. The expenses of re-delivery shall be borne by the seller.

*(iii) Right of re-sale (Sec-54)*

With the right of lien and right of stoppage in transit, another right which the seller shall get is the right of resale. Sec – 54 of contract of sale of goods act enumerates the situations under which the right of re-sale is exercised. The situations are discussed bellow.

(a) Where the goods are of a perishable nature. In this case no notice is required to give to the buyer of his intention to resell the goods by the seller.



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(b) Where the seller gives a notice to the buyer of his intention to resell the goods and the buyer doesn't within reasonable time pay or tender the price.

(c) Where the seller has expressly reserved a right of resale, in case the buyer makes default. In such a case, on resale though the original contract of sale is rescinded, the unpaid seller doesn't lose his right to claim damages for breach of the contract.

The buyer gets a good title to the goods, who purchase the goods in resale transaction.

**(A) Right of withholding delivery**

Where the properly in goods has not passed to the buyer, the unpaid seller has in addition with his other remedies like right of lien and stoppage in transit, a right of withholding delivery. It is similar and co-extensive with other rights where the property has passed to the buyer. This right can be exercised even if the sale is of credit sale,, and goods are of specific or uncertain.

**(B) Rights of unpaid seller against the buyer personally**

In addition to the rights against the goods, an unpaid seller has the following rights against the buyer personally.

(1) *Suit for price (sec. 55)*

When under a contract of sale the property in goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, seller may sue him for the price of goods. In case there is condition to pay the price on a certain day and the buyer wrongfully neglects or refuses to pay the price, the seller may sue for it and property in goods may not be passed.

(2) *Suit for damages for non-acceptance (sec. 56)*

Where the buyer wrongfully neglects or refuses to accept and pay for the goods the seller may sue him for damages for non-acceptance. The measures of damage is described in sec.73 and 74 of the Indian contract Act.

(a) Where there is an available market for goods in question the measure of damages is the difference between the contract price and the market price of the date of breach.

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(b) In the absence of such market the measure of damages is the estimated loss directly and naturally resulting in the ordinary course of events, from the breach of the contract.

(c) *Suit for interest (sec.61)*

If the buyer wrongfully refuses to accept and pay for the goods, the court may award interest on price from the date of the tender of goods and if the sale is of credit nature, interest will run from the expiry of the credit period. The rate of interest is fixed by the court. The seller can only recover the interest if he is to recover the price. When only he can sue for damages for breach of contract he is not entitled to interest.

**Key points to remember**

Contract of sale

Agreement to sale

Essentials of a contract

1. A valid contract
2. Bilateral contract
3. Agreement for the transfer of ownership
4. Price

Difference between sale and agreement to sale, subject matter of contract of sale (goods)

Effect of destruction of subject matter.

Price

Condition and warranty

Difference between condition and warranty

Express and implied condition and warranty

Caveat Emptor

Exception to the Doctrine of Caveat Emptor.

Transfer of Ownership

Rules regarding transfer of property –

1. Specific goods in deliverable state
2. Specific goods not in deliverable state
3. when goods have to be measured, tested etc.



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4. Unascertained goods and its appropriation

5. Goods sent on approval or on sale or return.

Passing of Risk

Sale by non-owners

Performance of the contract

Delivery of goods

Rules regarding delivery of goods.

Unpaid seller and his rights

Unpaid seller

Rights of an unpaid seller

(A) Right against the goods

(B) Right against the buyer personally

(A) Right against the goods

(a) when the property in goods has passed

(i) Right of lien

(ii) Right of stoppage of goods in transit

(iii) Right of re-sale

(b) When the property in goods hasn't passed, Right of withholding delivery.

(B) Right against the buyer personally

(i) Suit for price

(ii) Suit for damages for non-acceptance

(iii) Suit for interest.

**Questions**

1. Define the term contract of sale State its essential characteristics.
2. Explain the difference between sale and agreement to sale.
3. What is the subject matter of sale ? Discuss the effect of destruction of specific goods in a contract of sale.
4. (i)Define and distinguish between a condition and warranty.

   (ii)Under what circumstances a breach of condition be treated as a breach of warranty.

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5. Explain and illustrate the implied conditions and warranty in a contract of sale.
6. Explain the doctrines of Caveat Emptor and state the exceptions to it.
7. Describe the rules regarding transfer of properly in a contract for sale.
8. "Nemo Det Quod Non-Habet" define it and state the exceptions to this rule.
9. When may a non-owner of goods hold a valid title to transfer goods to another person under the sale of Goods Act ?
10. What is meant by delivery of goods ? what are the rules as to delivery of goods under the sale of goods act ?
11. When can a seller of goods be treated as an unpaid seller ? what are his rights against the (a) goods and (b) the buyer personally?
12. Explain the nature of right of lien. When can the unpaid seller exercise the right of lien ? Under what circumstances is the lien terminated ?
13. Discuss the seller's right of stoppage-in-transit. when does it come to an end ?
14. When can an unpaid seller resale the goods ?
15. Discuss the rights of unpaid seller against the buyer personally.



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# UNIT–IV NEGOTIABLE INSTRUMENTS (N.I.)

NOTES

## OBJECTIVES OF THE CHAPTER

- Introduction
- Definition of Negotiable instruments
- Negotiable instrument Act 1881
- Characteristics of N.I.
- Presumption as to N.I.
- Definition and meaning of promissory note, bill of exchange and cheque.
- Crossing of cheque
- Types of Negotiable Instruments.
- Maturity of a negotiable instrument
- Parties to negotiable instrument
- Holder and holder in due course
- Dishonour of a negotiable instrument
- Noting and protesting
- Bouncing of cheques
- Discharge of parties from liability of N.I.
- Material alteration.

## NEGOTIABLE INSTUMENTS

### OBJECTIVES

### Introduction –

In the everyday business, businessmen are not interested to do every transactions with money. Because carrying money in all transactions was considered to be inconvenient. The risk of theft, snatching, docoity etc. lies in it. So the man discovered a safe and effective substitution of money, which will become easy in carrying from place to place and there are no fear of loss, theft & docoity. This gives birth to the use of negotiable instruments. Negotiable instruments are used in most of the business transactions now-a-days. Simply a negotiable instrument is a piece of paper which entitles a person to a sum of money and which is transferable from person to person by



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mere delivery, or by endorsement and delivery. These negotiable instruments are freely used in business transactions as a substitute of money. It is a safe and convenient mode of dealing with money related transactions.

**Definition of Negotiable Instrument –**

The term negotiable instrument means a document transferable by delivery. The general principle relating to transfer of ownership in goods is that a person can't give a better title than he himself has. But negotiable instrument is an exception to this principle. In case of a negotiable instrument a person who takes it in good faith and for value gets a better title than the transferor. The description given in sec.13 of the negotiable instruments Act 1881 says that, "A negotiable instrument means a promissory note, bill of exchange, or cheque payable either to order or to the bearer". Justice Wills has defined it as, "one, the property in which is acquired by any one who takes it bonafide and for value not withstanding any defect of title in the person from whom he took it".

Thus a negotiable instrument is one which when transferred by delivery or by endorsement and delivery passes to the transferee a good title to payment irrespective of the title of the transferor provided the transferee is a bonafide holder for value without notice of any defect in the trustee transferor. There are mainly three kinds of negotiable instruments used in the society. They are promissory notes, bill of exchange and cheque. Except these other types of negotiable instrument are also available by usage or law. An instrument is a negotiable instrument if it satisfies two conditions, namely.

(1) that it is in a form which is capable of being used by the holder for the time being in his own name and

(2) that it is transferable like cash by delivery.

Example, 'A person wants to purchase a T.V. for Rs.12,000 and he doesn't have ready cash. He wants to pay Rs. 2000 per month in 6 months to purchase it. The seller is also ready for it but he wants that he shouldn't go after the buyer every month. In this case negotiable instrument helps. The buyer can issue post dated cheques for the coming months. Seller shall encash the cheque every month and get his money.





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## Negotiable instrument Act 1881 –

The law in India relating to negotiable instruments is contained in the negotiable instrument Act 1881. It deals with promissory notes, bill of exchange and cheque. This law is based entirely on the principle of mercantile law of England. This Act is applicable to persons resident in India, whether foreigner or Indian. The provisions of this Act are not applicable to hundis and other native Instruments.

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## Characteristics of Negotiable Instrument –

(a) **Property :** The possessor of the negotiable instrume is assumed to be the owner of the property contained therein. The property in it can be transferred easily without any formality. Property here means complete right of ownership and not merely a right of possession.

(b) **Negotiability :** The property in a negotiable instrument is freely transferable from one person to another. Where the instrument is bearer, it is transferable by mere delivery and in case of order instrument, it is transferable by endorsement and delivery.

(c) **Good Title :** A holder in due course i.e. a person who is a bonafide transferee of a negotiable instrument for value gets a good title even if the transferor had the defective title. The general principle laid down in the maxim. "nemodat quod non habet" means the general principle 'no one can give a better title than he himself has doesn't apply on negotiable instruments.

(d) **Right to sue in own name :** When the negotiable instrument is dishonoured, the transferor of that negotiable instrument has right to sue in his own name for the recovery of the amount. A negotiable instrument can be transferred any number of times till its maturity and the holder of the instrument need not give any notice of transfer to the debtor.

(e) **Prompt payment :** A negotiable instrument ensures the holder prompt payment because in the case of dishonour, the goodwill of the persons who are party to that negotiable instrument may be adversely affected and ruin their credibility.

Example of Negotiable Instrument – by statute

(a) Promissory notes. (b) bill of exchange, (c) cheque.

By usage or custom.



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(a)Share warrants, (b) port trust debentures, (c) Indira Vikas Patras, (d) Government promissory notes, (e) Treasury bills, (f) hundis, (g) Banker's drafts,.

Example of non-negotiable instruments

(a)Money orders, (b) Postal orders, (c) Share certificates, (d) Fixed deposit receipts, (e) Letter of credit, (f) National saving certificates.

Presumption as to negotiable instruments –

Sec. 118 and 119 of the negotiable instrument Act hold certain presumptions which the court presumes in regard to negotiable instruments. These are discussed as follows : -

(a) Consideration – It is presumed that consideration is present in every negotiable instrument similar to consideration of Indian contract Act.

(b) Date – Every instrument is preseumed to be made or drawn on the date that appears on it.

(c) Time of acceptance. In case of bill of exchange this is presumed that the bill is accepted within a reasonable time after its date and before its maturity.

(d) Time of transfer – it is presumed that every transfer of a negotiable instrument was made before its maturity. Every transfer is Prima facie presumed to have been made before its maturity, unless the contrary appears from the date of endorsement on the instrument.

(e) Order of endorsement – Until the contrary is proved it shall be presumed that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.

(f) Stamp – Unless the contrary is proved, a lost promising note, bill of exchange or cheque is presumed to have been duly stamped. A similar presumption will arise when a negotiable instrument has been destroyed.

(g) Holder in due course – It is presumed that every holder is a holder in due course. A holder in due course is a person who



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has paid consideration for the instrument and has taken in good faith. This means that unless the contrary is proved every holder is presumed to have taken the instrument for value and in good faith.

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(h) Proof of protest-Sec. 119 lays down that in a suit upon an instrument which has been dishonoured, the court shall on proof of the protest presume the fact of dishonour, unless and until such fact is disproved. Protest operates as a prima-facie evidence of dishonour, but is upon to rebuttal by the other side.

**Negotiable instrument Act. 1881 –**

The law in India relating to negotiable instruments is contained in the Negotiable instruments Act 1881. It deals with promissory notes, bill of exchange and cheques. This law is based entirely on the principle of mercantile law of England. This Act is applicable to persons resident in India, whether foreigner or Indian. The provisions of this Act are not applicable to hundis and other native instruments. But this Act doesn't affect the provisions of sec. 31 and 32 of the Reserve Bank of India Act 1934. The object of sec. 31 is to prevent banks and private persons from infringing the government monopoly of issuing the paper currency (notes) in India. Sec. 32 of the Reserve Bank of India Act provides that if a person issues bills or notes payable to bearer on demand or a note payable to bearer he shall be punishable with fine of an amount equal to the amount of the bill or note.

**TYPES OF NEGOTIABLE INSTRUMENTS :-**

**PROMISSORY NOTE**

- **Definition :**

  U/S 4 of negotiable instruments Act promissory note is defined as, "An instrument in writing (not being a bank note or currency note) 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". Thus promissory note is a promise in writing to pay a certain sum of money to a specified person or to his order.

- **Illustration :**

  A signs an instrument in the following terms –

(a) "I promise to pay B or order Rs.500".

(b) "I acknowledge myself to be indebted to B in Rs. 1,000 to be paid on demand for values received.

The person who promises to pay is called the "maker". The person to whom payment is to be made is called the "payee".

Specimen form of promissory Note.

New Delhi

Nov. 17,1996

Three months after date, I promise to pay 'X' or order the sum of Rupees one thousand only for value received.

Stamp

Sd/ A.B.

- **Essential characteristics of a promissory note –**

The definition given in sec. 4 reveals certain essential characteristics of a promissory note. An instrument to be a promissory note must fulfil the following essentials :

(1) ***It must be in writing.***

A promissory note should be in writing. The writing may be in ink or pencil and may be written on any paper, book or any other substitute for paper. It also includes printing, photography and lithography. No particular form of words is necessary for the validity of a promissory note provided the requirement of this section are complied with.

(2) ***It must contain an express promise to pay***

The essentials of a promissory note is an express promise to pay. A mere acknowledge of debt without express promise to pay is not a promissory note. Similarly a mere receipt for money doesn't amount to a promissory note even when it contains the terms of repayment. A mere implied under taking to pay is not sufficient. The words " I am liable to" or 'I am bound to pay" only constitute an acknowledgement of liability to pay not amount to a promise to pay. Thus the following are not promissory notes.

(a) I am liable to A a sum of Rs. 1000



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(b) Mr X I owe you Rs. 1000.

(3) ***The promise to pay must be unconditional.***

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A promissory note must contain an unconditional promise to pay. The promise to pay must not depend on the happening of a contingency. A conditional promissory note is not negotiable and hence invalid. A promise to pay "when able" or as soon as possible is conditional. But the promise to pay doesn't become conditional if the amount is made payable at a particular place or after a specified time of the happening of an event which must happen.

Example

(a) "I promise to pay B Rs. 500 in D's death, provided D leaves one enough to pay that sum" is not a valid promissory note.

(b) "I promise to pay B Rs. 500 seven days after my marriage with C is not a promissory not because the maker may not marry at all.

(c) But "I promise to pay 'X' A Rs.500 seven days after the death of A" is a promissory note because it is not conditional as death is certain though the time of death is not certain.

