BUSINESS LAWS

(DBC31)

(BACHELOR OF COMMERCE)

ACHARYA NAGARJUNA UNIVERSITY

CENTRE FOR DISTANCE EDUCATION

NAGARJUNA NAGAR,

GUNTUR

ANDHRA PRADESH

LESSON - 1

LAW OF CONTRACT

1.0 OBJECTIVES :

After studying this lesson, you should be able to understand

- to learn the nature and importance of contract
- Definitions of Contract
- History of Contract Act
- Essentials of Valid Contract
- Classification of Contracts

STRUCTURE :

1.1 INTRODUCTION :

The Indian Contract is the most important constituents of Indian Mercantile Law. It affects every person since every one of us enters into a contract virtually every day. When a person takes a seat in a bus or lends a book to the friend or deposits money in a bank account or purchases goods on credit, he enters into a contract though he may not be conscious of this fact. The law of contract is of immense importance to a businessman since all his transactions are based on contracts.

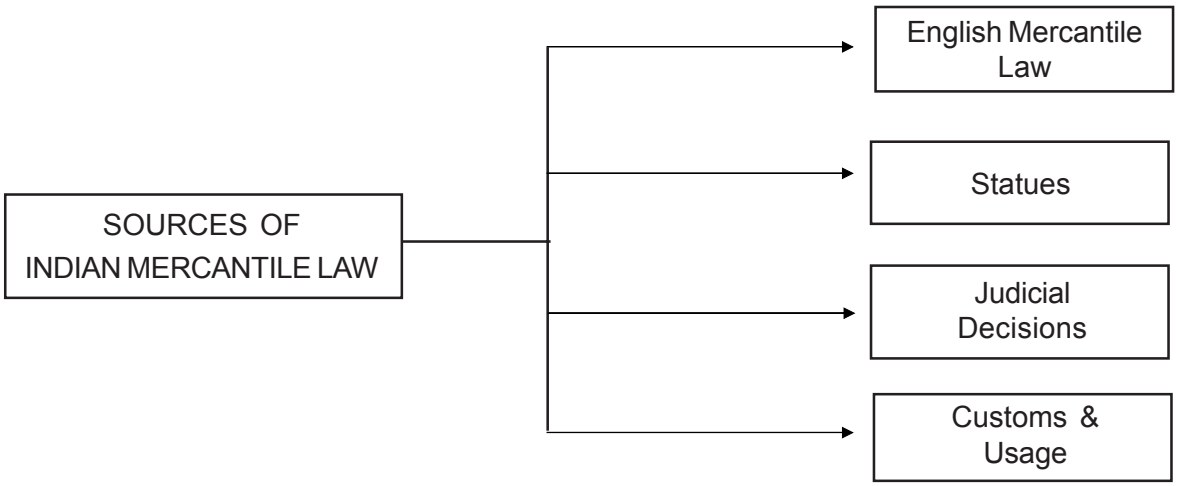
The Indian Contract Act came into force from 1st September, 1872. It hsa been amended several times. The notable amendments have been in 1886, 1891, 1899, 1930, 1932 and 1997. The Act has been mainly enacted to ensure that the obligations prescribed by agreements and the reasonable expectations created by them are fulfilled by the concerned parties to the agreement. The Act applies to the whole of India expect the state of Jammu and Kashmir.

1.2 SOURCES OF INDIAN BUSINESS LAW :

The main source of Indian Mercantile Law are as follows :

1. English Mercantile Law : Indian Mercantile Law is largely based on English Mercantile Law. As a matter of fact, even after independence, in the absence of provisions regarding any matter of the Indian Law, the provisions of the English Law are generally accepted in the Indian courts.

2. Statutes of Indian Legislatures : Most of Indian Laws are in the form of Acts passed by the Legislatures. Both the Central Legislatures (i.e., the Parliament) and the State Legislatures are empowered to enact laws relating to matters which come within their Jurisdiction. For example the Companies Act 1956 enacted by the Parliament while the different State Legislatures have enacted the Sales Tax Acts applicable to their respective states.



3. Judicial Decisions : Past Judicial decisions acquire the force of precedents and are generally followed by Law courts in deciding similar cases. In our country, the courts have been divided into three groups : (i) the Supreme Court, (ii) the High Courts and (iii) the Sub-ordinate Courts. The Supreme is the final court of appeal. For the court of same stature, earlier decisions have only a guiding and persuasive value. However, for a court of a lower stature, the decision given by the court of a higher stature, the decision given by the court of a higher stature regarding the same subject matter is usually taken as having binding effects.

4. Customs and Usage : Customs and usage also plan a significant role in regulating business transactions. This fact has been accepted by many Indian status. For example : Section 1 of the Indian Contract Act states that 'nothing therein' contained shall affect any usage or customs of trade'. Similarly Section 1 of the Negotiable Instruments Act also provides that 'nothing therein contain shall affect any legal usage relating to instruments in an oriental language.

1.3 CONTRACT DEFINITIONS :

It will be appropriate to go through definitions given by some eminent Jurists to understand the meaning of the term contract.

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

2. "An agreement creating and defining obligations between the party" - Salmond.
3. "Rule of external human actions enforced by sovereign political authority" - Halland.
4. "A rule of conduct imposed and enforced by the sovereign" - Austin.

The term Business Law, Commercial Law and Mercantile Law are synonymous. Business Law deals with rights and obligations arising out of mercantile transactions among mercantile persons. Business Law denotes the aggregate body of legal rules connected with trade, industry and commerce.

Business or mercantile laws include law relating to contracts, sale of goods, negotiable instruments, partnership, companies, insurance, carriage of goods, insolvence consumer protection etc.

Simple stated, "Law" operates, to regulate the actions of persons with repsect to one another and entire group or society and the state.

However the scope of mercantile law is ever widening due to increasing complexities of business world.

1.3.1 Legal Obligation :

The agreement should give rise to a legal obligation, i.e., obligation which is enforceable at law. Agreements which give rise only to social or domestic obligations cannot be termed as contracts. An agreement to go to a picture or attend a marriage cermony is not a contract as it does not give rise to any legal obligation.

1.3.2 An Agreement :

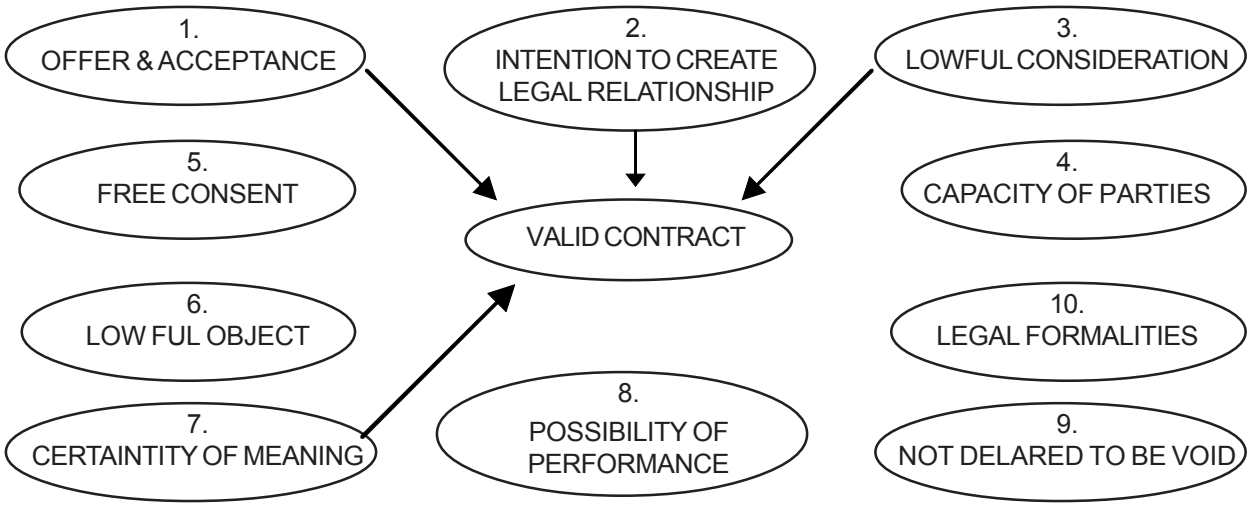
There has to be an agreement between two parties. An offer when accepted becomes an agreement. Thus, an agreement implies an offer and acceptance. The term offer implies the willingness of a person to do or not to do something and its communication to the other, while acceptance means assent by the party to whom the offer has been made.
For Example : If 'A' says to 'B' that he is willing to sell him his car for a sum of Rs. 70,000/-, it is an offer from 'A'. If 'B' gives his assent to this offer, it will be said that he has accepted the offer and an agreement will come into existence.

1.4 ESSENTIAL ELEMENTS OF A VALID CONTRACT :

All agreements are not contracts. Only that agreement which is enforceable at law is a contract. An agreement which is not enforceable at law cannot be a contract. Thus, the term agreement is more wider in scope than contract. **All contracts are agreements but all agreements are not contracts.**

An agreement, to be enforceable by law, must possess the essential elements of a valid contract as contained in Section 10 of the Indian Contract Act. According to Section 10, all agreements are contracts if they are made by the free consent of the parties, competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void. As the details of these essentials from the subject - matter of our subsequent lessons.

ESSENTIAL ELEMENTS OF A VALID CONTRACT



1. **Offer and Acceptance :** In order to create a valid contract, there must be a "lawful offer by one party and lawful acceptance" of the same by the other party. The objective "lawful" means 'offer' and its acceptance must confirm to the rules laid down in the Indian Contract Act regarding valid 'offer' and acceptance and its communication.
2. **Intention to create Legal relationship :** In case, there is no such intention on the part of parties, there is no contract. Agreement of social or domestic nature do not contemplate legal relating.

The leading case on this point is :

BALFOUR VS BALFOUR (1919)

A husband (Mr. Balfour) promised to pay his wife (Mrs. Balfour) a household allowance of £ 30 (Pounds) every month. Later the parties separated and the husband failed to pay the amount. The wife suied for the allowance. Held, agreements such as these were outside the realm of contract altogether.

In commercial and business agreements, the presumption is usually that the parties intended to create legal relations. But this presumption is refuttable which means that it must be shown that the parties did not intent to be legally bound. Therefore, the wife and husband relationship is not legal relationship. So, this contract is void (an agreement not enforceable by law).

Another leading case on this point is :

ROSE AND FRANK CO. VS CROMPTON BROS (1923)

Two firms entered into a written contract for the sale and purchase of tissue paper. The agreement contained a clause to the effect that "this arrangement is not entered into, nor is this memorandum, written, as a formal or a legal document, and shall not be subject to legal jurisdiction in the law courts". Since the goods were not delivered, the buyer brought an action for non-delivery. It was held that there is no contract as the parties never intended to created legal relationship.

3. **Lawful consideration :** Consideration has been defined in various ways. According to Blackstone, "Consideration is recompense given by the party contracting to another". In the words of Rollock; "Consideration is the price for which the promise of another is brought".

Consideration is known as quid pro-quo or something in return.

Consideration is an essential element in a contract, promises made for nothing are unforceable under the Indian Contract. An agreement without consideration subject to certain exceptions is void. In the absence of consideration a promise or undertaking is purely gratuitous and, however, sacred and binding in honour, creates no legal obligation. The legal maxim being Ex nudo pacto non oritur actio (out of a bare agreement no action arises). Consideration may take the form of money, goods, services, a promise to marry, a promise to forbear fromsuing the promise etc. Consideration may be past, present of future. But it must be real and lawful.

4. **Capacity of Parties :** The Parties to an agreement must be competent to contract. If either of the parties does not have the capacity to contract, the contract is not valid.

According to Section 11 "every person is competent to contract, who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject". Accordingly, the following persons are incompetent to contract : (a) Minors, (b) Persons of unsound mind and (c) Persons disqualified by law to which they are subject.

5. **Free Consent :** 'Consent' means the parties must have agreed upon the same thing in the same sense. According to Sec. 13, "Two are more persons are said to consent when they agree upon the same thing in same sense". This is called consensus ad idem in English Law.

Example : A who owns two cars, one Maruti and the other Santro, offers to sell B one car. A intending it to be the Maruti Car. B accepts the offer thinking that it is the Santro. There is no consesus and hence no contract.

According to Section 14, "consent is said to be free when it is not caused by - 1) Coercision or (2) undue influence, (3) Fraud or (4) Mis-representation or (5) Mistake.

6. **Lawful Object :** The object of an agreement must be lawful. Object has nothing to do with consideration. It means the purpose or design of the contract. Thus, when one hires a house for use as a gambling house.

The object is said to be unlawful if -

a) it is forbidden by law;
b) it is of such nature that if permitted it would defeat the provisions of any law;
c) it is fraudulent;
d) it involves an injury to the person or property of any other;
e) the court regards it as immoral or opposed to public policy.

7. **Certainity of Meaning** : According to Section 29, "Agreements the meaning of which is not certain or capable of being made certain are void". The terms of the contract must be precise and certain. It cannot be left vague. A contract may be void on the ground of uncertainty. Thus, a purported acceptance of an offer to buy a lorry, an hire-purchase terms' does not

costitute a contract if the hire purchase terms are never agreed. Similarly an agreement 'subject to war clause' is too vague to be enforceable.

8. **Possibility of Performance :** If the act is impossible in itself, physically or legally, it cannot be enforced at law. For example, Mr. A agrees with B to discovers treasure by magic. Such agreement is not enforceable.

9. **Not declared to be void or illegal :** The agreement though satisfying all the conditions for a valid contract must not have been expressly declared void by any law in force in the country. Agreements mentioned in Section 24 to 30 of the Act have been expressly declared to be void for example agreements in restraint of trade, marriage legal proceedings etc.

10. **Legal formalities :** An oral contract is a perfectly valid contract, except in those cases where writing is required in cases of sale, mortgage, lease and gift of immovable property, negotiable instruments, memorandum and articles of association of a company etc. Registration is required in cases of documents coming within the scope of Section 17 of the Registration Act.

All the elements mentioned above must me present in order to make a valid contract. If any one of them is obsent the agreement does not become a contract.

1.5 CLASSIFICATION OF CONTRACTS :

Contracts may be classified on the basis of their

a) Validity
b) Formation
c) Performance

A. Validity or Enforceability	B. Formation	C. Performance
* Valid Contracts	* Express Contracts	* Executed Contracts
* Void Contracts	* Implied Contracts	* Executory Contracts
* Void agreements	* Quasi Contracts	i) Unilateral Contracts
* Voidable Contracts	* EDI Contracts	ii) Bilateral Contracts
* Unenforceable Contracts		
* illegal agreements		

1.5.1 Classification of Contracts :

There are briefly discussed as under :

A. 1. **Valid Contract :** An agreement enforceable at law is a valid contract. An agreement becomes a contract when all the essentials of a valid contract as laid down in Section 10 are fulfilled.

2. **Void Contract :** An agreement which was not enforceable at law is called as Void Contract. A void contract is not necessarily unlawful, but is distitute of legal effects. The law will not enforce such a contract, nor can it be made valid by the parties.

Ex : A contract between a citizen of Pakistan and India is a valid contract during peace but if war breaks out between the two countries, the agreement will come void contract.

3. **Void Agreement :** According to Sec. 2 (g), "An agreement which is not enforceable by law by either of the parties is void".
No legal rights of obligations can arise out of a void agreement.

4. **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.
Ex : A, a person of weak intelligence made a gift of his entire property to B, who was in a position to dominat him. The gift having been obtained by undue influence is voidable at the option of 'A'.

5. **Unenforceable Contracts :** It is contract which is otherwise valid, but cannot be enforced because of some technical defects like absence of a written form or absence of a proper stamp.

6. **Illegal Agreements :** A contract which is either prohibited by law or otherwise against the policy of law is an illegal agreement.

Ex : A contract to commit dacoity is an illegal contract and cannot be enforced at law.

1.5.2 Contracts classified according to formation :

B. 1. **Express Contract :** An express contract is one entered into by words which may be either spoken or written, where the proposal and acceptance is made in words, it is an express contract.

2. **Implied Contract :** When the proposal or acceptance is made otherwise than in words, it is an implied contract. Implied contracts can be smelled out of the surrounding circumstances and the conduct of the parties who made them. So, where a person employs another to do some work the law implies that the former agrees to pay for the work.

3. **Construction or Quasi Contract :** It is a contract in which there is no intention on either side to make a contract, but the law imposes a contract. Thus, a binder of lost goods is under an obligation to find out the true owner and return the goods.

4. **E.D.I. Contracts :** These contracts are entered into between the parties using internet. In electronic commerce, different parties / persons create network which are linked to other networks through EDI (Electronic Data Inter-change). This helps in doing business transactions using electronic mode.

1.5.3 Classification on the basis of Performance :

Contracts may be classified on the basis of extent of their performance. Such contracts may be :

C. 1 **Executed Contract :** An executed Contract is one where both the parties have performed their obligations or carried out the terms of the contracts. In other words, it is a completed contract.

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

2. **Executory Contract :** Where the contract is yet to be performed either wholly or partially or one or both the parties have yet to perform their obligations, the contract is executory contract. Thus, executory contract may be (a) Unilateral, (b) Bilateral.

a) Unilateral Contract : A unilateral contract is one in which a promise on one side is exchanged for an act on the other side.

b) Bilateral Contract : These are the contracts where a promise on one side is exchanged for a promise on the part of the other party.

1.6 SUMMARY :

A contract is made between two or more parties which the law will enforce. According to Sec. 2 (h), a contract is an agreement enforceable by Law.

Essential of Contract : The valid contract has having the essential features, those are (1) Offer and acceptance, (2) legal relationship, (3) Lawful consideration, (4) Capacity of parties, (5) Free consent, (6) Lawful object, (7) Certainity of meaning, (8) Possibility of performance, (9) Declared to be void or illegal, (10) Legal formalities.

Classification of Contracts : Contracts may be classified on the basis of their (a) validity, (b) formation and (c) performance.

1.7 TECHNICAL TERMS :

1.	Agreement	:	An offer when accepted becomes an agreement.
2.	Contract	:	An agreement enforceable by law.
3.	Illegal Agreement	:	An agreement against the provisions of law.
4.	Void Agreement	:	An agreement enforceable at the time when it was made.
5.	Voidable Contract	:	An agreement enforceable at the option of one or more parties thereto, but not at the option of the other or others.

1.8 SELF-ASSESSMENT QUESTIONS :

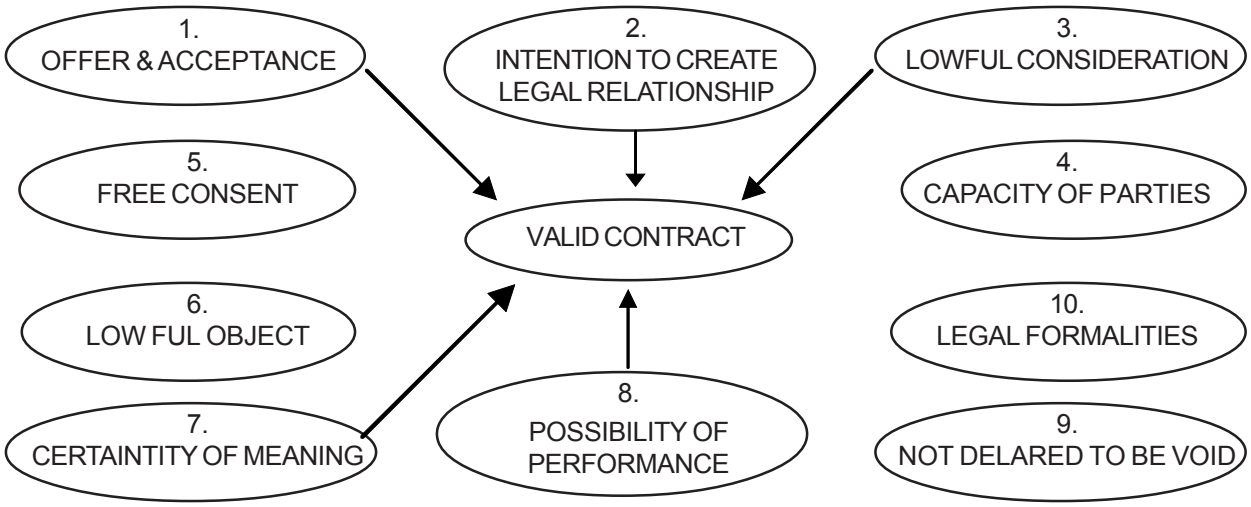
1. What is the object and nature of the law of contract ?
2. Describe the essentials of a valid contract ?
3. All agreements are not contracts but all contracts are agreements. Discuss.
4. Define Contract Act ? Explain the various types of contracts.

1.9 REFERENCE BOOKS :

1. K.C. Garg & R.C. Chawla and other; *Business Law*, Kalyani Publishers, New Delhi, 2007.
2. N.D. Kapoor, *Mercantile and Industrial Law*, Sultan Chand & Sons, New Delhi, 2003.
3. S.N. Maheswari & S.K. Maheswari, *Business Laws*, Himalaya Publishing House, New Delhi, 2004.
4. S.I. Inyengar, *Mercantile Law*, S. Chand & Co., New Delhi.
5. *Bare Acts - Indian Contract Act*, 1872.

- Dr. D. NAGESWARA RAO

ESSENTIAL ELEMENTS OF A VALID CONTRACT



1. **Offer and Acceptance :** In order to create a valid contract, there must be a "lawful offer by one party and lawful acceptance" of the same by the other party. The objective "lawful" means 'offer' and its acceptance must confirm to the rules laid down in the Indian Contract Act regarding valid 'offer' and acceptance and its communication.
2. **Intention to create Legal relationship :** In case, there is no such intention on the part of parties, there is no contract. Agreement of social or domestic nature do not contemplate legal relating.

The leading case on this point is :

BALFOUR VS BALFOUR (1919)

A husband (Mr. Balfour) promised to pay his wife (Mrs. Balfour) a household allowance of £ 30 (Pounds) every month. Later the parties separated and the husband failed to pay the amount. The wife suied for the allowance. Held, agreements such as these were outside the realm of contract altogether.

In commercial and business agreements, the presumption is usually that the parties intended to create legal relations. But this presumption is refuttable which means that it must be shown that the parties did not intent to be legally bound. Therefore, the wife and husband relationship is not legal relationship. So, this contract is void (an agreement not enforceable by law).

Another leading case on this point is :

ROSE AND FRANK CO. VS CROMPTON BROS (1923)

Two firms entered into a written contract for the sale and purchase of tissue paper. The agreement contained a clause to the effect that "this arrangement is not entered into, nor is this memorandum, written, as a formal or a legal document, and shall not be subject to legal jurisdiction in the law courts". Since the goods were not delivered, the buyer brought an action for non-delivery. It was held that there is no contract as the parties never intended to created legal relationship.

LESSON - 2

OFFER AND ACCEPTANCE

2.0 OBJECTIVES :

On completion of this lesson, you should be able to understand

- Definition and meaning of offer
- Essentials of valid offer
- Acceptance, its meaning and defintions
- Essentials of valid acceptance

STRUCTURE :

2.1 INTRODUCTION :

A contract is an agreement enforceable by law. An agreement is every promise and every set of promises forming the consideration for each other section 2 (e). Section 2 (b) defines a promise follows : "A proposal, when accepted, becomes a proposal". It means an agreement is an accepted proposed.