(4) ***It should be signed by the makers***

The signature of the maker in the face of the note is the most essential feature. In the absence of the above the note can't be called as a promissory note. Signing means writing one's own name on same document or paper in order to give effect to the contract contained in the document. Mere marks or initials are signatures if they are intended to be such. Further the mind of the maker should accompany the signature. This means that the maker should intend to subscribe to the terms of the instrument. Thumb mark is sufficient when the maker is moderate, but when he is able to write this mark will not be sufficient.

(5) ***The mark must be certain***

The promissory note should point out with certainity the person who undertakes to pay. The note must show on its face the person who is liable as a maker. A promissory note may be made by several persons jointly or jointly and severally. The maker must be capable of being ascertained – whether he may be described by name or by his designation.



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**(6) *The payee must be certain***

The promissory note must point out with certainty the party who is to receive the money. Where a document doesn't specify the person to whom the money is to be paid, it is not a promissory note. The payee should be certain at the time of execution. The payee must be ascertained by namė or by designation. A promissory note payable to the secretary of a club, or a manager of a bank or the principal of a college is regarded as payable to a certain person. A promissory note payable to several individuals is not invalid on the ground of uncertainty. But it is noted here that the maker and the person who is to receive the payment can't be one and the same person.

**(7) *The sum payable must be certain***

The amount expressed to be payable by the promissory note must be certain and not susceptible of contingent additions or substractions. Thus, a document containing a promise to pay money and paddy isn't a promissory note. The promise must be to pay a definite sum and nothing else. Like

(a) "I promise to pay B Rs. 500/- and all other sums which may be due to him".

(b) "I promise to pay B Rs. 500 and all fines according to rules".

Are not termed as valid promissory notes. But

(a) 'I promise to pay Rs. 2,000 with 12% p.a. interest'.

(b) 'I promise to pay B Rs. 2000/- in 10 equal installments each month. In case of default the whole of the remaining sum shall become due'.

The above sentences are valid promissory notes.

**(8) *The promise should be to pay money only***

It is essential that the medium of payment must be money only and not bonds, bills or any other article. A promise to do something in addition to or other than to pay money can't be a promissory note. Ex. A promises to pay Rs. 200/- and paddy does not make the promissory note valid.

**(9) *Other formalities***

There are certain other formalities which are usually found in a



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promissory note but not essential by law. These are date, place, consideration, attention etc. It is not essential to the validity of a promissory note that it should contain the name of the place where it is made or the place where it is payable. Similarly it is valid without a date. But where the amount is payable at a certain time after date, the date should be mentioned. But a promissory note must properly be stamped as required by the Indian stamp Act 1899 and the stamp should be properly conclude with the maker's signature on it.

(10) It may be payable on demand or after a definite period of time where no time is mentioned.

(11) It can't be made payable to bearer on demand.

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## BILL OF EXCHANGE

- **Definition :**

Under section 5 of the negotiable instrument Act Bill of exchange is defined as .

"An instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or the order of a certain person or to the bearer of the instrument".

Thus a bil of exchange is a written and signed order to a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer.

- **Parties to a bill :**

There are three parties to a bills of exchange

(a) drawer, (b) drawee and , (c) payee.

(a) drawer – the maker of the bill is called the drawer.

(b) Drawee – the person who is ordered to pay is called the drawee.

(c) Payee – the person to whom or to whose order the money is directed to be paid is called the payee.

In some cases drawer and the payee may be one person. The payee is called the holder of the bill. The drawee of the bill who has signified his assent to the order of the drawer is called the acceptor.



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Specimen form of bill of exchange

Chandigarh

May. 31,2006

Three months after, date/ pay to D Y or order, the sum of Rs. 1000/- (Rupees one thousand only) for value received.

Stamp

Sd/ A.B.

To

M/s P.Q

Chowk Sadar

Meerut.

**Essential characteristics of a bill of exchange :**

The essential requirements of the bill are more or less the same as that of a promissory note. These are mentioned in brief :

(1) It must be in writing.

(2) It must contain an express order to pay

(3) The order to pay must be unconditional.

The drawer's order to the drawee must be unconditional and should not make the payment of the bill dependent on a contingency.

(4) It must be signed by the drawer.

(5) There must be three parties to the instrument and the parties must be certain.

(6) The order must be to pay a certain sum of money.

(7) It must comply with other formalities like date, place, consideration, attestation etc. It must affixed with stamp of appropriate value.

Difference between a promissory note and bill of exchange.

| Promissory Note | Bill of Exchange |
|---|---|
| 1. Number of parties : Two parties, makers and the payee. The maker and payee mustn't be the same person. | 1. Three parties are there, drawer, drawee and payee. In some case the drawer and payee may be the same person. |
| 2. Nature of payment : There is an unconditional promise to pay. | 2. There is an unconditional order to pay. |



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| | |
|---|---|
| 3. Acceptance : It doesn't require any acceptance. | 3. It requires an acceptance of the drawee before it is presented for payment. |
| 4. Liability : In this case it is primary and absolute as the maker himself promises to pay the money. | 4. Liability of bills of exchange is secondary and conditional because he becomes liable to pay only when the acceptor fails to pay. |
| 5. Notice of dishonour : No need to give a notice of dishonour to the maker. He is liable to pay the amount due on a note even if no notice of dishnour is given. | 5. In case of dishonour i.e. either due to non-payment or non-acceptance, notice must be given to all parties liable to pay. |
| 6. Position of the maker : Maker stands in immediate relation with the payee. Promissory note can't be made conditional because the maker of a note originates the instrument. | 6. Drawer of a bill stands in immediate relation with the aceptor and not the payee. |
| 7. Nature of acceptance : A promissory note is signed by the maker himself. Therefore, it doesn't require acceptance before it is presented for payment. | 7. But bill may be accepted conditionally becuse the acceptor of the bill is not the originator of the bill and his contract is supplimentary. |
| 8. Payable to bearer : Can't be made payable to the bearer. | 8. But a bill requires the acceptance of the drawee before it is presented for payment. |
| 9. Protest : No protest is required in case of a promissory note. | 9. A bill can be made payable to the bearer but not the bearer on demand. But foreign bills must be protested for dishonour when such protest is required by law of place where they are drawn. |
| 10. Copies : Promissory note can't be drawn in sets. | 10. Bills can be drawn in sets. (foreign bills) |

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## CHEQUE

- **Definition :**

A cheque is the means by which a person who has funds in a bank withdraws the same or some part of it.

Sec.6 of the negotiable instrument Act 1881 defines a cheque as a, "bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a turncated cheque in the electronic form".

**Explanation :**

(a) Cheque in the electronic form means a cheque which contains the exact mirror image of a paper cheque and is generated, written and signed in a secure system for safety.

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

A cheque is a bill of exchange with two additional features :

(a) It is always drawn on a specified banker

(b) It is always payable on demand.

Thus by a cheque the banker is directed to pay a certain sum of money on demand.

Essential features of a cheque

(1) It must be in writing

(2) It should contain an unconditional order to pay.

(3) Order should be to pay a certain sum of money.

(4) It should be signed by the drawer.

(5) Cheque must be payable on demand only.

(6) No stamp is required to be affixed on cheques.

A cheque must be addressed by one person to another. So a bank draft is not a cheque. Usually cheques are written on printed forms supplied by the banks on their depositors. A cheque doesn't require any acceptance. A cheque is not invalid by reason that it is ante-dated or post-dated. A cheque may bear the date of a Sunday or a holiday. A banker may refuse to pay a cheque which is not dated. Generally it becomes due on the date specified on it. In India the cheque usually be presented for payment within six months from the date mentioned in it.

Form of a cheque



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No. CANARA BANK Dated
Bhubaneswar.

NOTES

Pay Mr. B.................................. or Bearer. Rupees five hundred only
Rs. 500/- Account No. 201600 110000237
Sd/A.

Distinction between a bill of Exchange and cheque.

| Bill of Exchange | Cheque |
|---|---|
| 1. Drawee : A bill of exch. can be drawn or any person including a banker. | 1. A cheque is always drawn on a bank. |
| 2. Acceptance : A bill requires acceptance before payment can be demanded for the drawee. | 2. A cheque doesn't require any acceptance. |
| 3. Payable on demand : A bill can be payable on demand or certain days after the specified date. | 3. A cheque is drawn payable on demand. |
| 4. Grace days : A grace period of three days is allowed for payment in case of Bills of Exchange. | 4. No grace period is allowed because the cheque is payable on demand. |
| 5. Crossing : No provision of crossing is required. | 5. A cheque may be crossed |
| 6. Notice of dishonour : Notice of dishonour should be sent to the drawer of a bill of exchange in case of dishnour. | 6. No notice of dishonbour is given to the drawer of a cheque when it is dishonoured. |
| 7. Stamp : It must be properly stamped. | 7. It doesn't require any stamp. |
| 8. Stopping payment (counter manded) : The payment of bill can't be stopped by the drawer. | 8. The payment of the cheque can be stopped in case the notice of customer's death or insolvency arises. |
| 9. Noting & protesting : In case of dishonour of a bill it should be noted and protested for dishonour. | 9. But cheque is not noted or protested for dishonour and is generally inland. |



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| | |
|---|---|
| 10. Presentment : Presentment for payment to the drawee is essential otherwise the drawer will be discharged. | 10. The drawer of a cheque is not discharged by failure of the holder to present it in due time unless the drawer has sunstained damage by the delay. |
| 11. Statutory protection : no such protection is available to the drawee or acceptor of a bill of exchange. | 11. A banker is given statutory protection with regard to payment of cheques in certain circumstances. |

**Crossing of A Cheques**

Cheques are of two types, open cheques and crossed cheques.

Open cheques are those which are paid over the counter of the bank. They need not be put through a bank account. If it goes to the wrong hand and from him it is transferred to a holder in due course the latter will get a good title of the cheque. Open cheques are liable to great risk, and there is chance of loss or stolen and the finder of the cheque can get it encashed at the bank unless the drawer in the meantime countermanded payment.

With a view to avoid such risk and to protect the owner of the cheque a system of crossing was introduced. Crossing provides a protection and safeguard to the owner of the cheque by giving secure payment through a banker. Crossing is a direction to the banker not to pay the cheque across the counter but to pay to a bank only or to a particular bank in an account with the bank.

**Modes of Crossing –**

There are two modes of crossing provided by the negotiable instrument Act. As (a) General crossing and (b) Special crossing.

(a) General Crossing (Sec. 123) :

A cheque is said to be crossed generally when it bears across its face an addition of :

(i) the words "and company" or any abbreviation there of between two parallel transverse lines, either with or without the words not negotiable or

(ii) two parallal transverse lines simply either with or without the words not negotiable.



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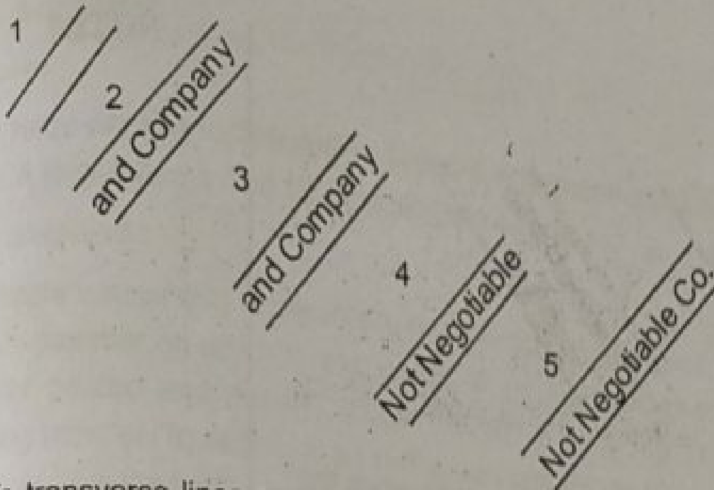
For example

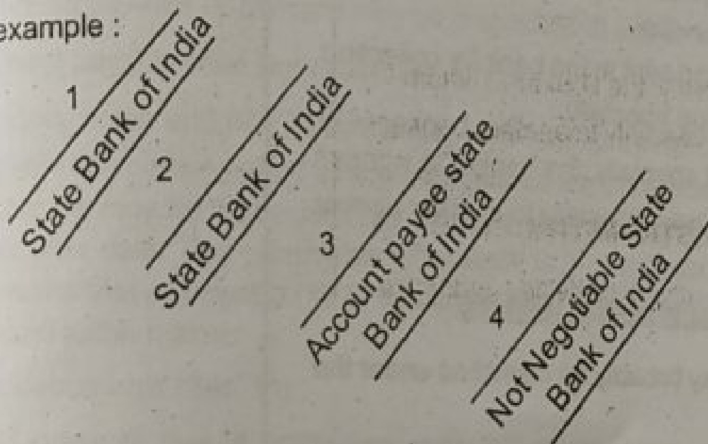



To transverse lines are essential for general crossing and the lines must be drawn across the face of the cheque. In this case the drawee bank doesn't make the payment of the cheque at the counter but the payment is to be made only to another bank who collects the cheque on behalf of the holder.

(b) Special Crossing (Sec. 124) :

In this case the name of the banker is to be added across the face of the cheque with or without the words 'not negotiable'. Transverse lines are not required for a special crossing. It makes the cheque more safer than the general crossing.

For example :




**Restrictive Crossing :**

Another type of crossing adopted by the commercial and banking usage is known as restrictive crossing. It restricts the payment of the cheque in certain ways. In such a crossing the words 'Account payee only' are added. The addition of these words make the cheque non transferable.



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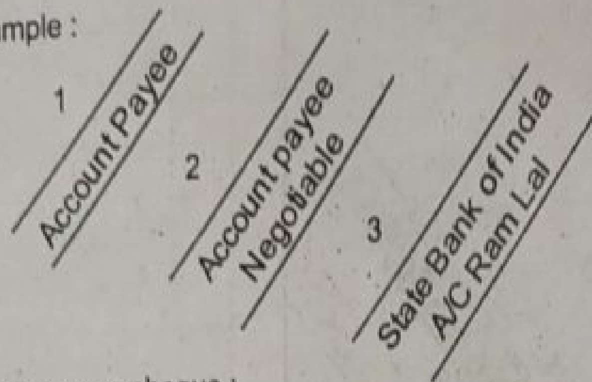
For example :




Who can cross a cheque :

1. The drawer – While issuing a cheque the drawer can cross the cheque generally or specially.
2. The holder – The holder can also cross the cheque in the following manner.
   (i) If the cheque is not crossed,
   (ii) If the cheque is crossed generally we can cross it specially.
3. The banker – The banker can also cross the cheque in the following manner.
   (j) If the cheque is not crossed and sent to the bank for collection, banker can cross the cheque generally or specially.
   (ii) If it is crossed generally and sent to the bank for collection, bank can cross the cheque specially.
   (iii) If the cheque is crossed specially, the banker to whom it is crossed, may again cross it specially to another banker for collection.