Therefore, these must be proposal or offer by one party and its acceptance by the other party for making an agreement. A offer to sell his Matiz car to Mr. B for Rs. 3 lacs. B accepts the offer. It will result into a contract.

Thus, offer and its acceptance subsequently is the universally accepted process for creating a contract where it is express or implied.

2.2 OFFER - DEFINITION - MEANING :

Offer or proposal is the starting point in the formation of a contract. Section 2 (a) defines offer as "when one person signifies to another his willingness to do or to obtain from doing anything with a view to obtaining the assert of that other to such act or obstinence". Thus, an offer consists of two parts.

1. a promise by the offerer to do or obtain from doing something and
2. a request to the offeree for giving his acceptance offerer is not bound by his promise until the offeree accepts it unconditionally.

2.3 ESSENTIALS OF VALID OFFER :

1. Offer must be capable of creating legal relations :

The offerer must intend the creation of legal relations. He must intend that if this offer is accepted a legally binding agreement shall result the essential element is that there must be an express or tact reference to the legal relations of the consenting parties. The leading case is Balfour v Balfour.

2. Offer must be communicated to the offeree :

There can be no offer by a person to himself. It must always be communicated to the offeree. If there is no communication of an offer, there is no acceptance resulting in the contract.

The leading case on this point is :

Lalman Shukla V Gauri Dutt 1913

L sent his servant 'G' to trace his missing nefhew.

L in the mean time annunced a reward for porividing information about the missing boy. G, in ignorance of the announcement traced the boy and informed L. 'G' later on came to know of the reward and he claimed it. His claim was dismissed on the ground that he was ignorant of the offer. It was further held that is was the duty of the servant to search for the boy.

3. Offer must be made with a view to detaining the assent of the other party :

An offer must be distinguished from mere expression of intention :

The leading case on this point is

Harris V Nickerson (1873)

N advertised in the news to effect sale of his goods on a particular day at a particular place. 'H' travelled a long distance to bid for the things. On arrival, he found that the sale was cancelled. He sued N for breach of contract. It was held that advertisement was merely expression of an intention and not an offer which could be accepted by travelling to the place of intended sale.

4. An offer may be conditional :

An offer can be made subject to a condition. In that case it can be accepted only subject to the condition. A conditional offer lapses when the condition is not accepted.

The leading case on this point is :

Thomson V. L.M. & S. Railway (1930)

T, who could not read, took an excurtion ticket on the railway. On the front of the ticket was printed "for conditions see back". One of the conditions was that the railway company would not be liable for personal injuries to passengers. 'T' was injured by a railway accident. Held 'T' was bound by the conditions and could not recover any damages. Where a condition attached to an offer is against public policy, it will not be enforced merely because it had been implied accepted by the offeree.

5. Offer should not contain a team the non-compliance of which would amount to acceptance.

One cannot say while making the offer that if the offer is not accepted before a certain date, it will be presumed to have been accepted.

Example : A writes to B, "I offer to sell my house for Rs. 40,000/-. If I do not receive a reply to monday next, I shall assume that you have accepted the offer," there will be no contract if B does not reply.

6. Lapse of an offer : An offer lapses

a) If either offeror or offeree dies before acceptance

b) If it is not accepted within (i) the specified time or (ii) a reasonable time, if not time is specified what is a reasonable time ? It depends on the circumstances. Five months has been held to be are unreasonable delay in accepting an offer to buy shares in a company.

c) An offer can also lapse by revocation.

d) If the offeree does not make a valid acceptance.

7. An invitation to offer is not an offer :

An offer must be distinguished from an invitation to offer. In the case of an invitation to offer the aim is merely to circulated information or realiness to negotiate business with anybody who on such information comes to the person sending it. Such invitations are not offers in the eyes of law and do not become promises on acceptance.

The leading case on this point is :

Harvey V Facie

Harvey sent a telegram to facey stating "will you sell us the estate of Bumber Hall Pen - Pounds 900".

Harvey sent another telegram to facey, stating "we agree to buy Bumper Hall Pen for sum of Pounds 900 asked by you. Please send us your title deeds in order that we may get early possession.

But facie did not send any reply to the last telegram sent by Harvey. Hence Harvey field as case against Facie claiming the Bumper hall pen estate. The court held that there was no concluded contract.

2.4 WHEN COMMUNICATION OF AN OFFER IS REVOCATION :

When the contracting parties are physically present and negotiate in person, an agreement comes into existence the movement, the offeree gives his absolute and unqualified acceptance to the proposal made by the offerer. When the parties are at a distance and the offer and acceptance are exchanged through post, rules contained in Sections 4 and 5 apply.

1. Communication of an Offer (Section 4) :

The communication of a proposal is completed as soon as it comes to the knowledge of the offeree.

Example : A proposes by letter to sell a brouse to B at a certain price. The communication of the proposal is complete when B receives the letter. Section 4 clearly indicates that actual communication of the offer is not necessary. It is sufficient if the offer comes to the knowledge of the offerer. Then it is for the latter to accept or reject the offer.

2.5 ACCEPTANCE - MEANING AND DEFINITION :

When the person to whom the offer is made signifies the assent thereto, the offer is said to be accepted [Sec. 2 (b)]. Thus, acceptance is the consent of the party to whom the offer has been made to the establishment of legal relations between himself and the offerer. It is an assent to the terms of the offer.

Examples : 'A' offers to sell his house to 'B' for Rs. 1,00,000/-. 'B' accepts the offer to purchase the house Rs. 1,00,000/-.

Acceptance may be express or implied :

When acceptance is made by words, spoken or written, it is an express acceptance. If it is accepted by conduct, it is an implied acceptance. Thus, where a person boards a train or bus, the impliedly accepts to pay the usual fare. Similarly, when a person goes to a hotel and eats some food, he impliedly accepts to pay for it.

Who may accept :

An offer can be effected only by the person to whom it is made. It means that the person to whom the offer is made can alone accept it. It cannot be accepted by another without the consent of the person making it. Thus, where offer is made by 'A' to 'B', the acceptance by 'C' would be inoperative.

2.6 ESSENTIALS OF VALID ACCEPTANCE :

1. Acceptance must be absolute and unconditional :

An acceptance must unconditional and unqualified. Accepting an offer with conditions, variations and reservations amounts to counter offer and rejection of the original offer. The acceptor must comply with the terms of the offer. A variation or alteration, however, small of the offer, will make the acceptance invalid.

The leading cae on the point is

Neele V Mrritt (1930)

'M' offered to sell land to 'N' at $ 280 'N' replied accepting the offer and enclosing $ 30 and promised to pay balance amount by monthly instalments of $ 50 each. Since 'N' accepted the offer subject to making payments in instalments, it was held that the acceptance conditional and qualified.

2. Acceptance must be communicated to the offerer :

Acceptance must be communicated to the offerer to create a binding contract. Mere mental acceptance not evidenced by words or conduct is in the eyes of laws no acceptance. But where the offer is to be accepted by being acted upon, no communication to the offerer will be necessary unless the communication is stipulated for in the offer itself.

Example : The manager of railway company received a draft agreement relating to the supply of coal, wrote 'approved' on it and kept it in his drawer, it was held that there was no contract as the acceptance had not been communicated.

3. Acceptance must be made with in a reasonable time :

Acceptance to be valid must be made within the time allowed by the offerer and if no time is specified, it must be made within a reasonable time. What is a reasonable time is question of fact

depending on the particular circumstances. Acceptance must be made at any time till the offer is alive. Acceptance made after the offer has been withdrawn is invalid.

The leading case on this point is :

Ramsgate Victoria Hotel Co V Montefiore (1866) :

A person applied for shares in a company in June. He cannot be found by an allotment made late in November.

4. If must be according to the mode prescribed or usual or reasonable time (Sec. 7 (2) :

The proposer may lay down the manner of acceptance in his offer. In case the acceptance is not given in the prescribed mode, the proper may reject the acceptance and inform the offeree within a reasonable time. But he fails to do so, he shall be taken to have accepted the acceptance. If the proposer has not prescribed any mode of acceptance, the acceptance must be given in some usual and reasonable manner.

Example : An offer is made to take shares indicating that the answer is to come by a telegram. It is accepted but the acceptance is sent by an ordinary letter. The offerer can reject the acceptance as not being in the prescribed mode.

5. The acceptance must be aware of the proposal at the time of the offer :

Acceptance follows offer. In the accepter is not aware of existence of the offer and conveys his acceptance, no contract comes into being. There must be a knowledge of the offer before anyone could consent to it. An act done in ignorance of the offer of a reward cannot be called an acceptance.

The leading case is :

Lalman Shukla V Gauri Dutt (1913)

'A' sold his business to his manager 'B' without disclosing the fact to his customers. 'C', a customer, who had a running account with 'A', sent an order for the supply of goods to 'A' by name. 'B' received the order and executed the same. 'C' refused to pay the price. It was held that there was no contract between 'B' and 'C' because 'C' never made any offer to 'B' and as such 'C' was not liable to pay the price to 'B'.

6. Acceptance must be given before the offer lapses or before the offer is revoked :

It means that acceptance must be made while the offer is in force i.e., before the offer has been revoked or offer has lapsed.

7. Acceptance cannot be implied from silence :

No contract is formed if the offeree remains silent and does nothing to show that he has accepted the offer.

The leading case on this point is :

Brogdon V Metropolitan Railway Co. (1877)

A draft agreement relating to the supply of coal was sent to the manager of a railway company for his acceptance. The manager wrote the word 'approved' on the agreement but by an oversight the document remained in his drawer. Held there was no contract as it was only mentally accepted and there was no expression of his mental determination.

Acceptance of a proposal may sometimes be inferred from silence or inaction. As a rule silence does not imply acceptance, but in the silence may be indicative of assent to the proposal.

2.7 REVOCATION OF ACCEPTANCE :

An acceptance can be revoked at any time before the communication of acceptance complete as against the acceptor, but not afterwards.

Where an acceptance is sent by post, it stands complete against the acceptor when the letter reaches offerer. It means that acceptance can be revoked before the letter actually reaches the offerer.

Therefore, the communication of revocation of acceptance can be revoked before the letter actually reaches the offerer.

Therefore, the communication of revocation of acceptance must reach the offerer before acceptance. But in English law once an acceptance given cannot be revoked at all.

2.8 SUMMARY :

According to Sec. 2 (e) every promise and every set of promises forming consideration for each other is called an agreement. A proposal when accepted by another party becomes a promise. Sec 2 (a) defines proposal or offer as "when one person signifies to another his willingness to do or to obtain from doing anything with a view to obtaining the assent of what other the such one act or he is said to make an offer.

When the person to whom the offer is made signifies his assent thereto, the offer is said to accepted (Sec. 2 (b)). Thus the acceptance is the consent of the party to whom the offer has been made to the establishment of legal relations between himself and the offerer. The acceptance required some important essentials, then only it is valid. The word 'revocation' means taking back. Both an offer as well as an acceptance may be revoked.

According to Sec. 5, a proposal may be revoked any time before its acceptance is complete as against the proposer but not afterwards. Revocation of an offer after its acceptance ineffective. According to Sec. 5, an acceptance may be revoked at any time before the communication of acceptance is completed as against the acceptor but not after words.

2.9 TECHNICAL TERMS :

Acceptance	:	The consent of the parties to whom the offer has been made
Revocation	:	Taking back of an offer or acceptance
Offer	:	A communication by one person to other of his willingness to do or obstain from doing with the objective of getting the acceptance of the other.