## DIFFERENT TYPES OF NEGOTIABLE INSTRUMENTS

The negotiable instruments may broadly be classified under the following heads :

(1) Bearer instruments :

Any instrument "As payable to bearer which is expressed to be so payable or on which the only or the last endorsement is an endorsement in blank. "The last endorsement in blank also converts an order instrument into a bearer instrument. It isn't necessary that the instrument should contain his name. he may however be required to acknowledge payment of money by singing on the instrument.



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Example –

(a) Pay Mr. A or bearer

(b) Pay bearer

(c) A bill is made payable to 'Srikanth or order' Srikanth endorses it in blank & negotiates it. The bill is payable to bearer.

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(2) Order instrument :

A negotiable instruments is payable to order which is expressed to be so payable or which is expressed to be payable to a particular person and doesn't contain words prohibiting or restricting transfer. To negotiate an instrument payable to order the signature of the holder is necessary.

Example :

(i) pay to Mr X or order,

(ii) pay to Mr. Z.

(iii) pay to the order of Mr. B.

(3) Instruments payable on demands (Sec. 19) :

Cheques are always payable on demand. In a promissory note or on bill of exchange, the expressions, 'at sight' and 'on presentment' mean payable on demand. If no time for payment is mentioned in the instrument, it is payable on demand. Instruments payable on demand may be prescribed at any time.

(4) Instrument payable after sight (Sec.21) :

Promissory notes and bills of exchange, may be expressed to be payable at a certain period after sight or after date. Thus a bill of exchange may be made payable 90 days after sight or six months after date. The expression 'after sight' in a promissory note means that payment is not to be demanded till it has been presented to the maker.

(5) Inland instruments (Sec. 11) :

Sec. 11 provides that "A promissory note, bill of exchange or cheque drawn or made in India and made payable in or drawn upon any person resident in India shall be deemed to be an Inland instrument. A bill drawn in Delhi upon a merchant resident in New York and payable in Kolkatta is an inland instrument. A bill drawn and payable in India remain an Inland bill even if it has been endorsed in a foreign country. A bill is presumed to be an inland bill unless the contrary appears on face of it.



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Examples of inland bills are :-

(a) A bill drawn in Mumbai on a Merchant in Delhi and payable in Singapore.

(b) A bill drawn in Chennai upon a merchant resident in Rome and payable in Goa.

(6) Foreign instruments (Sec. 12) :

An instrument which is not an inland instrument is a foreign instrument. This implies that any instrument drawn in India on a person resident abroad or drawn in a foreign country on a person resident in a foreign country but payable in India is a foreign instrument. Inland bills need not be protested for dishnour while foreign bill must be protested for when so required by the law of the place where it is drawn. Foreign bills are drawn in sets to avoid danger of loss.

Example of foreign bills

(a) A bill drawn in India and made payable in Tokyo.

(b) A bill drawn in New York and made payable in India.

(7) Ambiguous instruments (Sec. 17 and 18) :

Sec.17 of the Act provides that, "where an instrument may be constructed either as a promissory note or a bill of exchange, the holder may at his discretion treat it as either of them. A promissory note when addressed to a third person who accepts it, may be treated by the person who receives it, as a bill or a note. Similarly where in a bill the drawer and the drwee are the same person, or where the drawee is a fictitious person, or a person not having capacity to contract, the instrument is ambiguous and the holder may treat it as a bill or note.

Example of ambiguous instrument :

(a) X draws a bill on Y and endorses it to Z, Y is a fictitious person. Z may treat the bill as a note by X .

(8) Inchoate instrument (sec. 20) :

An incomplete or blank negotiable instrument but duly stamped and properly signed is called an inchoate instrument. For example one not mentioning the amount payable, or leaving blank the name of the payee or one without date. Where any one signs





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and delivers to another an instrument wholly blank or incomplete he hereby gives prima facie authority to the holder to make or complete it as an instrument for any amount not exceeding the amount covered by stamp. But no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid there under.

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Example

(a) A owed Rs. 200 to B. He gave a promissory note to B for the amount. He put a 10 paise stamp on it and left the amount blank authorizing B to fill it up for the amount due. B filled up Rs. 300. B can't recover more than Rs. 200.

Some points are to be taken in connection with an inchoate instrument.

(1) The liability of a person who signs and delivers a blank or an inchoate instrument aries only when the blanks are filled in and the instrument completed.

(2) A signer doesn't incur any liability as a maker, drawer, or acceptor until he has delivered the instrument to another. Delivery is essential to fix up liability.

(3) An inchoate instrument must be filled up strictly in accordance with the authority given.

(4) The blanks must be filled up within a reasonable time.

(5) Instruments which don't require stamps aren't covered by the above provisions.

(9) Accommodation Bills :

An accommodation bill is one which is drawn by one person and accepted by another, without consideration merely to enable the drawer to raise money on the bill by discounting it. Here the relationship of the drawer and drawee is not of creditor and debtor but that of 'accommodation party' who is accommodating it and 'accommodated party' who accommodated it. When a person endorses a bill without consideration he is called a 'backer' and the operation is called 'backing the bill'.



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(10) Fictitious Bill (Sec. 42) :

When the name of the drawer or payee or both are fictitious the bill is called a fictitious bill. Fictitious means a person not in existence or a pretended person. An acceptor of such a bill drawn in a fictitious name and payable to the drawer's order isn't relieved from liability to a holder in due course claiming under an endorsement by the same hand as the drawer's signature and purporting to be made by the drawer. If the holder in due course is able to show that the signatures of the supposed drawer and first endorser are in the some handwriting, the acceptor is liable to him.

(11) Undated Bills :

Where the date of a bill is not mentioned and where the date of the acceptance of a bill, payable at a fixed period after sight is omitted, any holder may insert the true date of issue or acceptance as the case may be and such insertion is not considered to be a material alteration. The instrument will not be considered to be invalid merely because it is undated. In case of wrong date also the parties remain liable.

(12) Banker's Draft :

It is an order addressed by one bank to another or by a bank to its branch directing the latter to pay a specified sum of money to a named person or his order. These drafts are drawn either against cash deposit or against debit to current accounts with the bankers.

Characteristics of a bank draft –

(a) It is drawn by a banker upon its branch or upon another bank.

(b) It is payable on demand.

(c) It can't be payable to bearer.

(d) It can't be stopped or countermanded except by the order of the court.

(13) Bills in Sets :

Bills in sets are generally used in case of foreign bills. Inland bills rarely drawn in sets. Bills in set are drawn in several parts and each part is numbered. The drawer must sign and deliver all of them to the payee with duly stamped. If an acceptor gives his acceptance on more than one part and they go into the hands of different holders in due course, he shall be liable on every such part as if it were a separate bill.



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### Documentary Bill

A documentary bill is one to which document of title like bill of lading are annexed. When the bill is accepted or paid the documents of title are handed over. This is usually seen in foreign trade transactions.

### Escrow

When a bill is delivered conditionally or for a special purpose as a collateral security or for safe custody only and not for the purpose of transferring absolutely property there in it is called an escrow. When an instrument is delivered conditionally between immediate parties there is no liability to pay unless conditions agreed upon are fulfilled. The rights of a holder in due course is not affected due to fulfillment of conditions.

## MATURITY OF NEGOTIABLE INSTRUMENTS

Payment can be demanded on an instrument only when it is due. When the payment is due, the instrument is at maturity. Thus maturity means the date on which the promissory note or a bill of exchange falls due. A promissory note or a bill of exchange may be payable on demand or on a specific date or after a specific date. If no time is mentioned, then it is payable on demand. Usually a cheque is payable on demand. When the instrument is payable on demand no question of maturity arises. In other cases the maturity arises at the time of payment.

In a promissory note or bill the expression 'at sight' or 'in presentment' means on demand. Like this cheque, payable on demand becomes payable at once and there is no question of maturity arises.

Days of grace were originally granted to the acceptor by way of favour. But it is now claimed as a legal right. If an instrument is payable by installments each installment is entitled to days of grace.

Calculation of the date of maturity –

(1) When a promissory note or a bill is expressed to be payable at a certain month or date, or after sight or after a certain event the period of payment terminates three days after stated number of months. Example – A bill dated 20th April 1993 is payable one month after date. It is matured on 23rd May 1993.

(2) If the month in which the period would terminated has no

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corresponding day the period shall be held to terminate on the last day of such month. So a bill dated 31st August is made payable three months after date is at maturity on 3rd December.

(·) Where a bill of exchange or promissory note payable after sight, or after the date, or after happening of a certain event, time of payment is calculated by excluding the day on which the instrument is drawn or presented for acceptance or the day on which such event happens. Examples – A bill payable thirty days after sight is presented for payment on 1st January. It falls due on 3rd day after 31st January i.e. 2nd February.

(4) If the date on which a bill or a note falls due is a public holiday, the instrument shall fall due on the next preceding business day. Public holdings include all Sundays, and any other day declared by the central government, by notification in the official Gazette to be a public holiday. Thus if an instrument is at maturity on a Sunday, it will be deemed to be due on Saturday and not on Monday. Example – A bill of exchange dated 12th March is payable three months after date. If 15th June is a Sunday then it will payable on 14th June i.e. on Saturday.

**Payment in due course (Sec. 10)**

Payment in due course discharges a negotiable instrument and all the parties who are primarily liable to pay the amount due on the instrument. Sec. 10 decries payment in due course as payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in its possession thereof under circumstances which don't afford a reasonable ground for believing that he isn't entitled to receive payment of the amount there in mentioned.

i.e. if a bill has been lost or stolen and a finder of the bill presents it for payment, payment to it isn't payment in due course, if the person paying it knows that it is a stolen one and the person demanding payment isn't entitled to be paid. But if he has no knowledge and makes the payment in good faith, it would be a payment in due course.

**PARTIES TO NEGOTIABLE INSTRUMENTS**

The main parties to a promissory note are drawer and payee and in case of bill and cheque the parties are drawer, drawee and



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payee. Besides these parties, there are other persons who become parties to a negotiable instrument. These are discussed below.

- Parties to promissory note – (i) Maker, (ii) Payee, (iii) Holder, (iv) Endorser, (v) Endorsee.
- Parties to a bill of exchange – (i) Drawer, (ii) Drawee, (iii) payee, (iv) acceptor, (v) holder, (vi) endorser, (vii) endorsee, (viii) Drawee in case of need, and (ix) acceptor for honour.

(1) **Maker/ Drawer -** The person who promises to pay the amount stated in the promissory note is known as maker. And the person who draws a bill or cheque is called the drawer.

(2) **Drawee** – The person on whom a bill or a cheque is drawn is the drawee. In case of cheque the drawee is always a bank.

(3) **Payee** – The person to whom the amount of promissory note, or bill or cheque is payable is known as the payee. In case of a bill or a cheque the drawer may himself be the payee.

(4) **The Acceptor** – The person who accepts a bill called as the acceptor. Normally drawee is the acceptor. Still a stranger can also accept a bill on behalf of a drawee.

(5) **Endorser** – when the holder transfers or endorses the negotiable instrument to any other person, the holder becomes the endorser.

(6) **Endorsee** – The person to whom the negotiable instrument is endorsed is called the endorsee.

(7) **Holder** – Holder of a negotiable instrument means any person who is legally entitled to the possession of it and to receive or recover the amount due thereon from the parties. He is ether the payee or endorsee. The finder of a lost bill payable or a person in wrongful possession of such instrument is not a holder.

(8) **Drawee in case of need** – When in a bill, the name of another drawee is mentioned in addition to the original drawee, such a person is called as 'drawee in case of need'. His name is given in the bill by the drawer or by any endorser. The drawee in case of need is merely in the position of a drawee who has not accepted the bill. The bill can't be presented to him for cceptance but only for payment. If he is mentioned in the bill such a bill is not dishonoured until it has been dishonoured by such a drawee in case of need.



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(9) **Acceptor for honour** – Any person can voluntarily become a party to a bill as an acceptor by accepting it for the honour of the drawer or of any person. When the drawee refuses to accept the bill or to furnish better security when demanded by the notary, any person may accept the bill with the consent of the holder, in order to safeguard the honour of the drawer or any other party and bind himself by an acceptance. Such bill is treated as alive and isn't considered to be dishonoured till it is dishonoured by the acceptor for honour.

**Holder and holder in due course :**

**Holder – (Sec. 8) –**

The holder of a negotiable instrument means, any person, entitled in his own name, to the possession thereof and to receive or recover the amount due thereon from the parties thereto. A holder must therefore (a) have the possession of the instrument and (b) have the right to recover the money in his own name.

No person who though in possession of the instrument but has no right to recover the money due thereon is not a holder. The word 'entitled' suggests that the title of the holder, whatever it is, must have been acquired in a proper manner. Any person taking the instrument under a forged endorsement or a theft isn't a holder. Similarly an agent holding an instrument for his principal is not a holder, although he may receive its payment. This is because he is not entitled to recover the amount due thereon in his own name.

**Holder in due course (9) –**

The holder in due course is a person who has obtained the possession of a negotiable instrument for consideration in good faith without any notice of defect in the title of the person from whom he has taken it. In case of a bearer instrument, the holder in due course is a person who has acquired its possession for consideration before the amount mentioned in it became payable. In case of an order instrument holder in due course is a person who becomes the payee or endorsee of the instrument before the amount mentioned in it become payable.

A person must satisfy the following conditions to become as a holder in due course –

(a) He must acquire the possession of the instrument for valuable consideration.

(b) He must be the holder of the instrument.

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(c) He must have obtained the instrument before its maturity.

(d) He must have obtained the delivery of the instrument in good faith without the knowledge of any defect in the title of the person from whom he has taken its possession.

(e) The instrument should be complete and regular on the face of it.

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**Privileges of a holder in due course :**

The holder in due course occupies a very important position under the negotiable instrument Act. He enjoys certain exclusive privileges as discussed below.

(a) Presumption as to title (sec. 118) – The first privilege of a holder in due course is that every holder is a holder in due course and the burden of proving his title does not lie on him. But if it is proved that the instrument has been obtained from its lawful owner by an offence or was obtained from the maker or acceptor by means of fraud or for unlawful consideration, the onus of proof is shifted and the holder has to prove that he is a holder in due course.

(b) Right in case of an inchoate stamped instrument (sec. 20) – A holder in due course can fill in an inchoate stamped instrument for any amount provided the stamp is sufficient to cover the amount. The person who has signed and delivered an inchoate instrument can't plead as against the holder in due course that the instrument has not been filled in accordance with the authority given by him. But a holder who himself completed the instrument isn't a holder in due course. In other words to entitle a person to the rights of a holder in due course the instrument must have been completed before it was negotiated to him.

(c) Liabilities of the prior parties (sec.36) – Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied. 'Prior party' here means the maker or drawer, acceptor, and all endorsers. The holder in due course is entitled to maintain an action in his own name against all or any of the parties whose names appear on the instruments.

(d) Rights in case of a fictitious bill (Sec – 42) – The acceptor of a bill of exchange can't plead against a holder in due course that the bill is drawn in a fictitious name. The acceptor is liable on the bill to a holder in due course provided he can show that the signature of the supposed drawer and the first endorsement on it are in the handwriting of the same person.



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(e) Right in case of conditional delivery (sec. 46) – Where an instrument is delivered conditionally or for a special purpose, it may be shown that, as between immediate parties and a holder the instrument was delivered conditionally or for a special purpose only and not for the purpose of transferring the property therein absolutely. But the plan of conditional delivery or delivery for a special purpose is not available against a holder in due course because, if a bill is delivered conditionally or for a special purpose and negotiated to a holder in due course, a valid delivery of it is conclusively presumed, and he acquired good title to it.

(f) Rights in case of prior defect in the instrument (Sec. 58) – The defects on the part of the person liable on a negotiable instrument that the instrument had been lost, or obtained from him by means of an offence or fraud or for an unlawful consideration can't be set up against a holder in due course. Thus when a negotiable instrument is lost, or obtained by means of an offence or fraud or for an unlawful consideration, no other person except the holder in due course is entitled to receive the amount due on it.

(g) Instrument cured of all defects (Sec. 53) – Once a negotiable instrument passes through the hands of a holder in due course it is clear from all defects. Any body who takes a negotiable instrument from a holder in due course can recover the amount from all parties prior to such holder.

(h) Estoppels against denying original validity of instrument (Sec. 120)– No maker of a note and no drawer of a bill or cheque and the acceptor of a bill for the honour of the drawer is, in a suit thereon by a holder in due course, permitted to deny the validity of the instruments as originally made or drawn.

(i) Estoppels against denying capacity of the payee to endorse (Sec. 121) – The maker of a promissory note or the acceptor of a bill of exchange is prevented from denying against a holder in due course the existence of the payee and his capacity to endorse.

(j) Estoppels against denying signature or capacity of prior party (Sec. 122) – An endorser of a bill is estopped from denying against such holder the genuineness and the regularity of the drawer's signature or capacity to contract of all previous endorsements.



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**Difference between a holder and holder in due course -**

| Holder | Holser in due Course |
|---|---|
| 1. Nature or meaning : Any person entitled in his own name to the possession of the instrument and to recover the amount. due thereon from the liable parties is called holder. | A holder who has taken the instrument in good faith for value before maturity is called holder in due course. |
| 2. Consideration : Consideration mayn't be passed from the holder of the instrument. | Consideration is a must in this case. A person can't be a hodler in due course if he has taken the instrument without consideration. |
| 3. Title : Holder's title is not better than that of the transferor. | He has got a better title than that of the transferor. His title is free from all defects. |
| 4. Posession : Possession isn't necessary. | It is necessary in case of a holder in due course. |
| 5. Liability : He can enforce it against the person who has signed it and also against the transferor from whom he obtained it but not from all the prior parties. | A holder in due course can recover the amount from any of the prior parties until the instrument is duly discharged. |
| 6. Maturity : He may acquire the instrument even after maturity. | He must acquire the instrument before maturity. |
| 7. Privileges : A holder doesn't have any special privileges. | A holder in due course enjoys certain special privileges. |

**Capacity of parties to a negotiable instrument –**

Every person capable of contracting, may bind himself and be bound by making, drawing, acceptance, endorsement, delivery and negotiation of a note, bill of exchange or cheque. So the capacity to draw, make, accept or endorse a bill of exchange, promissory note or cheque is co-extensive with his capacity to enter into a contract like other contracts. Negotiable instruments Act doesnot prohibits a minor from being a party to a negotiable instrument .

**Minor** – A minor being incompetent to enter into a contract is incapable of making himself liable as maker, drawer/ acceptor or endorser on a negotiable instrument. A minor can draw a cheque provided he has funds in the bank. In case an instrumented is signed by minor and a major jointly, the minor is not liable but the major is.



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**Person of unsound mind** – Contract of persons of unsound mind as alos drunken persons, lunatics are void. Bills and notes drawn or made by such persons are void as against them, though the other parties remain liable.

**Insolvent** – An insolvent during insolvency can't accept or endorse a bill, though if he endorses an instrument of which he is the payee to a holder in due course the latter can recover from all parties except the insolvent.

**Corporation** – A corporation can't make, endorse or accept a negotiable instrument. The power of a corporation to bind itself by notes, bills and cheque is derived from its memorandum of association. So if a corporation or company issues a negotiable instrument by exceeding its powers as given to it by the memorandum, such a bill or note or cheque is void.

**Partners** – In a trading firm, every partner has prima facie authority to bind his co-partners by drawing, making, endorsing, accepting, transferring, negotiating bills or cheques and other negotiable papers in the name and on account of partnership. But the partner of a non-trading firm has no such implied authority.

**Agent** – An agent may be employed for the purpose of drawing, accepting or endorsing negotiable instruments, on behalf of his principal. But this power cannot be implied from the general authority of an agent to transact business and to receive and discharge debts on behalf of the principal. If the agent while signing the instrument doesn't mention as an agent, in this case he becomes personally liable on the instrument. The agent must make it clear that he is signing as an agent and he does not intend to incur personal liability.

**Joint Hindu family** – The 'karta' of a joint Hindu family represents the family in all dealings with the outside world. In case the karta has signed a bill or note for the purpose of business of the family, such an instrument is binding on all the members except minor members whose liability is limited to their share in the family property. But if he has signed an instrument in his individual name or capacity only he is liable and not the other members.

**Legal representative** – A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque



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is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him as such.

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## DISHONOUR OF A NEGOTIABLE INSTRUMENT

When an instrument remains unpaid on maturity, it is said to be dishonoured. The party liable to accept or pay may refuse to accept or pay the instrument when it is duly presented for acceptance or payment. Such refusal is called dishonoured. A cheque and a promissory note can only be dishonoured by non-payment but a bill of exchange can be dishonoured either by non-acceptance or non-payment.

**Dishonour by non-acceptance of bills (sec. 91) –**

A bill of exchange can be dishonoured by non-acceptance in the following ways –

1. If a bill is presented to the drawee for acceptance and he refuses to accept it or doesn't accept it within 48 hours from the time of presentment for acceptance. In case of several drawees if one of them makes a default in acceptance, the bill is deemed to be dishonored.
2. When the drawee is a fictitious person or he can't be identified after reasonable search
3. Where the drawee is incompetent to contract.
4. When the drawee has either become insolvent or is dead.
5. Where the presentment for acceptance is excused, and the bill isn't accepted.
6. Where the bill is accepted with a qualified acceptance, the holder may treat the bill of exchange having been dishonoured.

Where a drawee in case of need is named in a bil of exchange or in any endorsement thereon, the bill is not dishonoured till it has been dishonoured by such drawee.

Dishnour by non-acceptance of a bill gives the holder an immediate right of action against the drawer and the endorser. There is no need to wait till the date of maturity or to present the bill for payment.



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**Dishonour by non-payment (Sec. 92) –**

When the maker of the note, the acceptor of the bill or drawer of a cheque makes default in payment on the date of its maturity, it is said as dishonour by non payment. U/s 76, an instrument is taken as dishonoured by non-payment when presentment for payment is excused and instrument when overdue;

**Notice for Dishonour –**

When a negotiable instrument is refused for acceptance or payment, notice of such refusal must immediately be given to parties to whom the holder wishes to make liable. Failure to give notice of the dishonour by the holder would discharge all parties other than the maker or the acceptor.

The object of giving notice of dishonour is not to demand payment but to indicate to the party that the contract has been broken by the principal debtor and he being a surety would now be liable for the payment. Notice of dishnour doesn't mean mere knowledge, there must be a formal communication of the fact of dishonour. There must be indicated in the notice that the reason for refusal of payment on presentment. A notice of dishonour must be given within reasonable time having regard to the circumstances of the case. With loss or miscarries of the notice the party is not discharged from the liability.

**Notice by whom ;**

When a negotiable instrument is dishonoured either due to non-acceptance or non-payment, the holder of the instrument must give the notice of dihonour to all the prior parties whom he seeks to make severaly liable therein. The agent of any such party may also be given notice of dishonour. A notice given to a stranger is not valid. Each party receiving notice of dishonour must in order to render any prior party liable give notice of dishonour to such party within a reasonable time after he has received it.

**Notice to whom :** Notice of dishonour must be given to all parties to whom the holder seeks to make liable. No notice need be given to a maker, acceptor or drawee, who are the parties primarily liable and it is their duty to provide for the payment of the instrument on due date



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and at proper place. Notice may be given to an endorser, a duly authorized agent of the person to whom it is required to be given. In case of death of such a person, it may be given to his legal representative.

**Mode of notice :** Notice of dishonour may be oral or written or partly oral and partly written. It may be sent by post. It may be in any form but it must inform the party to whom it is given either in express term or by reasonable intendment that the instrument has been dishonoured and in what way it has been dishonoured and that the person served with the notice will be held liable thereon. The notice must be dispatched by the next post or on the day next after the dishonour.

**Place of notice :** The place of business or at the residence of the party for whom it is intended, is the place where notice is to given.

**When notice of dishonour is unnecessary :** Notice of dishonour must be given by a holder to the persons whom he seeks to make liable on the instrument. But notice of dishonour is not necessary in the following cases-

(a) When it is dispensed with by the party entitled therto. It means, the party who is entitled to the notice may expressly or impliedly waive the same.

(b) In order to charge the drawer, when he has countermanded payment.

(c) When the party charged couldnot suffer damage for want of notice.

(d) When the party entitled to notice can't after due search be found or where the party bound to give can not give notice through no fault of his own.

(e) Where the drawer and acceptor are the same person.

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

(g) When the party entitled to notice, knowing the facts, unconditionally agrees to pay the amount.

(h) When the omission to give notice is caused by unavoidable circumstances.



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**Duties of the holder upon dishonour**

(1) Notice of dishonour - when an instrument is dishonoured by non-acceptance or non-payment the holder must give notice of dishonour to all the parties whom he seeks to make liable thereon.

(2) Noting and protesting – when a note or bill of exchange has been dishonoured, the holder may get such dishonour to be noted or protested by notary public.

(3) Suit for money - After the formalities of noting and protesting, the holder may bring a suit against the liable parties for the recovery of the amount due on the instrument.

**Noting and protesting**

**Noting of a dishornoured instrument –**

When a promissory note or a bill is dishonoured the holder can sue the drawer and the endorsers after giving due notice of dishonour. Noting provides a convenient method of authenticating the fact of dishonour. Noting is a minute recorded by a notary public on the dishonoured instrument or on a paper attached to such instrument about the fact of dishnour. Notary public is a person appointed under the notaries act. When a bill is to be noted, the bill is taken to a notary public who presents it for acceptance or payment as the case may be and if the drawee or acceptor refuses to accept or pay the bill, the bill is noted as stated above. Noting should specify in the instrument (a) the fact of dishonour, (b) the date of dishonour, (c) the reason for dishonour, (d) the notary's charge, (e) a reference to the notary's register, (f) the notary's initials.

Noting must be made within a reasonable time after dishonour. Noting is compulsory for foreign bills but not for Inland bills and cheques. Noting itself has no legal effect but if noting is done within a reasonable time protest may be drawn later on and the holder has an authentic evidence of dishonour to prove his case.

**Protest –**

The protest is the formal certificate attesting the dishonour of the instrument and based upon the noting. Protesting is a formal



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declaration on the bill after noting by the holder for better security. The main advantage of protest is that the court on proof of the protest shall presume the fact of dishonour.

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When the promissory notes and bills of exchange are required to be protested, notice of protest must be given instead of notice of dishonour in the same manner and same condition to prior parties. It may be given by the notary public who make the protest (sec. 102). Inland bills may or may not be protested. But foreign bills must be protested for dishonour when such protest is required by the law of place where they are drawn. (Sec. 104).

**Contents of Protest :**

The protest should contain the following U/s 101 – as

(1) The instrument itself or a copy of it and of everything written or printed thereon.

(2) The name of the person for whom and against whom the instrument has been protested.

(3) The fact of reasons for dishonour.

(4) The time and place of demand and dishonour.

(5) The signature of the notary public,

(6) In case of acceptance for honour or payment for honour the person by whom or for whom such acceptance or payment was offered and effected.

**Compensation for dishonour (Sec. 117) :**

Sec. 117 lays down the rules for determining the amount of compensation payable to the holder or any endorsee in case of dishonour of the instrument –

(1) The holder is entitled to the amount due upon the instrument together with the expenses properly incurred in presenting, noting and protesting it.

(2) An endorser who has paid the amount due on the instrument is entitled to the amount so paid with interest at 18% per annum from the date of payment until realization thereof along with all expenses caused by dishonour and non-payment.

(3) When a person sought to be charged resides at a place different from that at which the instrument was payable, the holder is



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entitled to receive such sum at the current rate of exchange between the two places, in the country in which the amount is payable.

(4) A party entitled to compensation may draw a bill payable at sight or on demand for the amount due to him together with all expenses properly incurred by him upon the party to compensate him. Such a bill is called 'redraft'. The redraft must be accompanied by the dishonoured instrument and the protest if any. The parity who makes payment of a redraft is entitled to draw a similar draft on the parities prior to him. In case of dishonour of redraft the drawer is liable to make compensation as in case of original bill.

**Bouncing of Cheques :**

The negotiable instrument Act 1881 has an amendment in 1988 about the better circulation and payment of cheques. This chapter comprises the penalties in case of dishonour of certain cheques for insufficiency of funds in the accounts.

A cheque is said to be bounced or dishonoured when there is insufficiency of funds in the drawer's account or the drawee makes default in payment upon being asked to pay the same. In such cses the drawee is punishable with imprisonment extending up to one year or with fine extending to twice the amount of the cheque or with both (Sec. 138).

Offence under Sec-138 is constitued as follows :

(1) The cheque should have been issued by the drawer to the payee in the discharge of any legally enforceable.

(2) Cheque should have been presented to the bank within 6 months of the date on which it has drawn or period of its validity whichever is earlier.

(3) The cheque should have been returned by the bank un-paid because the amount of money standing to the credit of the account is insufficient.

(4) The payee or the holder in due course of the cheque should have been noticed demanding payment within 30 days from the drawer on the receipt of information of dishonour of cheque from the bank.