2.10 SELF - ASSESSMENT QUESTIONS :

1. Define offer. What are the essentials of a valid offer ?
2. What do you understand by the term "acceptance" ? What conditions must be fulfilled to convert a proposal into a promise.

3. Discuss the rules relating to offer, acceptance and revocation with suitable examples.
4. Acceptance is to an offer what a lighted match is to a train of gun-power.

2.11 REFERENCE BOOKS :

1. K.C. Garg and others, *'Business Law'*, Kalyani Publishers, New Delhi, 2007.
2. S.N. Maheshwari and S.K. Maheshwari, *Business Laws*, Himalaya Publishing House, New Delhi, 2004.
3. Bare Act, *Indian Contract Act, 1872.*
4. S.I. Inyengar, *Mercantile Law*, S. Chand & Co, New Delhi,

- Dr. D. NAGESWARA RAO

LESSON - 3

CONSIDERATION

3.0 OBJECTIVES :

On completion of this lesson, you should be able to understand

- the concept of consideration
- the essentials of consideration
- the stranger to contract
- no consideration no contract

STRUCTURE :

3.1 INTRODUCTION :

Consideration is the foundation of every contract. The law enforces only those promises which are made for consideration. Where one party promises to do something, it must get something in return. This 'something in return' is called consideration. Consideration is the life-blood of every contract. In the absense of consideration a promise or undertaking in purely gratutions. However, sacred and binding in honour, it creates no legal obligation.

3.2 DEFINITIONS :

According to pollock "Consideration is the price for which the promise of other is bought and the promise thus given for value is enforceable". According to Englisha case 'Currie V Misa as "Some right, interest, profit or benefit accruing to one party or some forbearance, detriment, loss or responsibility, given suffered or undertaken by the other". [(1875) 10 Ex. 162].

Section 2 (d) of the Indian Contract Act defines consideration as :

a) when at the desire of the promisor
b) the promise or any other person
c) has done or obstained from doing, or does or obstains from doing, or promises to do or obstain from doing.
d) something, such act or obstinence or promise is called a consideration for the promise.

3.3 ESSENTIALS OF VALID CONSIDERATION :

Following are the essential elements of consideration.

1. It must move at the desire of the Promisor:

The first essential element of consideration is that the act or obstinence must have been done at the disire of a third party cannot be a consideration. The desire of the promisor may be express or implied.

The leading case on this point is :

Durga Prasad V Baldeo [1880]

'D' promised to pay 'P' a commission on articles sold by him in a bazar in which he occupied a shop in consideration of 'P' having expented money in the construction of such bazar. The money had not been spent by 'P' at the request at 'D' but was spent by him at the desire of the collector of the district. In a suit by 'P' it was held that there was no consideration for the promise made by 'D' and hence no contract.

A promise to subscribe to a public or a charitable object is unenforceable because there is no benefit to the promisor. But where the other party has undertaken a liability on the faith of the promise made by the promisor, it is enforceable.

2. It must move from the promisee or any other person :

As long as there is a consideration for a promise, it is immaterial who has given it. It may move from the promisee, or if the promisor has no objection, from any other person. This is wider than the concept in England, where consideration can move only from the promisee. Consideration move from a stranger but it must flow at the desire of the promisor.

The leading case is :

Chinnayya V Ramayya (1882)

An old lady made a gift of her property to her daughter with a direction to pay a certain sum of money to the maternal uncle by way of annuity. On the same day, the daughter executed a writing in favour of the brother agreeing to pay the amount. The daughter did not, however, pay the annuity and the uncle sued to recover it. It was held that there was sufficient consideration for the uncle to recover the money from the daughter.

3. Consideration may be past, present or future :

The words, "has done or obstained from doing, or does or obstains from doiong : "or promises to do or to obstain from doing" indicate that consideration may be past, present or future.

Past Consideration :

A looks after the childrens of 'B' at B's request. A year later 'B' agrees to pay a sum of Rs. 1,000/- for his services. For the promise of 'B', the services of 'A' will be taken as past consideration. When the promisor receives consideration simultaneously with his promise, the consideration is termed as 'present consideration'.

Present Consideration :

Ex : 'A' agrees to sell his car to 'B' for a sum of Rs. 90,000/-. 'B' pays money to 'A' at the time of making of the contract. Consideration will be taken as present for 'A'.

Future Consideration :

Ex : 'A' look after the children of 'B' and 'B' promises to pay 'A' all expenses incurred by him in this connection at the end of the year. Consideration is a future one for 'A'.

4. It need not be adequate :

It is no where laid down that the consideration should be adequate to the promise. Adequate is for the parties to decide at the time of making the agreement. Inadequacy of consideration is no ground for refusing the performance of the promise, unless it is evidence or fraud. It should be of some value in the eyes of law. Even a smallest consideration is sufficient provided it has some value.

Ex : A agrees to sell his house worth Rs. 10 lacs to 'B' for Rs. 10 thousand. As consent to the agreement was freely given, the agreement is a contract not withstanding the inadequacy of the consideration.

5. Consideration must be real :

Though consideration need not be adequates yet it must be real and not illusory. Thus, a promise to do that which a person is by law bound to do, does not amount to consideration. Consideration has also to be competent. If it is physically impossible, vague or legally impossible, the contract cannot be enforced. Thus, a promise by a man to make two parallel meet is no good consideration.

A promise not to sue for a reasonable time is a good consideration. Similarly if a person compromises and agrees to accept a smaller sum in settlement of his claim, this would be sufficient consideration for the opposite party's promise to pay sum.

The leading case is :

Indira Bai V Makrand, AIR 1931.

A's husband did not give maintenance allowance to her which he had promised to pay. When she was about to sue her husband for this, husband requested her not sue and promised her to pay monthly maintenance allowance. It was held that A's for Bearance to sue is a consideration for husbands agreement for payment of maintenance allowance.

6. Consideration must be lawful :

The consideration for an agreement must be lawful. An agreement is void, if it is based on unlawful consideration. The consideration of an agreement is lawful unless -

i) it is forbidden by law; or

ii) is of such a nature that if permitted it would defeat the provisions of any law; or

iii) is fradulent; or

iv) involves or implies injury to the person or property of another; or

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

Example : A promise to obtain for 'B' an employment in the public service and 'B' promises to pay Rs. 1,000/- to A. The agreement is void as the consideration for it is unlawful.

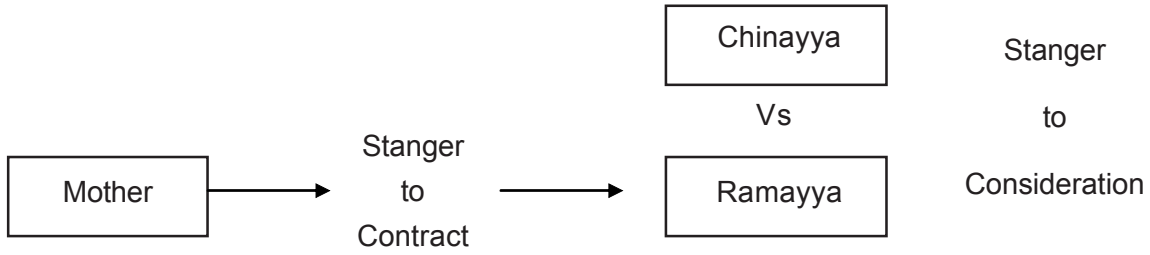
7. It must be something which the promisor is not already bound to do :

A promise to do what one is already bound to do, either by general law or under an existing contract, is not a good consideration for a new promise. There will be no determinent to the promisee or benefit to the promisor over and above their existing rights or obligations.

3.4 STRANGER TO CONSIDERATION :

Under the Indian Contract Act 1872 consideration for a contract may move from the promisee or any other person i.e., a stranger to the consideration can also enforce the contract. But under the English Law the consideration for the contract must move from the promisee and promisee only, therefore a strange to consideration cannot enforce it. So, in India the consideration may move from a stranger. This law was established in the case of : Chinayya V Ramayya

An old lady Lakshmi Rani gifted her property to her own daughter Ramayya, with the direction to pay a certain sum of money annually to Chinnayya, her maternal uncle. On the same day Ramayya executed an agreement with Chinnayya agreeing to pay the amount annually. Later on, Ramayya refused to honour the agreement on the ground that there is no consideration. Chinayya sued for the recovery of the annuity. It was held that there was sufficient consideration i.e., the property given to her by the sister of Chinayya.



3.5 IMPORTANCE OF CONSIDERATION :

Consideration is the foundation of every contract. The law insists on the existence of consideration if a promise is to be enforced as creating legal obligations. A promise without consideration is null and void. It is called a naked promise or 'Nudum Ractum". Thus if 'A' promises to pay 'B' Rs. 10,000/- without anything in return, this constitutes a bare promise and gives no right of action.

3.6 NO CONSIDERATION NO CONTRACT EXCEPTIONS :

Every agreement to be enforceable at law must be supported by valid consideration. An agreement made without consideration is void and is unenforceable except in certain cases. Section 25 specifies the cases where an agreement through made without consideration will be valid. These are as follows :

1. Natural love and affections [Sec. 25 (2)] :

The mere existence of a near relation between the parties without the motivating force of natural love and affection will not render an agreement enforceable even though it is in writing and registered.

2. Compensation for Services rendered [Sec. 25 (2)] :

An agreement made without consideration may be valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promisor or something which the promisor was legally compellable to do.

3. Time-barred debt [Sec. 25 (3)] :

A promise to pay a time-barred debt is also enforceable.

4. Agency [Sec. 185] :

There is one more exception to the general rule. It is given in Section 185 which says that no consideration is needed to create an agency.

5. Guarantee [Sec. 127] :

A contract of guarantee is made without consideration.

6. Remission [Sec. 63] :

No consideration is required for an agreement to receive less than what is due. This is called remission in the law.

3.7 SUMMARY :

Consideration is the foundation of every contract. It means something accepted and agreed upon as a return or equivalent for the promise. According to the Contract Act the consideration is valid and enforceable by law when it has some important essentials. Contracts without consideration are void. But it has some exceptions, those are naturla love and affection, compensation for services rendered, Time - barred debt agency, guarantee contracts and memission.

3.8 TECHNICAL TERMS :

1.	Consideration	:	some thing accepted and agreed upon as a return.
2.	Past Consideration	:	Consideration received by the promisor before the date of the promise.
3.	Present Consideration	:	The consideration received by the promisor simultaneously with this promise.
4.	Future Consideration	:	Consideration to be received by the promisor in future for his present promise.

3.9 SELF - ASSESSMENT QUESTIONS :

1. Define consideration ? Explain the essentials of valid contract.
2. Consideration is present, past and future. Explain with suitable examples.

3. An agreement without consideration void. Explain the exemptions.
4. No consideration - No Contract - Comment.
5. A stranger to consideration can sue, but a stranger to contract cannot sue, comment.

3.10 REFERENCE BOOKS :

1. S.N. Maheswari & S.K. Maheshwari, *Business Laws*, Himalya Publishing House, New Delhi, 2004.
2. *Contract Act 1872*, Bare Fet.
3. K.C. Garg & Others, *Business Laws*, Kalyani Publishers, New Delhi, 2007.

- Dr. D. NAGESWARA RAO

LESSON - 4

CAPACITY OF PARTIES

4.0 OBJECTIVES :

On completion of this lesson, you should be able :

- to learn which parties competence to enter into valid contract
- to learn which parties / persons are incompetent to contract
- disqualify by status
- disqualify by mental status - Minors
- disqualified by unsound mind
- persons disqualified by any law to which they are subject matter

STRUCTURE :

4.1 INTRODUCTION :

For a valid contract, the parties to a contract must have capacity i.e, competence to enter into a contract. Every person is presumed to have capacity to contract but there are certain persons whose age, condition or status renders them incapable of binding themselves by a contract in capacity must be proved by the party claiming the benefit of it and until proved the ordinary presumption remains.

4.2 COMPETENT PARTIES :

Section 11 of the Contract Act deals with the competency of parties and provides that, every person is competent to contract who is the age of majority (Eighteen year completed) according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any Law.

4.3 Incompetent Parties :

That the following persons are incompetent to enter into the contract.

a) Minors : Below 18 years

b) Reason of unsound mind : Idiocy, lunacy or insanity, drunkenness, hypnotism, mental decay.

c) Other pesons : 1) Alien enemies, 2) Ambassadors and foreign soveriegn, insolvents, convict, corporations, married women, professional persons.

4.4 MINOR AGREEMENTS :

An infant or a minor is a person who is not a major. According to the Indian Majority Act, 1875, a minor is one who has not completed his or her 18th year of age. A person attain majority on completing his 18th year in India. In the following two cases, a person continues to be a minor until he completes the age of 21 years.

a) Where a guardian of a minor person or property has been appointed under the Guardians and Wards Act, 1890 or

b) Where the superintendence of a minor's property is assumed by a court of wards.

An amendment to this act was made by Indian Majority (Amendment) Act, 2000 which fixed uniform age of majority as 18 Years irrespective of the fact whether any guardian has been appointed but president's assent to the kid has yet to be obtained.

4.4.1 EFFECTS OF MINOR'S AGREEMENT :

A minor's agreement being void is wholly devoid of all effects. When there is no contract there should be no contractual obligation on either side. The various rules regarding minor's agreement are discussed in the lesson :

1. An agreement with or by a minor is void :

Section 10 of the Contract Act requires that the parties to a contract must be competent and Section 11 says that a minor is not competent.

The leading case is :

Mohari BIBI V. Dharmo Das Ghose (1903)

"A a minor borrowed Rs. 20,000/- from 'B' and as a security for the same executed a mortgage in his favour. He became a major a few months later and filed a suit for the declaration that the mortgage executed by him during his majority was void and should be cancelled. It was held that a mortgage by a minor was void and B was not entitled to repayment of money".

2. No ratification :

An agreement with minor is completely void. A minor cannot ratify the agreement even on attaining to authorise an act cannot give it validity by ratifying it.

3. Minor can be a promisee or beneficiary :

If a contract is beneficial to a minor it can be enforced by him. There is no restriction on a minor from being a beneficiary, for example, being a payee or a promisee in a contract. Thus a minor is capable of purchasing immovable property and he may sue to recover the possession of the property upon tender of the purchase money. Similarly a minor in whose favour a promissory note has been executed can enforce it.

The leading case is :

Raghava Chariar V Srinivasa

A mortgage was executed in favour of minor, and it was held that he could get a decree for enforcement.

4. No estoppel against a minor :

Where a minor by misrepresenting his age has induced the other party to enter into a contract with him, he cannot be made liable on the contract. There can be no estoppel against a minor.

The leading case is :

Sadiqui Alikhan V Jai Kishore

It was held that a rule of estoppel cannot be applied against a minor. This does not mean that the minor should allowed to retain the benefit of his own fraud. But in India, it was been held that the court can direct the minor to pay back compensation to other party in such cases.

5. No specific performance except in certain cases :

A minor's contract being absolutely void, there can be no question of the specific performance of such a contract. A Guardian of a minor by an agreement for the purchase of immovable property; so the minor cannot ask for the specific performance of the contract which the guardian had no power to enter into.

But a contract entered into by the guardian or manager on minor's behalf can be specifically enforced if

1. The contract is within the authority of the guardian or manager.
2. It is for the benefit of the minor.

The leading case is :

Lalchand V Narhar

A bond was executed by widow acting as guardian of her minor son for the payment of her deceased husbands debts, the minor's estate can be held liable for the payment as per the bond.

6. Liability for Torts :

A tort is a civil wrong. A minor is liable in tort unless the tort in reality is a breach of contract. But a minor cannot be made liable for a breach of contract by framing the action on tort. You cannot convert a contract into a tort to enable you to sue an infant.

7. No insolvency :

A minor cannot be declared insolvent as he is incapable of contracting debts and dues are payable from the personal properties of minor and he is not personally liable.

8. Partnership :

A minor being incompetent to contract cannot be a partner in a partnership firm, but under Sec. 30 of the Indian Partnership Act, he can be admitted to the benefits of the partnership.

9. Minor can be an agent :

A minor can act as an agent. But he will not be liable to his Principal for his acts. A minor can draw, deliver and endorse negotiable instruments without himself being liable.

10. Minor as Shareholder :

A minor, being incompetent to contract cannot be a shareholder of the company.

11. Surety for a minor :

In a contract of guarantee when an adult stands surety for a minor then he (adult) is liable to third party as there is direct contract between the surety and the third party.

12. Liability for necessaries :

The case of necessaries supplied to a minor or to any other person whom such minor is legally bound to support is governed by Section 68 of the Indian Contract Act. A claim for necessaries supplied to a minor is enforceable by law. But a minor is not liable for any price that he may promise and never for more than the value of the necessaries. There is no personal liability of the mind, but only his property is liable.

The leading case is :

Nash. V Inman

Inman an infant undergraduate in Cambridge bought cleven fancy waistcoats from Nash. He was at the time adequately provided with clothing. Held the waistcoats were not necessary and the price could not be recovered. Thus, the case is void.

Certain services rendered to a minor have been held to be 'necessaries'. These include education, medical advice, a house given to a minor on rent for the purpose of living and continuing his studies, etc.

4.5 PERSONS OF UNSOUND MIND :

As per Section 11 of Contract Act, for a valid contract each party to the contract must have a sound mind. Contracts made by persons of unsound mind are void.
Unsoundness of mind may arise front :

i) Idiocy : An idiot is a person with no intervals of saneness. He is incapable. His mental powers of unsounding even ordinary matters are absent because of lack of development of brain. The agreement with an idiot is void.

ii) Lunacy or Insanity : It is a disease of brain. A benatic loses the use of his reason due to some mental strain or disease.

iii) Drunkenness : It produces temporary incapacity till the man is under the effect of intoxication creating importance of mind. He stands on the same footing as a lunatic.

iv) Hypnotism : It also produces temporary in capacity till the person is under the impact of artificially induced sleep.

v) Mental decay : It is on account of old age etc. Thus, an agreement with person of unsound mind is void.

4.6 PERSONS DISQUALIFIED FROM CONTRACTING BY ANY OTHER LAW :

It refers to statutory disqualifications imposed on certain persons in respect of their capacity to contract

1. Alien ememies :

An alien is competent to contract with citizens of India living in India. He can maintain an action on a contract entered into by him during peace time. But if a war is declared, an alien enemy cannot enter into any contract with an Indian citizen.

2. Foreign Sovereigns ambassadors :

These persons are immune from the jurisdiction of local courts. These persons have a right to contract but can claim the privilege of not being sued.

3. Insolvents :

An insolvent cannot enter into a contract as his property vests in the official receiver or official assignee. This disqualification of an insolvent is removed after he is discharged.

4. Convict :

A convict while undergoing imprisonment is incapable of entering into a contract. But this disability comes to an end on the expiry of the sentence.

5. Corporations :

A corporation is an artificial person recognised by law. It exists only in the eyes of law. It is competent to enter into a contract only through its agents.

6. Married women :

A woman is competent to enter into a contract. Marriage does not affect the contractual capacity of a woman. She can even find her husband in cases of pressing necessity. A married woman may sue or be sued in her own name in respect of her separate property.

7. Professional Persons :

Doctors and advocates are included in this class. In India these personal disqualifications do not exit. According to the Bar Council Act 1927, an advocate of the High Court can enter into a contract with his client and can also bring a suit against him for his fees.

4.7 SUMMARY :

According to 1872 Contract Act, the capacity of parties has an essential pre-request. For a valid contract, the parties to a contract must have capacity i.e., competence to enter into a contract. Section 11 of the Contract Act deals with the competence of parties. When a person having age of majority and who is of sound mind is competence to enter into a contract. Therefore, those persons are - Minors, persons of unsound mind, and persons disqualified by any law to which they are subject. These contracts entered into by the above persons are void.

4.8 TECHNICAL TERMS :

1.	Minor	:	A minor is one who has not completed his / her 18th Year of age.
2.	Major	:	A person attains majority on completing his / her 18 year of age in India.
3.	Convict	:	A person undergoing imprisnment is incapable of entering into a contract.
4.	Insolvent	:	Ones property vests in the official receiver or offical assignee.

4.9 SELF - ASSESSMENT QUESTIONS :

1. Parties to a contract must be competent to contract. Explain.
2. Discuss the provisions of law relating to contracts by minors.
3. Discuss the law relating to contracts by persons of unsound mind.

4.10 REFERENCE BOOKS :

1. K.C. Garg & Others, *Business Laws*, Kalyani Publishers, New Delhi, 2007.
2. S.N. Maheswari & S.K. Maheshwari, *Business Laws*, Himalya Publishing House, New Delhi, 2004.
3. N.D. Kapoor, Mercantile and Industrial Law, Sultan Chand & Sons, New Delhi, 2000.
4. Contract Act, 1872, Bare Act.

- Dr. D. NAGESWARA RAO

LESSON - 5

FREE CONSENT

5.0 OBJECTIVES :

On completion of this lesson, you should be able to :

- know the meaning and definition of consent
- know the free consent
- circumstances when consent is not free
- understand the terms, coercion, undue influence, fraud, misrepresentation and mistake

STRUCTURE :

5.1 INTRODUCTION :

Free Consent of all the parties to a contract is one of the essential elements of a valid contract as per requirement of Section 10. The parties to a contract should have identity of minds. This is called "consensus ad idem" in English Law. A contract which is valid in all other respects may still fail because there is no real consent to it by one or both of the parties.

5.2 MEANING AND DEFINITION OF FREE CONSENT :

Section 13 of Contract Act, two or more persons are said to consent when they agree upon the same thing in the same sense.

Not only the parties to a contract should have identity of mind but the consent of the parties must also be real and free. Free consent is an essential requisite of a valid contract. Free consent is the consent which has been obtained by the free will of the parties out of their own accord.

5.3 CIRCUMSTANCES WHEN CONSENT IS NOT FREE :

According to Section 14, consent is said to be free when it is not caused by -

1. Coercion or 2. undue influence or 3. Fraud or 4. Misrepresentation or 5. mistake.

When consent to an agreement is caused by coercion, undue influence, misrepresentation or fraud, the contract is voidable at the option of the party whose consent was so caused. But when consent is caused by mistake, the agreement is void,

5.4 COERCION :

In simple words, coercion is threat or force used by one party against another for compelling him to enter into an agreement. Section 15 of the Indian Contract Act defines coercion or the committing or threatening to commit any act forbidden by the Indian Penal Code or an unlawful detaining or threatening to detain, any property to the prejudice of any person with the intention of inducing any person to enter into an agreement.

The leading case is : Ranganayakamma V Alwar (1889)

- A girl of 13, last her husband and her husbands relatives refused to have the husband's corpse removed unless she adopted one child of their choice. It was held that the adoption was not bringing on her as her consent was obtained under Coercion within the meaning of Section 15 since any person who obstructed a dead body from being removed would be guilty of an offence under Section 297 of the Indian Penal Code.

Duress : Coercision in India is know as duress in England. If the consent of the other party to a contract is obtained under fear caused by threats of bodily harm, it is known as the use of duress. The scope of the term coercion is wider than the term duress.