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(5) The drawer of the said cheque should have failed to take payment within fifteen days of the said notice given by the payee or the holder.

Another condition of liability is that the cheque should have been given for the discharge in whole or in part of any debt or other liability of a legally enforceable nature. Sec.139 provides that it shall be presumed that the holder received the cheque in discharge of a debt or liability. Sec. 140, provides that the drawer shall not be allowed the defence that he had no reason to believe when we issued cheque that it would be dishonoured.

Sec. 141 states that if the person committing an offence is a company, liability will also be incurred by every person who at the time the offence was committed was in charge of and responsible to the company for the conduct of the business and shall be liable to the proceedings against and punished accordingly. Even otherwise, if a person is a director, manager, secretary etc, he would also be liable if it can be shown that the offence was committed with his consent or connivance or is attributable to any neglect on his part in this regard.

## DISCHARGE OF PARTIES FROM LIABILITY IN RELATION TO NEGOTIABLE INSTRUMENTS

Discharge from liability in relation to the negotiable instruments implies the liability of the party on the instrument comes to an end. In relation to negotiable instrument, the term discharge has two meanings–

(1) the discharge of the instrument

(2) the discharge of one or more parties liable on the instrument :

When an instrument is discharged, it ceases to be negotiable. If after its discharge an instrument comes into the hands of a holder in due course, he has no right upon it. But when only a particular party is discharged, the instrument continues to be negotiable with the liabilities of undercharged parties attaching thereto. The rights and obligations relating to the instrument are extinguished when discharge of negotiable instrument comes.

### Discharge of instrument

A negotiable instrument may be discharged in any of the following ways.

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(1) By payment in due course – When a negotiable instrument is ultimately meant for payment of the amount due on the instrument to the holder would result in the discharge of the parties to the instrument. The parties primarily liable to the instrument like the maker, the acceptor, drawee etc, if make the payment then it will be discharged. But if a party secondarily liable makes payment or makes it to any other person other than the holder, the instrument is not discharged. Sec. 82 provides that the maker, acceptor or endorser of a negotiable instrument is discharged form liability thereon to all parties thereto, if the instrument is payable to bearer, or has been endorsed in blank and such maker acceptor or endorser make the payment in due course. Payment in due course means payment in accordance with the apparent tenor of the instrument in good faith and without negligence. So an instrument payable to bearer or endorsed in blank or discharged by payment in due course by the party primarily liable to the person entitled to receive payment.

(2) Debtors as holder (sec. 90). If a bill of exchange which has been negotiated is at or after maturity held by the acceptor in his own right, all rights of action thereon are extinguished. An acceptor of a bill may become holder of a bill by virtue of negotiation at or after maturity. But in order to discharge the instrument it is necessary that the acceptor should become the holder at or after maturity. If he becomes holder before maturity he may reissue the bill.

(3) By renunciation – when the holder of an instrument at or after its maturity absolutely and unconditionally renounces or gives up his right against all the parties to the instrument, the instrument is then discharged. But the renunciation must be in writing.

(4) By cancellation (Sec.82) – When the holder cancels the name of the drawer or acceptor on a note or a bill, the instrument is discharged because this consideration will discharge all the parties.

(5) By material alternation or lapse of time. An instrument stands discharged when the party primarily liable is discharged by material alternation in the instrument or by lapse of time making the debt time barred under the limitation Act.



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**Discharge of a party or parties :-**

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The maker, acceptor or endorser of a negotiable instrument may be discharged from liability in the following ways -

(1) Discharge by cancellation (Sec. 2(a) - If the holder of a negotiable instrument or his agent deliberately cancels the name of any party on the instrument, with an intention to discharge him such party is discharged from liability to the holder. The cancellation of name of any party by the holder discharges such party and all subsequent parties who have a right of recourse against the party whose name is canceled. The cancellation must be intentional and apparent. However the cancellation is done under a mistake, or without the authority of the holder it would be inoperative.

(2) Discharge by release (Sec. 82(b) – If a holder of a negotiable instrument releases any party to the instrument by any method other than cancellation, the party so released is discharged from liability. But the release of one of joint parties will not release all.

(3) Discharge by payment – payment to party in possession of the bearer instrument discharges the party. But the payment must be of whole amount and to the holder or his agent.

(4) Discharge by allowing drawee more than forty-eight hours – Usually the drawee is entitled to retain the bill for 48 hours to consider whether he accepts the bill or not. If the holder doesn't get back the bill after 48 hours, he can treat the bill as dishonoured. But if instead of giving a notice of dishonour to all prior endorsers, he allows the drawee more time of deliberation; all previous parties not consenting to such allowance are discharged from liability to such holder.

(5) Discharge by delay in presentment of cheque Sec. 84(15) – Where a cheque is not presented for payment within a reasonable time of its issue and the drawer suffers damage through such delay he is discharged from liability to the extent of damage he has suffered and no more. If the amount in the cheque was in excess of the sum the drawer had with the banker, he suffers damage only in that sum and is discharged to that extent.



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(6) Cheque payable to order (Sec.85) – A banker who pays in due course a cheque drawn upon him is discharged from liability though the endorsement of the payee may be forged. Suppose a cheque drawn payable to A or order endorsed to B and C steals the cheque from B and forged B's endorsement upon it and gets paid in due course. The paying banker will be discharged from liability.

Where a drawer issues a bearer cheque the drawee banker is discharged if he makes the payment to the bearer.

(7) Draft drawn by one branch on another (sec. 85(A) – Where a demand draft is drawn by one office of the bank upon another office of the same bank, for a sùm payable, to order, the banker is discharged from liability if it makes the payment in due course even though the endorsement of the payee may be forged or unauthorized.

(8) Discharge by taking qualified acceptance (sec. 86) – If a holder of a bill takes a qualified or limited acceptance with his own risk and discharges all the parties prior to himself, unless he obtains their consent.

(9) Discharge by operation of law – Discharge takes place on account of an order of the court for insolvency by the lapse of time or merger.

(10) Discharge by payment of altered instrument (sec.89) – Where a negotiable instrument has been materially altered but doesn't appear to have been so altered, or where a cheque is presented for payment which doesn't at the time of presentation appear to be crossed, payment on such an instrument discharges the party liable provided he makes the payment according to the apparent tenor of the instrument and in due course.

(11) Discharge by material alteration (Sec. 87) – A material alteration of a negotiable instrument renders the same void as against the persons who were parties to it before such alteration, unless they have consented to the alteration.

## MATERIAL ALTERATION

Any alteration which changes the legal identity of the instrument either in terms of operation or in relation to parties to it, is a material alteration. Every alteration is not to avoid a instrument,



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to avoid the instrument the alteration must be a material one. Sec.87 provides that material alteration of a negotiable instrument renders the same void as against any one who is a party there to at the time of making such alteration and doesn't consent thereto'. The identity or character of the instrument is affected or its liability is extended by the alteration, it will amount to a material alteration. Any alteration in an instrument which causes to speak a different language in legal effect from that which it originally spoke, is a material alteration. It is immaterial whether the alteration is beneficial or prejudicial or whether it is made by a stranger or a party to the instrument.

Following are instances of alteration – (a) alteration of date, (b) alteration of name, (c) alteration of time, (d) alteration of place of payment, (e) alteration of amount , (f) alteration of rate of interest, (g) alteration by the addition of a new party, (h) dealing an instrument in a material part, (i) the difference in apparent error of a cheque and the truncated cheque.

But the above list is not exhaustive. There may be other material alterations depending upon the nature and facts of each particular case. For example –

(a) Alteration made to carryout the original intention of the parties e.g. the subsequent insertion of the words 'or order' where the drawer of a bill forgets to use these words.

(b) Correction of a mistake in date or of a clerical error e.g. where a bill was dated 1969 instead of 1996 and subsequently the agent to the drawer corrected the mistake.

(c) Alteration made with the consent of parties.

(d) Alteration made before the instrument is dead.

(e) Alteration which is not apparent and the instrument goes into the hands of a holder in the course.

(f) The addition of words which could not prejudice any one.

Alteration Authorised by the Act.

1. Filing blanks in inchoate instruments (Sec. 20).
2. Conversion of blank endorsement into endorsement in full (Sec. 49).
3. Making acceptance conditional (sec. 86).
4. Crossing of an uncrossed cheque, conversion of general crossing to special crossing with addition of words like 'not negotiable' to a crossed cheque. (Sec.125).

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Effect of material alteration –

Material alteration discharges the parties liable on the instrument at the time of the alteration; and the instrument is rendered void. The person who made the alteration and all subsequent endorsees are bound by the bill as altered. Any material alteration, if made by an endorsee, discharges his endorser from all liability to him in respect of the consideration thereof.

**Key Words**

Negotiable instrument act 1881

Promissory note

Bill of exchange.

Cheque

Crossing of a cheque

Bearer instrument

Order instrument

Ambiguous instrument

Inchoate instrument

Bills in sets

Documentary bill

Payment in due course

Parties to negotiable instrument

Drawer, drawee, payee, endorser, endorsee, acceptor, holder, drawee in case of need.

Holder

Holder in due course

Dishonour by non-acceptance of bill

Dishonour by non-payment

Notice for dishonour

Noting

Protesting



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Bouncing of cheques

Discharge of instrument

Discharge of parties to instrument

Material alteration

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### Short Answer Questions

1. What is a negotiable instrument ?
2. What are the characteristics of a negotiable instrument ?
3. Write short notes on Accomodation Bill.
4. What is payment in due course ?
5. What is crossing of a cheque ?
6. Define holder in due course.
7. Discuss the presumptions of holder in due course.
8. Write short notes on noting of a dishonour instrument .
9. What is protesting ?

### Long Answer Questions :

1. What do you understand by negotiable instrument ? what are the special presumptions as to negotiable instrument ?
2. Define the term promissory note. What are the essential of a promissory note ?
3. What is a bill of exchange? State its essential features. How does it differ from a promissory note ?
4. Differentiate between a bill of exchange and a cheque.
5. Who are the parties to a negotiable instrument ?
6. Define the term holder and holder in due course. Distinguish between the two.
7. Briefly explain the capacity of a party to a negotiable instrument. State the extent to which a minor can be a party to a negotiable instrument.
8. Every holder in due course must be a holder, but every holder may not be a holder in due course. Discuss.



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9. What is meant by dishonour by non-acceptance and dishonour by non-payment ?
10. What is meant by 'noting' and 'protest' of a negotiable instrument ? Is noting and protest obligatory under the negotiable instruments Act?
11. State provisions regarding bouncing of cheques.
12. What do you understand by discharge of a negotiable instrument? when does it take place ?
13. What are the various modes of discharge from liability of parties to a negotiable instrument ?
14. Explain the meaning of material alteration in a negotiable instrument. What is the effect of such alteration ?
15. 'Any material alteration of a negotiable instrument renders the same void'. Discuss.



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# UNIT–V COMPANY LAWS

NOTES

## OBEJCTIVES

To familiarize the students with the various provisions of the Indian companies act 1956 as per requirements in corporate sector of India. This unit covers :

1. History of company legislation in India
2. Definition of a company
3. Characteristics of a company
4. Promotion and incorporation of a company
5. Registration and incorporation of a company
6. Memorandum of association
7. Articles of association
8. Distinction between memorandum and articles of association
9. Prospectus
10. Meetings
11. Quorum of meeting
12. Minutes of meeting
13. Voting in a meeting
14. Resolution of a meeting
15. Review exercises

### History of company legislation in India

The company legislation in India has closely followed the company legislation in England. In India, the first legislative enactment for registration of joint stock companies was passed in the year 1850. The concept of 'limited liability' was recognized, for the first time, in 1855 and in case of banking companies in 1858. Based on the English companies Act 1862 was passed the companies Act 1866 but had to be recast in 1882. This Act continued 1913 when it was replaced by the Indian companies Act, 1913, which regulated the Indian companies till the Act of 1956. The companies Act 1956 has been amended for several times since then. The major amendments were introduced in the years 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1974,



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1977, 1985, 1988, 1991 and 1996. In 1993, a bill called the companies Bill, 1993 was introduced in Rajya Sabha in order to simplify and rationalize and to consolidate the law on the subject. The various provisions of the bill were thrown open for comments and suggestions of various academic, professional, trade, business and industry organizations. A large number of comments and suggestions were made by these various bodies. A revised companies Bill is expected to be tabled before the parliament shortly to replace the Act of 1956.

**Definition of a company**

According to Lord Justice Lindley – "A company is an association of many persons who contribute money or money worth to a common stock and employed in some trade or business and who share the profit and loss arising there from. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is often more or less restricted".

According to Prof. Haney "A company is an artificial person created by law having separate entity, with a perpetual succession and common seal".

**Meaning of A company**

The above definitions clearly bring out the meaning of a company in terms of its features. A company to which the companies Act applies comes into existence only when it is registered under the Act. On registration a company becomes a body corporate i.e. it acquires a legal personality of its own, separate and distinct from its members. A registered company is therefore created by law and law alone can regulate, modify or dissolve it.

**Characteristics of a company**

1. **Separate legal entity :** A company is in law regarded as an entity separate from its members. It has an independent corporate existence. Any of its members can enter into contracts with it like an outsider. Shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital of the company. The company's money and property belong to the company and not to the shareholders.



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

3. **Perpetual succession :** Perpetual succession means that a company's existence persists irrespective of the change in the composition of its memberships.

4. **Common seal :** Since a company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal acts as the official signature of the company.

5. **Transferability of shares :** The capital of a company is divided into parts, called shares. These shares are-subject to certain conditions freely transferable from one person to another person by means of purchase and sale of shares.

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

7. **Capacity to sue :** A company can sue and be sued in its corporate name. It may also inflict or suffer wrongs. It can in fact do or have done to it most of the things which may be done by or to a human being.

**Promotion and incorporation of a company**

The term promotion refers to the preliminary steps taken for the purpose of registration and floatation of the company.

**Promoter :**

The persons who assume the task of promotion are called promoters. A promoter may be an individual, association, partner or company.

Section 2(6) defines the expression 'promoter' to mean a promoter who was a party to the preparation of the prospectus or of a portion therefore containing the untrue statement, but does not include any person by reason of his acting in a professional capacity in procuring the formation of the company.



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To be a promoter one need not necessarily be associated with the initial formation of the company, one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter.

A promoter originates the scheme for the formation of the company; gets together the subscribes to the memorandum; gets memorandum and articles prepared, executed and registered; finds the bankers, brokers and legal advisers, locates the first directors, settle the terms of preliminary contracts with vendors and agreement with underwriters and makes arrangements for preparation, advertisement and circulation of the prospectus and placement of the capital.

A person cannot, however become a promoter merely because he signs the memorandum as a subscriber for one or more shares.