5.5 UNDUE INFLUENCE :

Sometimes the parties to an agreement are so related to each other than one party is in a position to dominate the will of the other. One party is compelled to enter into an agreement against his will as a result of 'Undue infleuence' exerted by the other party who is in dominating position. Section 16 of the Indian Contract Act provides that, "a consent is said to be induced by undue influence where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and use the position to detain an unfair advantage over the other.

The leading case is - Ranee Annapurni V Swaminatha

A poor Hindu widow who was in dire need of money, was forced by a money lender to agree to pay 100 percent rate of interest. It was held to be a case of exerting undue influence upon a person in mental distress. The court reduced the rate of interest to 24 percent.

Effect of Undue influence : When consent to an agreement is caused by undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused.

5.6 FRAUD :

The term 'Fraud' includes all acts committed by a person with an intention to deceive another person. Fraud is the wilful representation made by a party to a contract with the intent to deceive the other party or to induce such party to enter into a contract.

According to Section 17, fraud means and includes any of the following acts done with intent to decieve or to induce a person to enter into a contract.

1. A false suggestion as to a fact known to be false or not believed to be true.
2. The active conceatment of fact by one having knowledge or belief of fact.
3. A promise made without any intention of performing it.
4. Any other act fitted to deceive.
5. Any such act or ommission as the law specially declares to be fraudulent.

ELEMENTS OF FRAUD :

1. The fraud must have been committed by a party to the contract or with his convenience or by his agent Fraud by a stranger to contract does not affect its validity.
2. There must be any one of the above mentioned ingredients in Act of fraud.
3. The Act of fraud must have been committed with intent to deceive and must actually deceive.
4. The other party must have suffered a loss.
5. The representation must have been aimed at the other party to the contract or his agent or with a view to induce the other party to enter into the contract.

MERE SILENCE IS NOT FRAUD :

A party to the contract is under no obligation to disclose the whole truth to the other party. "Caveat Emptor" i.e., let the buyer beware is the rule applicable to contracts. There is no duty to speak in such cases and silence does not amount to fraud. Similarly, there is no duty to disclose facts which are within the knowledge of both the parties.

Example : Word V Hobhs (1878) : H sold to W some pigs which were to his knowledge suffering from fever. The pigs were sold with all faults and H did not disclose the facts of fever to 'W'. Held there was not fraud.

SILENCE IS FRAUD : Where the circumstances of the case are such that it is the duty of the person observing silence to speak - for example in contracts of utmost good faith.

EFFECT OF FRAUD : When consent to an agreement is caused by fraud, the agreement is a contract voidable at the option of the party whose consent was so caused. A party whose consent to an agreement was caused by fraud has two remedies namely :

a. he may rescind the contract or
b. he may insist that the contract shall be performed and that he shall be put in the position in which he would have been, if the representation made had been true.

5.7 MISREPRESENTATION :

The word 'representation' means a statement of fact made by one party to the other before or at the time made by one party to the other before or at the time contract is made with regard to some existing fact or some past event which materially induces the formation of the agreement. A wrong representation when made innocently is misrepresentation.

Thus misrepresentation means false representation made innocently with an honest belife as to its truth by a party without any intention to deceive the other party.

ESSENTIAL REQUIREMENTS OF MISREPRESENTATION :

i. There should be a representation or assertion.
ii. Such representation must relate to a matter of fact which has become unture; and
iii. It was made before the finalisation of transaction with a view to induce the other party to enter into a contract.
iv. It must actually have been acted upon by the party.
v. It must have been made either by the party himself or by his duly authorised agent.

CONSEQUENCES OF MISREPRESENTATION :

When a misrepresentation has been made, the aggrieved party has the following alternative courses open to him.

i. He may avoid or rescind the contract; or

ii. He may affirm the contract and insist on the misrepresentation being made good;

iii. He may rely upon the misrepresentation, as a defence to an action on the contract.

When the consent is induced by misrepresentation and the aggrieved party has the means of discovering the truth with ordinary diligence, the contract cannot be get aside.

Ex : 'A' by misrepresentation leads 'B' erroneously to believe that 500 mounds of idigo are made annually at 'A's factory. B examines the accounts of the factory, which show that only 400 mounds of indigo have been made. After this, B lays the factory. The contract is not voidable on account of A's misrepresentation, because 'A' had the means of discovering the truth with ordinary diligence.

5.8 MISTAKE :

Mistake may be defined as an erroneous belief concerning something. It means that parties intending to do one thing have by intentional error done something else. It is a slip made not by design but by mis-chance. Mistake may be of two types. 1. Mistake of Law, 2. Mistake of fact.

1. Mistake of Law : May be three types.

a. Mistake of general law of the country.

b. Mistake of foreign law

c. Mistake of private rights of a party relating to property and goods etc.

a. Mistake of general law of the country :

The contract is binding because everybody is supposed to know the law of the country. The maxim ignoratia Juris non excusat (ignorance of law is no excuse) is applicable and the party cannot be allowed any relife on that ignorence. According to Section 21, "a contract is not voidable because it was caused by a mistake as to any law in force in India.

Example : A and B make a contract under the impression that a particular debt is barred by law of limitation. The contract is valid.

MISTAKE OF FOREIGN LAW AND PRIVATE RIGHTS OF A PROPERTY RELATING TO PROPERTY AND GOODS ETC. :

These are treated as mistake of fact. Here the agreement will be void in case of bilateral mistake only.

MISTAKE OF FACT

Mistake of fact may be either bilateral mistake or mistake of only one party i.e., unilateral mistake.

Bilateral Mistake : A mistake of fact in the minds of both the parties negatives consent and the contract become void. Section 20 provides that 'where both the parties to an agreement are under a mistake as to a matter of fact, essential to the agreement, the agreement is void.

Four conditions must be fulfilled before a contract can be avoided on the ground of mistake. These conditions are :

a. There must be mistake as to the formation of contract.
b. The mistake must be of both the parties, i.e., bilateral and not unilateral.
c. It must be mistake of fact and not of law.
d. It must be about a fact essential to the agreement.

The leading case is : Galloway V. Galloway (1914)

A man and a woman made a separation deed under which the man agreed to pay a weekly allowance to which the man agreed to pay a weekly allowance to the woman under a mistaken assumption that they were lawfully married. It was held that the agreement was void as there was common mistake on a point of fact which was material to the existence of the agreement. However, an erroneous opinion as to the value of the thing which forms subject matter of the agreement is not deemed to be a mistake as to a matter of fact.

The cases falling under bilateral mistakes are :

1. Mistake as to the subject - matter :

Mistake as to a subject-matter falls into six heads, namely a) existence, b) identity, c) title, d) price, e) quantity, f) quality.

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

a. Physically impossibility : A contract for the hiring of a room for witnessing the coronation procession was held to be void because unknown to the parties the procession had already been cancelled.

b. Legal impossibility : An agreement is void if it provides that something should be done while cannot legally be done. Thus a person cannot take lease of his own land.

UNILATERAL MISTAKE :

Section 22 provides that if one party alone is under a mistake of fact, the contract is not rendered voidable. In other words, while bilateral mistakes render a contract void, unilateral mistake is of no account. When the contract is clear, mistake of one of the parties cannot affect it. If a man due to his own negligence or lack of reasonable care does not ascertain what he is contracting about, he must fact the consequences.

The leading case is : HIGGINGS Ltd. Vs Northanpton Corporation (1927)

'H' contracted with the 'N' Corporation to build a number of houses. In calculating the cost of the houses, 'H' by mistake deducted a particular sum twice and submitted his estimates accordingly. The corporation agreed to the terms which were naturally lower than actual cost. It was held that the agreement was binding even though it was based upon erroneous estimates.

5.9 CONCLUSION :

Consent means the parties must have agreed upon the same thing in same sense". According to Sec. 13 "Two or more persons are said to consent when they agree upon the same thing in same sense". This is called consensus ad idem in English Law. According to Section 14, consent is said to be free when it is not caused by :

1) Coercion or 2) undue influence or 3) Fraud or 4) Mis-representation or 5) Mistake.

5.10 TECHNICAL TERMS :

Consent	:	Agreeing upon the same thing in the same sense by the parties concerned.
Fraud	:	International misrepresentation of facts
Free Consent	:	Consent is said to be free when it is not caused by coercion, under influence fraud, misrepresentation.

5.11 SELF - ASSESSMENT QUESTIONS :

1. Explain when a consent is not said to be free. What is effect of such consent on the formation of the Contract ?
2. Distinguish between coercion and undue influence illustrate your answer.
3. State the effect of mistake on validity of contract.
4. Distinguish between fraud and misrepresentation.

5.12 REFERENCE BOOKS :

1. K.C. Garg and others, *'Business Law*', Kalyani Publishers, New Delhi, 2007.
2. S.N. Maheshwari and S.K. Maheshwari, *Business Laws*, Himalaya Publishing House, New Delhi, 2004.
3. N.D. Kapoor; Business Laws, Sultan Chandra Sons, New Delhi, 2000.

- Dr. D. NAGESWARA RAO

LESSON - 6

LEGALITY OF THE OBJECT

6.0 OBJECTIVES :

On completion of this lesson, you should be able to :

- know the difference between consideration and object
- identify the cases where the objects and consideration of an agreement are unlawful.

STRUCTURE :

6.1 INTRODUCTION :

According to Section 23 Indian Contract Act, an agreement of which the object or consideration is unlawful is void. Object means purpose or design of the contract. It implies the manifestation of intention. Thus, if a person, while in insolvent circumstances transfers to another for consideration some property with the object of defrauding his creditors, the consideration of the contract is lawful but the object is unlawful. Both the object and consideration of agreement must be lawful, otherwise the agreement would be void. The word 'lawful' means 'permitted by law'. Section 23 of the Contract Act speaks as the things :

1. Consideration for the agreement
2. Object for the agreement; and
3. Agreement

6.2 UNLAWFUL CONSIDERATION AND OBJECT :

The consideration or the object an agreement unlawful 1) when it is forbidden by law, 2) If it is fraudulent, 3) If the court regards it as immoral, 5) It is being opposed by Public policy.

1. If it is forbidden by Law :

If the consideration or object for a promise is such as is forbidden by law, the agreement is void. It is forbidden by law, if the legislature penalises it as prohibity it. It is illegal and cannot become valid even if the parties act according to such agreement. Section 26, 27, 28 and 30 of the contract Act deal with cases where the consideration or object if an agreement is considered unlawful.

2. If it is fradulent :

Agreements which are entered into to promote fraud are void. Thus, an agreement for the sale of goods for the purpose of smuggling them out of the country is void and the price of the goods so sold, cannot be recovered.

3. If the court regards it as immoral :

Where the consideration or object of an agreement is such that the court regards it as immoral, the consideration is void. The word immoral means inconsistent with what is right.

4. It is being opposed by Public Policy :

Public Policy is that principle of law which holds that no citizen can lawfully do that which has a tendency to be injurious to the public. Any agreement which tends to promote corruption or injustice or is against the interests of the public is considered to be opposed to public policy.

6.3 AGREEMENTS OPPOSED TO PUBLIC POLICY :

1. Trading with enemy :

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

2. Stibling Prosecutions :

It is in public interest that criminals should be prosecuted and punished. An agreement to stifle or prosecution i.e., to prevent proceedings already instituted from running their normal course or to compromise a prosecution is illegal and void. Further, the withdrawal of prosecution with good motive, for example, for providing relief to the victims of a disaster was not considered to be against public policy by the Supreme Court. [Union Carbide Corporation V Union of India (1991)]

3. Maintenance and Champerty :

Maintenance may be defined as an agreement whereby a person promises to mountain a suit in which he has no interest. Champerty is an agreement whereby a person agrees to assist another in litigation in exchange of a promise to hand over a portion of the proceeds of the action.