**When promotion begins and ends**

The relationship between promoter and the company that he has floated must be deemed to be fiduciary relationship from the day the work of floating the company starts' and continues upto the time that the directors take into their hands what remains to be done in the way of forming the company.

The date upon which the person becomes a promoter can be a matter of great importance to him and the company.

The status of a promoter is generally terminated when the Board of directors has been formed and the Board starts governing the company.

**Legal position of a promoter**

The promoters occupy an important position and have wide powers relating to the formation of a company. So far as the legal position is concerned, a promoter is neither an agent nor a trustee of the proposed company. The correct way to describe his legal position is that a promoter stands in a fiduciary position towards the company about to be formed.

**Duties of promoters**

Promoter have been described to be in a fiduciary relationship (relationship of trust and confidence) with the company. This relationship of trust and confidence requires the promoter to make a



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fully disclosure of all material facts relating to the formation of the company. He should not make any secret profit at the expense of the company he promotes, without the knowledge and consent of the company and if he does so, the company can compel him to account for it.

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**Liabilities of Promoters**

**(A) For non-disclosure**

In case a promoter fails to make full disclosure of the time the contract was made, the company may either;

1. Rescind the contract and recover the purchase price where he sold his own property to the company, or
2. Recover the profit made, even though recession is not claimed of is impossible or
3. Claim damages for breach of his fiduciary duty.

**(B) In the course of winding-up of the company**

On an application made by official liquidator the court may make a promoter liable for misfeasance or breach of trust.

The death of a promoter does not relieve his estate from liability arising out of abuse of his fiduciary position.

**Remuneration of promoters**

A promoter has no right to get compensation from the company for his services in promoting the company unless there is a contract to that effect. In practice a promoter takes remuneration for his services in one of the following ways :

1. He may sell his own property at a profit to the company for cash or fully paid shares provided he makes a disclosure to this effect.
2. He may be given an option to a certain number of shares in the company at par.
3. He may take a commission on the shares sold.
4. He may be paid a lump sum by the company.

**Registration and incorporation of a company**

Section – 12 of the Indian companies act says that "any seven or more persons or where the company to be formed will be a private



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company any two or more person, associated for any lawful purpose may by subscribing their names to a memorandum of association and otherwise complying with the requirements of this act in respect of registration form an incorporated company, with or without limited liability". Thus the promoters will have to get together at least seven persons in the case of a public company and two persons in the case of a private company to subscribe to the memorandum of association.

**Procedure for registration & in corporation of a company**

Before proceeding, to register a company, the promoters have to, inter alia, decide the following aspects :

(1) **Type of company :** The first thing the promoters must decide is the type of company proposed to be floated. Under the Act only two types of companies can be registered viz.,

   i. Public companies

   ii. Private companies

(2) **Application for availability of name :** Section – 20 of the Indian companies act 1956 states that a company cannot be registered by a name, which in the opinion of the central Government is undesirable.

The department of company affairs has issued guiding instructions with regard to adopting a name.

Therefore, it is advisable that promoters should find out the availability of the proposed name of the company from the registrar of companies. The companies act 1956 requires that the promoters of a company under a proposed name to make an application in form no IA to the registrar of companies of the state in which the registered office of the proposed company is to be situated for ascertaining as to whether the proposed name is undesirable within the meaning of section – 20 of the act and whether the same is available for allotment, prescribed fee is to be paid along with the application.

Three names in order of priority should be submitted to afford flexibility to the registrar. The registrar of companies shall furnish the information regarding availability of name by way of a letter within seven days of the receipt of the application. Where the promoters are informed of the availability of name as proposed, such name shall be available for adoption by the promoters for a period of six months from the date of intimation by the registrar. This period may however, be extended by the registrar.

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**Corporate Identity number :** Registrar of companies is to allot a corporate identity number to each company registered on or after 1st November 2000.

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(3) **Preparation of memorandum and articles of association :** The memorandum of association is the constitution of a company. It is a document which defines the area within which the company can act. It is therefore, required to state the objects for which the company is being formed, the capital which it shall be allowed to raise, the nature of liability of its members, the name of the state where the registered office of the company shall be located etc. Likewise, another important document, namely, the articles of association containing the rules and regulations relating to the internal management of the company has also to be prepared.

(4) **Approval of memorandum and articles of association :** The draft of memorandum and articles of association should be prepared. Although as per the provisions of the Act, memorandum and articles of association must be printed, it is not advisable to print these document unless the same have been verified by the registrar of companies/ or the regional director. It is likely that the registrar or regional director may suggest some changes in these documents before issuing the licence. After the verification done by the registrar/ Regional director, the memorandum and articles may be printed as required by section – 15 of the Act.

Section-15 also requires that every memorandum should be signed by each subscriber who should add his address, description and occupation, if any, in the presence of at least one witness, who shall at least put the signature and shall likewise add his address, description and occupation, if any. The subscribers to the memorandum should also state clearly the number and nature of shares subscribed by them. However, it is not mandatory that the subscribers to the memorandum should also state clearly the number and nature of shares subscribed by them. However it is not mandatory that the subscribers to the memorandum should sign the memorandum and articles personally. A duly authorized agent through a power of attorney, may sign on behalf of a subscriber.



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(5) **Preparation of other documents :** The following documents are also required to be prepared by the promoters in connection with the incorporation of a company :

i. *Power of attorney :* with a view to fulfilling various formalities that are required for incorporation of a company; the promoters may execute a power of attorney in favour of one of them or an advocate or some other professional like the chartered accountant or the company secretary. The power of attorney should be prepared on a non-judicial stamp of the value prescribed by the stamp act of the concerned state.

ii. *Consent of the directors :* As per section 266, in the case of public limited company having share capital, a person cannot be appointed as a director by the articles of association unless, he has before the registration of the articles, either himself or through his agent, signed and filed, with the registrar his consent in writing to act as director. The consent must be in form no-29 of the companies (central government's) general rules and forms, 1956.

iii. *The particulars of directors :* whether the company names in its articles the persons who are to act as director, manager, secretary, etc, the particulars of such director, etc., may be filed, in duplicate, in form no.32, with the registrar at the time of registration. However, the said form no-32 can also be filed within 30 days of registration of the company or appointment of the first directors.

iv. *Notice of registered address :* As per section – 146 a company is required to have a registered office within 30 days of incorporation or from the day it commences business, whichever is earlier. A notice of the situation (that is the address) of the registered office of the company may be filed with the registrar in form no – 18.

v. *Statutory declaration :* Section – 33(2) requires a declaration to be filed with the registrar of companies along with the memorandum and the articles. This is known as "Statutory declaration of compliance".



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The declaration should be in form no – 1 on a non-judicial stamp paper of appropriate value with reference to the state in which the office of the registrar of companies is situated. Alternatively, non-judicial special adhesive stamps may be affixed to the declaration.

**Filing of documents for registration**

After the aforesaid documents are ready, the next step is filing of these documents with the registrar of companies of the concerned state of registration of the company.

**Certificate of incorporation**

After scrutinizing the documents filed and on being satisfied that they are in order, that the requisite fee has been paid and that all other legal requirements have been duly complied with, the registrar will enter the name of the company in the register of companies and shall certify under his hand that the company is incorporated and in the case of a limited company that the company is limited. The certificate so issued by the registrar is called the certificate of incorporation. After obtaining the certificate of incorporation from the registrar of companies a private limited company is entitled to commence the business but a public limited can not start the business after obtaining the certificate of incorporation. It can start the business only after obtaining the certificate of commencement.

**Commencement of Business**

The private company or a company having no share capital may commence business and exercise its various powers immediately after it is incorporated. The public company having share capital, on the other hand must obtain certificate to commence business from the registrar of companies before it can commence its business or exercise its borrowing powers. In order to obtain this certificate the company must comply with the provisions of section 149 of the companies act.

The certificate to commence business entitles the company to commence business given in the main objects clause of the memorandum of association. No business given in the "object" can be commenced without obtaining prior approval of the shareholders by way of special resolution. However the central government may on an application made by the Board of directors, allow a company to commence business in the "other object clause", even after an ordinary resolution is passed by the company in general meeting.

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**Memorandum of association**

**Meaning**

The memorandum of association is a document of great importance in relation to the proposed company. It contains the fundamental conditions upon which alone the company is allowed to be incorporated. It is the charter of the company. It lays down the area of operation of the company. It also regulates the external affairs of the company in relation to outsiders.

***Purpose of Memorandum*** : The purpose of memorandum is two fold :

(1) The prospective shareholders shall know the field in, or the purpose for, which their money is going to be used by the company and what risk they are undertaking in making investment.

(2) The outsiders dealing with the company shall know with certainty as to what the objects of the company are and as to whether the contractual relation into which they contemplate to enter with the company is within the objects of the company.

***Printing and Signing of memorandum [sec-15]*** : The memorandum of association of a company shall be –

(a) a printed one.

(b) divided into paragraphs numbered consecutively,

(c) signed by 7(2 in case of a private company) subscribers.

Each subscriber shall sign (and add his address description and occupation, if any) in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.

The memorandum of association printed on computer laser printers should be accepted by the registrar for registration of a company provided it is neatly and legibly printed.

***Form of memorandum [sec – 14] :***

The memorandum of association of a company shall be in such one of the forms in tables B, C, D and E in schedule I to the companies Act, 1956, as may be applicable to the case of the company, or in a form as near thereto as circumstances admit.



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**Contents of memorandum [sec-13] :**

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The memorandum of every company shall contain the following clauses (described as conditions of the company's incorporation) –

1. *The name clause [sec. 20] :* The name of a company establishes its identity and is the symbol of its existence. A company may subject to the following rules, select any suitable name :

   i. Undesirable name to be avoided : A company can't be registered by a name which, in the opinion of the central government, is undesirable and therefore rejected if it is either :

      (a) Too similar to the name of another company : or

      (b) Misleading i.e. suggesting that the company is connected with a particular business or that it is an association of a particular type when this is not the case.

   ii. In junction if identical name adopted : if a company gets registered with a name which resembles the name of an existing company, the other company with whom the name resembles can apply to the court for an injunction to restrain the new company from adopting the identical name.

   iii. Limited or private limited : as the last word or words of the name. The memorandum shall state the name of the company with limited as the last word of the name in case of a public limited company, and with 'private limited' as the last words of the name in case of a private limited company.

   iv. Prohibition of use of certain names. The Emblems and names (prevention of improper use) act, 1950 prohibits, the use of, or registration of a company or firm with, any name or emblem specified in the schedule to that act.

2. *The registered office clause [ sec. 146] :* Every company shall have a registered office from the day on which it begins to carry on business, or as from the 30th day after the date of its incorporation, whichever is earlier. All communications are to be addressed to that registered office.



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The situation of the registered office of a company determines its domicile.

3. *The objects clause [sec-13(1)]* : The objects of a company shall be clearly set forth in the memorandum, for a company can do what is within, or incidental to the objects stated in the memorandum. The objects clause both defines and confines scope of the company's powers. The purpose of the objects clause is :

1. To enable subscribers to the memorandum to know the uses to which their money may be put, and
2. To enable creditors and persons dealing with the company to know what is its permitted range of enterprise or activities.

4. *The capital clause [sec-13 (4)]* : The memorandum of a company, having a share capital, shall state the amount of the share capital with which the company is to be registered and the division thereof into shares of a fixed amount. The capital with which a company is registered is called 'registered' 'authorised' or 'nominal' capital. A company cannot issue more shares than are authorized for the time being by the memorandum. The shares issued by a company can only be equity shares or preference shares.

5. *The liability clause [ sec-13(2)]* : The memorandum of a company limited by shares or by guarantee shall also state that the liability of its members is limited. This means that the members can only be called upon to pay to the company at any time the uncalled or unpaid amount on the shares held by them, or up to the maximum of the amount which they have guaranteed.

6. *The association clause [sec-*13(4)] : The association clause states; "we the several persons whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names". This is followed by the names, addresses and descriptions of the subscribers and the number of shares taken by each one of them. Each subscriber has to take at least one share.





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The memorandum shall be signed by at least 7 subscribers in the case of a public company, and by at least 2 subscribers in the case of a private company. The signature of each subscriber shall be attested by at least one witness who cannot be any of the other subscribers.

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### Articles of association

#### Meaning

The articles of association or just articles are the rules, regulations and bye-laws for the internal management of the affairs of a company. They are framed with the object of carrying out the aims and objects as set out in the memorandum of association.

The articles are next in importance to the memorandum of association which contains the fundamental conditions upon which alone a company is allowed to be incorporated. They are as much subordinate to, and controlled by the memorandum.

In framing the articles of a company care must be taken to see that regulations framed do not go beyond the powers of the company itself as counter plated by the memorandum of association.

***Contents of Articles :*** Articles usually contain provisions relating to the following maters.

(1) Share capital, rights of shareholders, valuation of these rights, payment of commissions, share certificates.

(2) Lien on shares

(3) Calls on shares

(4) Transfer of shares

(5) Transmission of shares

(6) Forfeiture of shares.

(7) Conversion of shares into stock

(8) Share warrants

(9) Alternation capital

(10) General meetings and proceedings threat

(11) Voting rights of members, voting and poll, proxies.

(12) Directors, their appointment, remuneration, qualifications, powers and proceedings of Board of directors.



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(13) Managers

(14) Secretary

(15) Dividends and reserves

(16) Accounts, audit and borrowing powers,

(17) Capitalization of profits

(18) Winding up

***Companies which must have their own articles sec – 26 :*** The following companies shall have their own articles, namely.

(a) Unlimited companies,

(b) Companies limited by guarantee

(c) Private companies limited by shares.

The articles shall be signed by the subscribers of the memorandum and registered along with the memorandum.

A public company may have its own articles of association. If it does not have its own articles, it may adopt table – given in schedule to the act.

Regulations required in case of an unlimited company, a company limited by guarantee and a private company [sec-27].

*(1)* *Unlimited company :* In the case of an unlimited company, the articles shall state –

*(2)* *Company limited by guarantee :* in the case of a company limited by guarantee, the articles shall state the number of members with which the company is to be registered.

*(3)* *Private company :* In the case of a private company having a share capital, the articles shall contain provisions which –

   (a) restrict the right to transfer shares,

   (b) limit the number of its members to 50 (not including employee-members), and

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



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**Form and signature of articles [sec-30]** : The articles shall be –

(a) printed

(b) Divided into paragraphs and

(c) Signed by each subscriber of the memorandum (who shall add his addresses, description and occupation, if any) in the presence of at least one witness who will attest the signature and likewise add his address, description and occupation, it any.

The articles of association printed on computer laser printer should be accepted by the registrar for registration of a company provided they are neatly and legibly printed.