The agreement for supplying funds by way of 'maintenance' or champerty is valid, unless :

a) It is unreasonable so as to unjust to the other party or,

b) It is made by a malicious motive like that of gambling in litigation or oppressing other party by encouraging unrighteous suits, and not with the bonafide object of assisting a claim believed to be just.

4. Traffic relating to public offices :

Agreements concering the sole of public offices are bad as they promote corruption. Sec.6(f) of the transfer of property Act provides that a public office cannot be transferred nor can be salary of a public officer.

5. Agreements tending to create interest apposed to duty :

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

6. Marriage brocage Agreements :

A marriage brocage agreement is an agreement whereby a person promises for reward to procure the marriage of another. Such agreements are void being against public policy.

7. Agreements tending to create monopolies :

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

8. Agreements to influence elections to Public Offices :

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

9. Agreement in restraint of personal liberty :

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

Example : 'A' borrowed money from a money lender and agreed that he would not without the lender's written consent leave his job, borrow money dispose of his property or move from house. It was held that the contract was illegal as it unduly restricted the liberty of 'A'. Harwood V Millers, Timber and Trading Company (1917).

10. Agreements interfering with marital duties :

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

6.4 AGREEMENTS, THE CONSIDERATION OR OBJECT OF WHICH IS UNLAWFUL IN PART :

Agreements of which consideration or object is unlawful in part, are subject to the following rules :

1. If the legal part of the agreement cannot be separated from the illegal part there :
   a) if there are several objectives but a single consideration the agreement is void if any of the objects is unlawful (Sec. 24)
   b) if there is a single object but several considerations, the agreement is void if any one of the considerations is unlawful (Sec. 24)

   Example : 'A' promises to superintend on behalf of 'B' a legal manufacture of Indigo, and an illegal traffic in other articles. 'B' promises to pay to 'A' a salary of 10,000 rupees a month. The agreement is void, the object of A's promise and the consideration for B's promise being in part unlawful.

2. Where there is a receiprocal promise to do things legal and also other things illegal, and the legal part can be separated from the illegal part, the legal part is a contract and the illegal part is a void agreement (Sec. 57).

   Example : 'A' and 'B' agree that 'A' shall sell to 'B; a house for Rs. 1 lack but that if 'B' used it as a place for gambling, he shall pay Rs. 2 lacks for it to 'A'. The first part of the agreement shall be valid and binding but the second part shall be void and unenforceable.

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

   Example : 'A' and 'B' agree that 'A' shall pay 'B' Rs. 1000/- for which 'B' shall afterwards deliver to 'A' either rice or smuggled opium. There is a valid contract to deliver rice and a void contract as to opium.

6.5 RECOVERY OF BENEFITS GIVEN UNDER ILLEGAL AGREEMENTS :

Money paid or property transferred under an illegal agreement is irrecoverable except in the following cases :

i. where the transferor is not equally guilt with the other party, i.e., transferee.

ii. where the transferor repents of making the agreement before any part of the illegal purpose is carried out.

iii. where the transferee was under a fiducracy duty to protect the plaintiff interests and had abused his duty by making the illegal agreement.

6.6 SUMMARY :

Consideration for a contract is different from its 'object'. Consideratin is the act, abstinence or promise made at the desire of the promisor where as the 'object' is the purpose for which the agreement is interned into. In order to make the contract valid both consideration and object of the contract should be lawful. An agreement, the consideration or the object of which is not lawful, cannot be enforced by law. This is because courts will not allow polluted hands to touch the pure foundations of Justice.

6.7 TECHNICAL TERMS :

1.	Object	:	The purpose for which an agreement is made
2.	Public Policy	:	A principle providing that no person can lawful do what which has a tending to be injurious to the publc or to the public good.

6.8 SELF - ASSESSMENT QUESTIONS :

1. In what cases the consideration and object of an agreement are said to be unlawful ?
2. A contract shall not be enforced if the court regards it as opposed to public policy, Discuss?
3. Discuss how far agreements in restraints of trade are enforceable in India ?

6.9 REFERENCE BOOKS :

1. S.N. Maheswari & S.K. Maheshwari, *Business Laws*, Himalya Publishing House, New Delhi, 2004.
2. K.C. Garg & Others, *Business Laws*, Kalyani Publishers, New Delhi, 2007.

- Dr. D. NAGESWARA RAO

LESSON - 7

CONTINGENT CONTRACTS

7.0 OBJECTIVES :

On completion of this lesson, you should be able to understand

- the meaning of a contingent contract
- the characteristics of a contingent contract
- differentiate between a contingent contract and a wagering agreement.
- Essentials of valid acceptance

STRUCTURE :

7.1 INTRODUCTION :

Contingent Contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened. If the event becomes impossible such contracts become void.

It is a sort of conditional contract in which the performance becomes due only upon the happening as non-happening of some events which is uncertain in nature.

Ex : A contract to pay 'B' Rs. 10,000/-, if B's house is burnt. This is a contingent contract. All contracts of insurance (except Life Insurance) guarantee and indemnity are contingents contracts.

7.2 MEANING OF CONTINGENT CONTRACT :

A contract may be (1) Absolute, (2) Contingent.

An absolute Contract is one where the promisor undertakes to perform the contract in all events.

A Contingent Contract is a contract to do or not to do sometihng if some event collateral to such contract does or does not happen (Sec. 31).

Example :

1) On 1st January, 'A' agrees with 'B' that he will sell his car to him for Rs. 70,000/- on the 15th January. This is an Absolute Executory Contract. In all circumstances both the parties must perform their respective obligations.

2) A promises, to pay, B Rs. 10,000/-, if B's house is burnt. The performance of the contract depends on a future event. It is, therefore, also a Contingent Contract.

7.2.1 COLLATERAL EVENT :

In a Contingent Contract, the even on which the performance of the contract depends is only collateral to the contract. It is an event regarding which neither of the parties makes any promise. It is important only because it marks the moment of which the rights created by the contract become enforceable.

The Act does not define the term ' Collateral Event'. But on the whole it seems to mean 'an event which is neither a performance directly promised as part of the contract, nor the whole of the consideration for a promise.

Ex : 'B' agrees to marry 'C' and 'A' in consideration of this agrees to pay B sum of Rs. 80,000/-. In this case each party has given a promise to another party and one's promise is consideration for the other. In case a party fails to perform his part, the other can have recourse to legal remedies. The performance of the contract does not depend on a collateral event. This is, therefore, not a contingent contract.

7.3 ESSENTIAL CHARACTERISTICS :

The essential characteristics of a contingent contract are :

1. The performance of the contract depends upon the happening or non-happening of a certain event in future.
2. The event is uncertain. If the event is bound to happen, the contract is due to be performed in every case, and therefore, it will not amount to a contingent contract.
3. The uncertain future event is collateral to the contract.

Contracts of insurance, contracts of indemnity and guarantee etc., are some of important examples of contingent contracts.

7.4 RULES REGARDING PERFORMANCE :

The rules regarding the performance of the contingent contracts are contained in Secs. 32 to 36 of the Contract Act, these rules are given below :

1. Contingent Contracts to do or not to do anything if an uncertain future event happens cannot be enforced by Law unless and until that event has happened. If the event becomes impossible such contracts become void (Sec. 32).

   Ex : A makes a contract with B to buy B's house if 'A' survives 'C'. This contract cannot be enforced unless and until 'C' dies in A's life time.

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

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

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

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

4. Contingent contracts to do or not to do anything, if a specified uncertain event happens with in a fixed time, become void if, at the expiration of the time fixed, such event has not happened or if, before the time fixed, such event becomes impossible (Sec. 35).

   Ex : 'N' promises to pay 'O' a sum of money if a certain ship does not return within a year, or is burnt within the year. The contract may be enforced if the ship does not return within a year, or is burnt within the year.

5. Contingent agreement to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made (Sec. 36).

   Ex : 'Z' agrees to pay 'X' Rs. 10,000/- if 'X' will marry 'Z's daughter 'Y'. 'Y' was dead at the time of agreement. The agreement is void.

7.5 CONTINGENT CONTRACT AND WAGERING AGREEMENT :

1. **Contingent Contract means** - A Contingent Contracts may not consist of reciprocal promises.
   Wagering Agreement means - A Wagering agreement consists of reciprocal promises. The performance of promise by each party, depends of the happening of an uncertain event.
2. Every Wagering Agreement is of a contingent nature, while every contingent contract is not a wagering nature.
3. In case of a wagering agreement the parties to the agreement have no other interest in the subject matter of the agreement. But in a contingent contract parties do have some other interest in the subject matter.
4. In a wagering agreement, the future event is the sole determining factor, while in a contingent contract, the future event is only collateral.
5. A wagering agreement is a absolute void while a contingent contract is perfectly valid.

7.6 SUMMARY :

In this lesson, we have discussed about the Contingent Contract, its characteristics, rules regarding performance and differences between Wagering Contract and Contingent Contract.

7.7 TECHNICAL TERMS :

1. Absolute Contract : A Contract where the promisor undertakes to perform a contract inall events
2. Contingent Contract : A contract to do or not to do something if some event collateral to the contract does or does not happen.

3. Wagering Agreement : It consists of reciprocal promises, but agreement.
4. Collateral Agreement : An event which is neither a performance directly promised as part of the contract nor the whole of the consideration for a promise.

7.8 SELF - ASSESSMENT QUESTIONS :

A. Short Answer Questions :

1. Define Contingent Contract. Discuss all the essential elements of a Contingent Contract.
2. Differentiate between Wagering Agreement and Contingent Contract.
3. To what extent the imposibility of the contingency affects the performance of the Contract.

7.9 REFERENCE BOOKS :

1. S.N. Maheswari & S.K. Maheshwari, *Business Laws*, Himalya Publishing House, New Delhi, 2004.
2. N.D. Kapoor, *Business Laws*, Sultan Chand & Sons, New Delhi, 2000.
3. K.C. Garg & Others, *Business Laws*, Kalyani Publishers, New Delhi, 2007.

- Dr. D. NAGESWARA RAO

LESSON -8

DISCHARGE OF CONTRACTS

14.0. Object : After going through this lesson the student can know. What is discharge of contract ? and what are the various modes of discharge of a contract.

Structure :

8.1. Introduction :

When the rights and obligations arising out of a contract are extinguished, the contract is said to be discharge or terminated. A contract may be discharged in many ways. The discharge of a contracts means that the parties are no more liable under the contracts:

8.2 Modes of discharge :

A contract may be discharged in many ways. The following are the various modes in which a contract may be discharged :

1) Discharge by agreement [Sec 62 & 63]

2) Discharge by operation of law

3) Discharge by breach [sec 39]

4) Discharge by performance [sec 37 & 38]

5) Discharge by impossibility [sec 56]

6) Discharge by lapse of time

8.3 Discharge by Agreement :

A contract may discharge by mutual agreement of the concerned parties. The rights and obligations created by an agreement can be discharged without their performance by means of another agreement between the parties which provides for the extinguishment of the earlier rights and obligations the parties may agree to terminate the existence of the contract by any of the following ways.

a) Novation

b) Rescission

c) Alteration

d) Remission

e) Waiver

f) Accord and satisfaction

g) Merge

a) Novation :-

The term 'Novation' means substitution of a new contract for the existing one. The new contract may be between the same parties or between different parties; the consideration mutually being the discharge of old contract. It is a transaction by which, with the consent of all the parties concerned, the old contract is revoked and substituted by a new contract. Unless there is an extinguishment of all rights and obligations under the old contract there is no novation. Since novation implies a fresh contract in place of original one, all the parties to the old contract must agree to it. The new agreement should be valid and enforceable. If the new agreement is unenforceable then the old contract revives..