**Distinction between memorandum and articles of association**

| *Memorandum of association* | *Articles of association* |
|---|---|
| 1. It is the charter of the company indicating the nature of its business, its nationality and its capital. It also defines the company's relationship with outside world. | 1. They are the regulations for the internal management of the company and are subsidiary to he memorandum. |
| 2. It defines the scope of the activities of the company, or the area beyond which the actions of the company cannot go. | 2. They are the rules for carrying out the objects of the company as set out in the memorandum. |
| 3. It being the charter of the company, is the supreme document. | 3. They are subordinate to the memorandum. If there is a conflict between the articles and the memorandum, the latter prevails. |
| 4. Every company must have its own memorandum. | 4. A company limited by shares need not have articles of is own. In such a case, Table A applies. |
| 5. There are strict restrictions on its alteration. Some of the conditions of incorporation contained in it cannot be alteredexcept with the sanction of the company law board. | 5. These can be altered by a special resolution, to any extent, provided they do not conflict with the memorandum and the companies act. |

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| | |
|---|---|
| 6. Any act of the company which ultravires the memorandum is wholly void and cannot be ratified even by the whole body of shareholders. | 6. Any act of the company which ultravires the articles (but intravires the memorandum) can be confirmed by the shareholders. |

***Legal Effect of Memorandum and Articles –***

The memorandum and articles, when registered bind a company and the members there of to the extent as if they had been signed by the company and each member.

The effect of these provisions is to constitute, through the memorandum and the articles of a company, a contract between each member and the company.

**Prospectus**

***Definitions :*** Section 2(36) defines a prospectus as "any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate.

***Meaning :*** Any document inviting deposits from the public or inviting offers from the public for the subscription of shares or debentures of a company is a prospectus. In other words prospectus is the basis on which the prospective investors form their opinion and take decisions as to the worth and prospectus of the company.

***Prospectus to be in writing :*** A prospectus must be in writing. An oral invitation to subscribe for shares in, or debentures of, a company, or deposits is not a prospectus. Likewise, an advertisement in television or a film is not treated to be a prospectus.

***Invitation to public :*** A document is not a prospectus unless it is an invitation to the public to subscribe for shares in, or debentures of a company. But if the documents satisfy the condition of invitation to the public, it is a prospectus even though it is issued to a defined class of the public.

***Dating of prospectus [sec.-56] :*** A prospectus issued by or in relation to an intended company, must be dated and that date is, unless the contrary is proved, taken as the date of publication of the prospectus.

***Signing of prospectus :*** In case the prospectus is issued by an intended company, it has to be signed by the proposed directors of





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the company or by their agents authorized in writing. In case of existing companies, the prospectus has to be signed by every person who is named therein as director of the company or by his agent authorized in writing.

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**Registration of prospectus [sec-60] :** A prospectus can be issued by or on behalf of a company only when a copy thereof has been delivered to the registrar for registration. The registration must be made on or before the date of publication thereof. The copy must be signed by every person who is named therein as director or proposed director of the company, or by his agent authorized in writing. Further such a prospectus must state on the face of it that a copy of it has been delivered to the registrar for registration on or before the date of its publication. If a prospectus is issued without a copy thereof being delivered under this section to the Registrar, the company, and every person who is knowingly a party to the issue of the prospectus shall be punishable with a kine which may extend to fifty thousand rupees.

**Objects of registration of prospectus :** The objects of registration of a prospectus are :

(1) To keep an authenticated record of the terms and conditions of issue of shares or debentures, and

(2) To pin point the responsibility of the persons issuing the prospectus for statements made by them in the prospectus.

**Contents of Prospectus :**

Prospectus is the window through which an investor can look into the soundness of a company's venture. The investor must, therefore, be given a complete picture of the company's intended activities and its position. This is done through prospectus which must secure the fullest disclosure of all material and essential particulars and lay the same in full view of all intending purchasers of shares.

***Matters to be stated and reports to be set out in prospectus [sec-56]:***

Sec-56 lays down that every prospectus issued –

(a) by or on behalf of a company or

(b) by or on behalf of any person engaged or interested in the formation of a company, shall



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(1) state the matters specified in part-I of schedule II and

(2) set out the reports specified in part-II of schedule – II.

The important contents of prospectus are as follows.

***Part-I of schedule – II***

**I. General Information**

(a) Name and address of registered office of the company

(b) Consent of the central government for the present issue and declaration of the central government about non responsibility for financial soundness or correctness of statements.

(c) Names of regional stock exchange and other stock exchanges where application is made for listing of present issue.

(d) Provisions relating to punishment for fictitious applications.

(e) Declaration about refund of the issue if minimum subscription of 90 percent is not received within 90 days from closure of the issue.

(f) Declaration about the issue of allotment refund within a period of 10 weeks.

(g) Date of opening of the issue, date of closing of the issue, date of earliest closing of the issue.

(h) Name and address of auditors and lead managers.

(i) Name and address of trustee under debenture trust deed.

(j) Rating from CRISIL (credit rating information of services of India limited) or any rating agency obtained for the proposed debenture/ preference share issue. If no rating has been obtained, this fact should be stated.

(k) Underwriting of the issue.

**II. Capital structure of the company**

(a) authorized, issued, subscribed and paid up capital

(b) size of present issue giving separately reservation for preferential allotment to promoters and others.

(c) Paid – up captital :



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i. after the present issue,

ii. after conversion of debentures (if applicable).

III. **Terms of the present issue**

(a) terms of payments

(b) rights of the instrument holders.

(c) How to apply – availability of forms, prospectus and mode of payment.

(d) Any special tax benefits for company and its shares holders.

IV. **Particulars of the Issue**

(a) objects

(b) project cost

(c) means of financing (including contribution at promoters)

V. **Company management and project**

(a) History and main objects and present business of the company.

(b) Subsidiaries of the company if any

(c) Promoters and their background.

(d) Names, addresses and occupations of manager, managing director and other directors including nominee directors, whole-time directors.

(e) Location of project

(f) Plant and machinery, technology process, etc.

(g) Collaboration agreements

(h) Infrastructure facilities for raw material, water, electricity etc.

(i) Schedule of implementation of the project and progress so far.

(j) Nature of product, approach to marketing and export possibilities.

(k) Future prospects – expected capacity utilization during the first 3 years from the date of commencement of production and the expected year when the company would be able to earn cash profits and net profits.

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**VI. Particulars in regard to the company and other listed companies under the same management which made any capital issue during the last 3 years :**

(a) Name of the company

(b) Year of the issue

(c) Type of the issue (public/ rights/ composite)

(d) Amount of issue

(e) Date of closure of issue

(f) Date of completion of delivery of share/ debenture certificate

(g) Date of completion of the project, where object of the issue was financing of the project

(h) Rate of dividend paid.

**VII. Outstanding litigation pertaining to**

(a) Matters likely to affect operation and finance of the company including disputed tax liabilities of any nature, and criminal prosecution launched against the company and the directors.

(b) Particulars of default, if any, in meeting statutory dues, institutional dues, and dues towards debenture holders and fixed depositors.

(c) Any material developments after the date of the latest balance sheet and their likely impact.

**VIII.** Management perception of risk factors eg. Sensitivity to foreign exchange rate fluctuations, difficulty in availability of raw materials or in marketing of products, cost/ time over –run etc.

**Part-II of Schedule – II**

**A. General Information**

1. Consent of directors, auditors, solicitors/ advocates, managers to issue, registrar of issue, bankers to the company, bankers to the issue and experts.
2. Experts opinion obtained, if any
3. Change, if any in directors and auditors during the last 3 years, and reasons hereof.



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4. Authority for the issue and details of resolution passed for the issue.

5. Procedure and time schedule for allotment and issue of certificates.

6. Names and addresses of the company secretary, legal advisor, lead manages, co-managers, auditors, bankers to the company, bankers to the issue and brokers to the issue.

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**(B) Financial Information**

1. Report by the auditors. A report by the auditors of the company with respect to (a) its profits and losses and assets and liabilities and (b) the rates of dividend paid by the company during the proceeding 5 financial years.

2. Reports by the accountants on the profits or losses of the business for the preceeding 5 financial years, and on the assets and liabilities of the business on a date which shall not be more than 120 days before the date of the issue of the prospectus.

3. Principal terms of loans and assets charged as security.

**(C) Statutory and other information**

1. Minimum subscription
2. Expenses of the issue giving separately fees payable to (a) advisers (b) registrars to the issue (c) managers to the issues (d) trustees for the debenture holders.
3. Underwriting commission and brokerage
4. Previous issue for cash
5. Previous public or rights issue, if any (during last 5 years).
6. Commission or brokerage on previous issue
7. Issue of shares otherwise than for cash
8. Debentures and redeemable preference shares and other instruments issued by the company outstanding as on the date of prospectus.
9. Option to subscribe



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10. Details of purchase of property
11. Details of directors, proposed directors, whole time directors, their remuneration, appointment and remuneration of managing directors, interest of directors, their borrowing powers and qualification shares.
12. Rights of members regarding voting, dividend lien on shares and the process for modification of such rights and forfeiture of shares.
13. Restrictions, if any on transfer and transmission of shares/ debentures.
14. Revaluation of assets, if any (during last 5 years).
15. Material contracts and inspection documents.

**Part-III of schedule – II – provisions applying to Parts – I and II of schedule – II**

1. Every person shall for the purposes of this schedule, be deemed to be a vendor who has entered into any contract, absolute or conditional, for the sale or purchase of any property to be acquired by the company.
2. In the case of a company which has been carrying on business for less than 5 financial years for which business has been carried on.
3. Reasonable time and place at which copies of all balance sheet and profit and loss accounts on which the report of the auditors is based and material contracts and other documents may be inspected.
4. Term 'year' wherever used here in earlier means financial year.

**Declaration :**

That all the relevant provisions of the companies act 1956 and the guidelines issued by the government have been complied with and no statement made in the prospectus is contrary to the provisions of the companies act, 1956 and rules there under.

The prospectus shall be dated and signed by the directors.

**MEETINGS**

**Meaning of meetings :** A meeting may be defined as a gathering or assembly, getting together of a number of persons for transacting any



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lawful business, for entertainment or the like. There must be at least two persons to constitute a meeting. In case of company meetings, in certain exceptional cases, even one person may constitute a valid meeting.

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***Kinds of Meetings :*** The meetings of a company may be classified as follows :

1. General meetings which include –
   i. statutory meeting
   ii. Annual general meetings and
   iii. Extraordinary meetings

   These meetings are called general meetings of a company as these are meetings of all the members of the company.

2. Class meetings of shareholders of different classes of shares where a company has more than one class of shares.

3. Meetings of creditors and debenture holders
   (a) during the lifetime of the company, and
   (b) at the time of winding up of the company.

**General meetings of shareholders**

1. Statutory meeting (sec-165)

   Every company limited by shares and every company limited by guarantee and having a share capital shall, within a period of not less than one month nor more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company. This meeting is called as 'statutory meeting'. This is the first meeting of the shareholders of a public company and is held only once in the lifetime of a company.

**Procedure at the meeting :**

(a) List of member : - At the commencement of the statutory meeting, the board shall produce a list showing the names, addresses



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and occupations of the members of the company and number of; shares held by them respectively. The list shall remain open and accessible to any member of the company during the continuance of the meeting.

(b) Discussion of matters relating to formational aspect : - The members present at the meeting shall be at liberty to discuss any matter relating to the formation of the company. They may also discuss any matter arising out of the statutory report. Previous notice for such discussion is not necessary. However, no resolution may be passed of which notice has not been given in accordance with the provisions of the Act.

(c) Adjournment :- The meeting may adjourn from time to time. At any adjourned meeting, any resolution (of which notice has been given), whether before or after the former meeting may be passed. An adjourned meeting shall have the same powers as the original meeting. The object of the adjournment may be to provide members with additional information as to the company's affairs.

2. Annual General Meeting

Every company shall in each year hold in addition to any other meetings a general meeting as its annual general meeting and shall specify the meeting as such in the notice calling it. There shall not be an interval of more than 15 months between one annual general meeting of the company and the next. A company may hold its first annual general meeting within a period of 18 months from the date of its incorporation. In that event it is not necessary for the company to hold any annual general meeting in the year of its incorporation or in the next year. Year means calendar year.

The registrar may, for any special reason, extend the time for holding any annual general meeting by a period not exceeding 3 months. But no extension of time is granted for holding the first annual general meeting.

There should be at least one annual general meeting per year and as many meetings as there are years.



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**Time and place of meeting :** Every annual general meeting shall be called during business hours on a day that is not a public holiday. It shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated.

NOTES

**21 days' notice [sec-171]** A general meeting of a company may be called by giving not less than. 21 days, notice in writing. It may be called with a shorter notice if it is agreed to by all the entitled to vote in the meeting.

**Consequences of failure to hold annual general meeting :** If a company fails to hold an annual general meeting –

1. Any member can apply, under sec- 167 to the company law board for calling the meeting.
2. The company and every officer who is in default shall be punishable with fine.

**Importance of annual general meeting :** it is only at the annual general meeting of a company that the shareholders can exercise any control over the affairs of the company. They can confront the directors, their elected representatives, at least once a year. They also get an opportunity to discuss the affairs and review the working of the company. They can also take the necessary steps for the protection of their interests. They can also take up any other business relating to the affairs of the company for discussion. Appointment of auditors is also made at the annual general meeting. Annual accounts are presented for the consideration of shareholders and dividends are declared in the annual general meeting.

**Extraordinary General meeting [sec-169] :** A statutory meeting and an annual general meeting of a company are called ordinary meetings. Any meeting other than these meetings is called an extraordinary general meeting. It is called for transacting some urgent or special business which cannot be postponed till the next annual general meeting. An extraordinary general meeting is called for some special business transactions such as :

i. Issue of right shares

ii. Increase in the remuneration of managing director, whole time director etc.

**Power of company law board to order meeting**

Under section 186 of the India companies act 1956 if for any reason it is impracticable for a company to call, hold or conduct an extraordinary general meeting, the company law board may call an extraordinary general meeting, either of its own motion or on the application of any director of the company, or of any member of the company who would be entitled to vote at the meeting. Any meeting called, held and conducted in accordance with any order of the company law board shall for all purposes be deemed to be a meeting of the company duly called, held and conducted.

**Requisites of a valid meeting**

A meeting can validly transact any business if the following requirements are satisfied :

1. *Proper authority :* The proper authority to convene a general meeting (whether statutory, annual general or extraordinary) of a company is the board of directors. The board should pass a resolution to call the general meeting at a duly convened meeting of the board. If the directors do not call the meeting, the members of the company law board may call the meeting.

2. *Notice of meeting :* A proper notice of the meeting should be given to the members and all others who are entitled to attend the meeting.

3. *Quorum of meeting :* As per sec 174 of Indian companies act 1956 quorum means the minimum number of members who must be present in order to constitute a valid meeting and transact business thereat. The quorum is generally fixed by the articles. If the articles of a company do not provide for a larger quorum, the following rules apply :

1. 5 members personally present in the case of a public company (other than a deemed public company) and 2 in the case of any other company, shall be the quorum for a meeting of the company. For the purpose of quorum a person may be counted as 2 or more members if he holds shares in different capacities, e.g. as a trustee and also in his own right.



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The representative of a body corporate appointed under sec-187 or the representative of the president of India or a governor of a state under sec-187-A is a member personally present for the purpose of a quorum.

2. If within half an hour a quorum is not present, the meeting, if called upon the requisition of members, shall stand dissolved. In any other case, it shall stand adjourned to the same day; place and time in the next week. The board of directors may adjourn the meeting to be convened on any particular day, time and place to be fixed on the date of the meeting itself or at least before the commencement of the same in the next week. Where the board of directors fails to do so, the meeting stands statutorily adjourned to the same day in the next week.

3. If at the adjourned meeting also, a quorum is not present within half an hour, the members present shall be the quorum.

**The Articles may provide for a larger quorum :**

The articles cannot provide for a quorum smaller than the statutory minimum. For the purposes of quorum, only members present in person and not by proxies are to be counted. A company cannot, by its articles or otherwisė, provide for proxies being counted for purposes of a quorum. Where the total number of members of a company becomes reduced below the quorum fixed for a meeting the rules as to quorum will be satisfied if all the members of the company are present.

Further Article 49(1) of table A requires the quorum to be present at the time when the meeting proceeds to transact business. It need not be present throughout or at the time of taking vote on any resolution. If during the meeting some shareholders leave so that quorum is not present, the meeting must be discontinued by adjournment. However, if a meeting is once organized and all parties have participated, no person or faction can by withdrawing capriciously and for the sole purpose of breaking the quorum, render subsequent proceedings invalid.

### Minutes of meeting (193 to 196)

Minutes are a record of what the company and directors do in meetings.

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**Minutes of proceedings of meeting (sec – 193)**

Every company shall keep a record of all proceedings of every general meeting and of all proceedings of every meeting of board of directors and of every committee of the board. This is done by making within 30 days of the conclusion of every such meeting concerned, entries of the proceedings in the books kept for that purpose. These records are known as minutes.

**Minutes Book :** The book in which the record of the proceedings of a meeting is kept is known as the minutes book. Separate minutes books are required to be kept for shareholder's general meetings of the company and directors meetings and usually there are also separate minutes books for committee meetings of the board of directors.

**Numbering of pages :** The pages of every minutes book shall be consecutively numbered. In no case is the attaching or pasting of papers of proceedings of a meeting allowed in minutes book.

**Signing of minute :** Each page of the minutes book which records proceedings of a board meeting shall be initialed or signed by the chairman of the same meeting or the next proceeding meeting. The last page of the record of proceedings each meeting in the minute's book shall be dated and signed. This has to be done. –

(a) In the case of a board or a committee meeting, by the chairman of the same or the next succeeding meeting and,

(b) In the case of a general meeting, by the chairman of the same meeting within 30 days of the meeting, or in the event of the death or inability of that chairman within 30 days of the meeting, by the director duly authorized by the board for the purpose.

**Fair and correct summary : -** The minutes of each meeting shall contain a fair and correct summary of the proceedings at the meeting, so that the absentee shareholders may be in a position to form some reliable idea of what transpired at these meetings. All appointments of officers made at any of the meetings aforesaid shall also be included in the minutes of the meeting.

**Evidentiary value of minutes (sec – 194) : -** Minutes of meetings kept in accordance with the provisions of sec-193 shall be evidence of the proceedings recorded therein and shall be conclusive of the facts stated therein.



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## VOTING

The motions proposed in a general meeting of a company are decided on the votes of the members of the company. The members holding any equity share capital therein have the right to vote on every motion placed before the company. Members holding preference shares can vote only on those motions which affect rights attached to their capital (sec-87).

A shareholder's vote is a right of property, and prima facie may be exercised by him as he thinks fit in his own interest. He is not found to exercise it in the best interests of the company. The voting may be :

1. by show of hands, or
2. by taming a poll.

**Voting by a show of hands (sec-177 and 178)**

At any general meeting, motions put to vote are in the first instance decided by a show of hands, unless a poll is demanded (sec-177). In taking a vote by show of hands, the duty of the chairman is to count the hands raised and to declare the result accordingly, without regard to the number of votes that a member raising the hand possesses. Proxies cannot be used on a show of hands.

***Chairman's declaration of result of voting by a show of hands conclusive (sec-178) :*** A declaration by the chairman as evidenced by an entry in the minutes book shall be conclusive evidence of the fact that a resolution has, on a show of hands, been carried.

***Rough and ready method :*** Voting by a show of hands may not effectively reflect the interest of the members of accompany.

***Voting by poll (sec-179) :*** Before or on the declaration of the result of voting on any motion on a show of hands, a poll may be taken by the chairman of the meeting of his own accord. It shall, however, be taken on a demand made in that behalf by the persons specified below :

(a) In the case of a public company having a share capital, a poll shall be taken on a demand by any member or members present in person or by proxy and holding shares in the company. –

   i. Which confer a power to vote on the resolution not being less than 1/10th of the total voting power in respect of the resolution, or



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ii. On which an aggregate sum of not less than Rs.50000 has been paid up.

(b) In the case of a private company having a share capital, a poll shall be taken on demand by one member having the right to vote on the resolution and present in person or by proxy if not more than seven such members are personally present, and by two such members present in person or by proxy if more than seven such member are personally present.

(c) In the case of any other company, a poll shall be taken on demand by any member or members present in person or by proxy and having not less then 1/10th of the total voting power in respect of the resolution.

The demand for a poll may be withdrawn at any time by the person or persons who made the demand.

**Time of taking poll (sec-180) –** A poll demanded on a question of adjournment or the appointment of chairman shall be taken forthwith. In any other case a poll shall be taken within 48 hours of the demand for poll.

**Meeting in continuance until result of poll ascertained -** A poll is complete when its result is ascertained, and not on an earlier day when the votes were cast. Where a poll is taken, the meeting is regarded as continuing until the ascertainment of the result of the poll.

A meeting reconstituted after a poll is in continuance of the same meeting and a poll itself is part of the meeting.

**Manner of poll and result thereof (sec-185) :** The chairman of the meeting has the power to regulate the manner in which a poll is to be taken. However the method usually followed is that of a ballot paper on which members record their decision i.e. for or against the motion. The result of the poll shall be deemed to be the decision of the meeting on the motion on which the poll is taken.

**Resolution :** The question which generally comes for consideration at the general meeting of a company are presented in the form of proposals called motions. A motion may be proposed by the chairman of the meeting or by any other member of the company. Before it is placed before the meeting by the chairman for discussion, it must be recorded by someone. The motion after the close of discussion, is

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formally put to vote by a show hands. It may either be carried or rejected. If a sufficient number of members demand, the motion may be put to poll. The final result is declared after the poll is taken. If a motion is carried, it becomes a 'resolution'.

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**Kinds of Resolution :**

There are three kinds of resolutions under the companies act, 1956.

1. **Ordinary resolution [sec-189(1)]**

   An ordinary resolution is a resolution passed at a general meeting of a company by a simple majority of votes (ie., votes cast in favour of the resolution exceed votes cast against it) including the casting vote of the chairman, if any. The votes may be cast by members in person or by proxy, where proxies are allowed. The required notice of the meeting should have been duly given. In ascertaining simple majority of the members, only the votes cast including the casting vote of the chairman, if any, have to be taken into account.

Unless the companies act or the memorandum or the articles expressly requires a special resolution or resolution requiring special notice, an ordinary resolution is sufficient to carry out any matter.

**When is an ordinary resolution required :** Ordinary resolution is necessary for the following among other purposes.

(a) Rectification of name or adoption of new name by a company where it resembles the name of an existing company with the previous approval of the central government [sec-22 (1)(a)].

(b) Issue of shares at a discount [sec-79(2)]

(c) Alteration of share capital [sec-94(2)]

(d) Re issue of redeemed debentures [sec-121]

(e) Adoption of statutory report [sec-165]

(f) Passing of annual accounts and balance sheet alongwith reports of board of directors and auditors [sec-210]

(g) Appointment of auditors and fixation of their remuneration [sec.224(1)]

(h) Appointment of first directors who are liable to retire by rotation [sec-255(1)]



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(i) Increase or reduction in the numbers of directors within the limit fixed by the articles [sec-258]

(j) Appointment of managing/ whole – time director [sec-269].

(k) Removal of a director and appointment of a director in his place [sec-284(1)]

(l) Approval of appointment of sole selling agents [sec-294] .

(m) Winding up a company voluntarily in certain events [sec.284(1) (a)].

(n) Appointment and fixation of remuneration of liquidators in a member's voluntary winding up [sec-490(1)]

(o) Nomination of a liquidator in a creditor's voluntary winding up [sec.502(1)].

**2. Special resolution [sec.-189(2)] : A special resolution is one which satisfies the following conditions :**

(a) The intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting.

(b) The notice has been duly given of the general meeting.

(c) The votes cast in favour of the resolution by members entitled to vote are not less than 3 times the number of votes cast against the resolution by members so entitled and voting. The members may vote in person, or where proxies are allowed, by proxies.

(d) An extraordinary statement setting out all material facts concerning the subject matter of the special resolution including, in particular, the nature of the concern or interest of every director and the manager, if any, shall be annexed to the notice of the meeting.

A copy of every special resolution together with the copy of the explanatory statement shall, within 30 days of the passing of the resolution, be filed with the registrar.

The object of requiring a majority of 3/4$^{th}$ of the votes for a special resolution is to protect the minority interests in important matters relating to the company's affairs.



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**When is a special resolution required ? Special resolution is necessary for the following among other purposes :**

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(a) Alteration of memorandum for changing the place at registered office from one state to another. Special resolution is also required for changing the objects clause of the memorandum.

(b) Change of name of a company with the consent of the central government [sec-21].

(c) Omission or addition of the word 'private' from or to, the name of a company [sec-21].

(d) Change of name of a charitable or other non-profit company by committing the word or words 'limited' or private limited [sec.25(3)].

(e) Alteration of the Articles of a company [sec-31(1)]

(f) Conversion of any portion of the uncalled capital into reserve capital [sec-99].

(g) Reduction of share capital [sec-100(1)]

(h) Variation of shareholders rights [sec.106]

(i) Removal of a company's registered office outside the local limits of any city, town or village [sec-146(2)].

(j) Keeping registers and returns at a place other than the registered office [sec-163(1)]

(k) Payment of interest out of capital [sec-208(2) and (3)].

(l) Applying to the central government for appointing an inspector for investigating a company's affairs in some cases [sec-237(a)]

(m) Appointment of sole selling or buying agent in the case of companies having paid-up share capital at Rs.50 lakhs or more [sec-294-AA(3)].

(n) Fixing the remuneration of directors where the articles require such resolution [sec-309(1)] .

(o) Allowing a director to hold an office of profit under a company [sec-314(1) and (1-B)].

(p) Alteration of memorandum to render the liability of directors unlimited [sec-323(1)].



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(q) Applying to the court to wind up a company [sec-433(a)].

(r) Winding up a company voluntarily [sec-484(1)(b)].

(s) Authorizing the liquidator of a company to accept shares as consideration for the transfer of its assets [sec-494(1)].

(t) Disposal of books and papers of a company in voluntary winding up when its affairs have been completely wounding.

The act requires sanction of shareholders by a special resolution in respect of a number of matters (in addition to those given above) dealt with in sec.81, 146, 149, 224-A, 370, 517, 546 and 579.

**Resolutions requiring a special notice (sec-190) :**

A resolution requiring a special notice is not an independent class of resolution. It is only a different kind of an ordinary resolution of which notice of the intention to remove a resolution has to be given to the company by the proposer. The notice shall be given not less than 14 days before the meeting at which the resolution is to be moved exclusive of the day on which the notice is served or deemed to be served and the day for the meeting.

**Company to give notice to members**

The company shall, immediately after the notice of the intention to move any such resolution has been received by it, give its members notice of the resolution in the same manner as it gives notice of the meeting. If this is not practicable (i.e. to give notice to the members individually), the company shall give notice to the members by advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles. The words 'appropriate circulation' mean circulation appropriate or proper in the circumstances of the case.

When is special notice required ? A special notice is required for a resolution in the following cases :

1. Appointment of an auditor other than the retiring ones (sec-225).
2. Provision that a retiring auditor shall not be re-appointed (sec-225)
3. Removal of a director before the expiry of his period.
4. Appointment of a director in place of one who is removed (sec-284).



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The articles of a company may provide for additional matters in respect of which special notice is required.

**Resolutions passed at adjourned meetings (sec-191).**

Where a resolution is passed at an adjourned meeting of (a) a company, or (b) the holders of any class of shares in a company, or (c) the board of directors of a company, the resolution shall, for all purposes, be treated as having been passed on the date on which it was in fact passed.

**Passing of resolution by postal ballot [sec-192-A is inserted by the companies (Amendment) Act, 2000.**

A listed public company may, and in the case of resolutions relating to such business as the central government may, by notification, declare to be conducted only by postal ballot, shall get any resolution passed by means of a postal ballot, instead of transacting the business in general meeting of the company.

**When is resolution said to be passed**

If a resolution as assented to by a majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened on that behalf.

**QUESTIONS :**

1. A joint stock company is an artificial person created by law with a perpetual succession and a common seal. Do you agree with this definition of a company ? Explain.
2. How is a company formed under the companies act, 1956? Enumerate the various documents to be filed with the registrar.
3. Who is a promoter? Discuss his legal position in relation to a company which he promotes.
4. The memorandum of association is the fundamental law or a charter defining the objects and limiting the powers of a company Explain.
5. Discuss the relationship between the articles and the memorandum of association of a company.
6. What is a prospectus? What are its contents ? Is it obligatory for a company to file prospectus or a statement in lieu of prospectus with the registrar of companies ?

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7. What are different kinds of meetings of the shareholders of a company? When and how are these meetings held?

8. What are the requisites of a valid meeting ?

9. What do you understand by a quorum? should a quorum be present throughout a meeting ? What is the procedure if a quorum is never formed ?

10. What is resolution ? Discuss the different types of resolution.

**Books suggested**


1. Company law -by A.K. Majuimdar & V.K. Kapoor-Taxman.
2. Mercantile Law - by N.D.Kapoor
3. Business and company law – by Chawla & Garg.


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