When an existing mortgage was replaced by a new agreement of mortgage which was not enforceable for want of registration, it was held that the parties were still bound by the original mortgage as was decided in the case of 'Shankar Lal Damoodhar vs. Ambalal Ajaipal AIR 1946'.

Novation may occur in two ways:-

1. New parties substituted for the old one. In this type the parties to the contract are changed but the contract remains the same. The usual and most common form of novation is substituting a new debtor in place of an old one with the consent of the creditor. Example: A. is indebted to B and B to C By mutual agreement B's debt to C and A's debt to B is cancelled and C accepts A as his debtor. This is novation.

2. Novation without changes of parties :-

Substitution of a contract may take place even without change of parties that is, sometimes the concerned parties to a contract agree to substitute the existing contract for a new contract. In such situations the original contract is discharged. Example : A owes B Rs 20000. A enters into an agreement with B and gives B a mortgage of his estate for Rs.10,000 in place of the debt of Rs. 20,000. This is new contract and extinguishes the old.

Rules regarding Novation are as follows :-

1. Novation must be done before the expiry of the original contract.
2. It is possible only by mutual consent of the parties and may not be compulsory.

3. New contract replacing the old one must be capable of legal enforcement
4. It must substitute the present contract, An agreement to substitute a contract in future will not be novations.
5. As a result of novation, old contract is totally discharged and law does not entertain any action based upon the terms of the old contract.

2. Rescission [sec.64]

Rescission means cancellation of the contract. It the parties to a contract agree to rescind it, the original contract need not be performed. This is discharged by rescission which requires mutual consent and consideration. Rescission means cancellation of the contract. Rescission results in the dissolution of the contract while novation results in dissoluation and replacement of the contract.

Example : A promises to supply certain goods to B on a certain day. Before the actual date of performance A and B mutually agree that the contract will not be performed.

A contract can be rescinded in any of the following ways:

1. By mutual consent : Parties may enter into a simple agreement to rescind the contract before its breach.

2. By the aggrieved party : When any of the parties has committed a breach of contract without, in any way, affecting the right to compensation from the breach of contract.

3. By the party whose consent is not free: In case of a viod able contract the party whose consent is not free, may rescind the contract if it so desires.

4. Non –performance till a long time: Where none of the parties has perfomed its part for a long time and no other party has objected against it, the contract may be taken as rescinded.

Rescission may either be total or partial. Former is the discharge of the whole contract while the latter is the variation of the original contract either by:

a) Rescinding some of the terms of the contract : or

b) Substituting new terms for the ones which are rescinded : or

c) Adding new terms without rescinding any of the terms of the original contract.

3. Remission (section 63)

It means acceptance of lesser amount or lesser degree of performance than what was actually due under the contract. It is a unilateral act of the promise discharging at his will and pleasure of the obligation of another.

Example : A owes large sums of money to B. C offered to pay lesser sum in satisfaction of B's claim on A. B accepted it. It was held that the acceptance was in full satisfaction and B cannot claim balance from A after receiving payment in full satisfaction [Kapur Chand vs. Himayat Ali khan. A.I.R. 1963 sc.250]

4. Waiver :

It means the abandonment of right which a person is entitled to A party to. a contract waives his right the other party is released of his obligations to constitute a waiver neither an agreement nor consideration is necessary.

Example : A agrees to repair the car of B. B later on forbids A to repair the car. A is no longer bound to perform the promise. Thus the contract is terminated by waiver.

5.Merger:

Merger takes place when an inferior right accruing to a party under a contract merges into a superior right accruing to the same party either under the same or the other contract. In such cases, the inferior rights merge into the superior rights. And on merger the inferior rights vanish and are not required to be enforced.

Examples : A purchases a house which he was having on lease. High right as a lessee will merge into his right as on owner as right of a lessee is inferior to the right of an owner.

6. Accord and satisfaction :

Accepting any other satisfaction than the performance originally agreed is known in English law as accord and satisfaction. Accord means the promise to accept less that what is due under the old contract. Satisfaction means the payment or the fulfillment of the smaller obligation. An accord is un enforceable: but an accord followed by satisfaction discharges the pre-existing obligation.

Once the promise accepts such satisfaction as discharge of the original obligation, the obligation is discharged.

Example: A owes Rs.1000. B agrees to accept Rs.750 in full satisfaction. The agreement to pay Rs.750 is an accord and the actual payment is the satisfction.

8.4. Discharge by operation of law :

Following are the circumstances under which the law regards the contract as discharged :

8.4.1. Unothorised material Alteration :

A material alteration made in a written document or contract by one party without the consent of the other, will make the whole contract void. An alteration which is not material or which is authorised will not affect the validity of the contract.

A) material alteration is one which changes in a significant manner, the legal identity or character of the contract or the rights and habilities of the parties to the contract.

8.4.2. Death :

Death of the promisor results in termination of the contract in cases involving personal skill or ability. In other cases, the rights and liabilities of the deceased person pass on to the legal representatives.

8.4.3. Insolvency :

A contract is discharged by the insolvency of one of the parties to it when an insolvency court passes "order of discharge".

8.4.4. Merger :

This has been explained in the previous point

8.5 Discharge by Breach of contract :

The breach of contract means the failure of a party to perform his obligations the party who fails to perform his obligations, is said to have committed a breach of contract. Breach is also a method of discharge of a contract. A breach of a contract may either be a) Actual Breach of contractor b) Anticipatory Breach of contract.

8.5 1. Actual breach of Contract :

Actual breach may take place a) at the time when the performance is due or b) during the performance of the contract. Actual breach of contract, at the time when the performance is Due.

Actual breach of contract occurs at the time when the performance is due, when one party fails or refuses to perform his obligation under the contract. For example, Where on the appointed day the seller does not deliver the goods or the buyer refuses to accept the delivery. If the time was the essence of the contract, the failure to perform the contract within the specified time results in breach of the contract.

Example : A agrees to deliver 5 bags of sugar to B on Ist August, but fails to do so on that date, hs is said to have committed a breach of contract. Similarly on Ist August A tenders the sugar but B for no valid reason, refuses to accept then B becomes guilty of breach.

8.5.2. Actual Breach during the performance of the contract :

It occurs when one party fails or refuses to perform the obligation under the contract during the performance of the contract. It is an actual breach of contract during its performance refusal of performance may be express or implied. This type of breach of contract occurs in the case of instalments contracts such as sale of good's delivery by instalments, payments by instalment ets.,

Example : Cort VS Ambergate Railway co(1851).

The plantiff contracted to supply to the defendant co.3900 tons of railway chairs at a certain price. After 1787 tons had been delivered the company told him that no more will be required. This is a breach of contract by the company.

8.5.3. Anticipatory Breach of contract:

It occurs when a parry refused to perform his promise under the contract before the time for performance arrives. It is a declaration by one party of his intention not to perform his obligation under the contract.

Section 39 of Indian contract Act lays down "when a party to the contract i) has rfused to perform or ii). Disabled himself form performing the contract, iii) in its entirely, the promises may put an end to the contract. Iv) Unless he had signified by words or conduct, his acquiescence in its continuance".

Anticipatory breach is premature destruction of the contract rather than a failure to perform it. A cancellation of the betrothal is an anticipatory breach of contract of marriage.

The promises can choose one of the following rights :-

a) He can treat the contract as broken and put an end to it on that ground. In such a case he is entitled to claim damages against other party as on breach of the whole agreement.

b) He is at liberty to keep the contract alive accept performance of it if made by the other party and claim damages for the part not performed. This is called waiving the breach in the continuance of the contract even after its breach by the other side.

Example :- A, a singer, enters into a contract with B, the manager of a theatre to sign at his theatre two nights, every week during the next two months, and B engages to pay her at the rate of Rs.100 for each night. On the sixth night A willfully absent herself from the theatre, B at liberty to put an end to the contract.

The anticipatory breach may take place either by express refusal to perform the contract or by some act of the promissor. Which makes the perfance impossible. In other words, it may be i) express or ii) implied anticipatory breach.

i) Express Renunciation : It takes place when one party renunciates his liability under the contract expressly, before the performance becomes due.

Example: A agreed to supply certain goods to B on 1st January. But before this dates A expressly informed B that he would not supply the goods to him. This is an anticipatory breach of contract by express refusal to perform it.

ii) Implied Repudiation:

A promisor may before the time of performance arrives by doing some act make the performance of the contract impossible it discharges the contract.

Example : A agreed to marry B. But before the agreed date of marriage, A married C. This is anticipatory breach of contract by A's conduct which has made the performance impossible.

8.5.3. Consequence of anticipatory Breach [Sec 39]:

When anticipatory breach occurs the aggrieved party can take the following steps.

1. He can treat the whole contract as broken and to claim damages against the other party although the time for the performance of contract has not yet arrived.

Hochester Vs De la tour [1853]

The defendant agreed on 12th April to employ the plaintiff as his courier and to accompany him upon a tour. The employment was to commence on 1st June. On 11th May, he wrote to the plaintiff that he had changed his mind, and hence, would not require a courier the plaintiff sued for damages before 1st June and succeeded. Lord Campbell observed that. "it cannot be laid down as a universal rule that, whereby an agreement an act is to be done on a future day, no action can be brought for a breach of the agreement till the day for doing the act has arrived".

iii) He can treat the contract as still operative and wait for the time of the performance and then hold the other party responsible for all the consequences of non-performance. But if he elects to take this course. The contract still remains operative for the benefit of both parties. By difference between the contract price and the price prevailing on the date fixed for performance.

When the contract is terminated, the aggrieved party may bring an action for damages for breach, but he will be bound to restore to the other party the benefits he may have receive under the contract.

A contract is discharged if its performance becomes impossible. In other words there is no question of discharge of a contract which is entered into perform something that obviously impossible. For instance an agreement to discover treasure by magic. In such causes, there is no contract to terminate. The impossibility in these cases is inherent in the transactions. Such a contract is void ab-initio. The impossibility of performance may be of two types.

Avery Vs Bowden (1856)

B chartered A's ship agreeing to load cargo within 45 days. However, an arrival of the ship, B showed his inability to load cargo. A however , did not treat the repudiation as immediate breach of contract and choose to wait till 45 days. Before expiry of 45 days war broke out which rendered performance illegal. It was held that A could not succeed as contract had ended by frustration and not by breach.

8.5.4. Measure of damages :

When an anticipatory breach of contract takes place, damages are measured as under .

i) If repudation of the contract is accepted and the contract is put to an end immediately, the damage will be measured by difference of price prevailing on the date breach and the contract price;

ii) If the contract is kept operative and subsisting then the damages will be measured .

a) Initial Impossibility

b) Subsequent Impossibility

a) Intial Impossibility (pre-contractual impossibility)

It is the impossibility which exists at the time of formation of a contract. If an agreement contemplates doing something which is absolutely impossible the same becomes void ab-inition the rule is based on the following two maxins.

i) Zex on cogit ad impossibiliatest i.e. the law does not recognise what is impossible and

ii) Impossibilium nulla obligatio est i.e,. what is impossible does not create an obligation.

b) Subsequent impossibility:[sec 56]

Impossibility which arises subsequent to the formation of contract is known as subsequent or supervening impossibility. A contract., which at the it was entered into, was capable of being performed may subsequently become impossible to perform or unlawful.

Example : A, contracts to take in cargo for B at a foreign port, A's government afterwards declares war against the country in which the port is situated. The contract becomes void when war id declares.

A contract becomes void on the ground of subsequent impossibility only if the following conditions are satisfied.

i) The act should have become impossible

ii) The impossibility should have been caused by circumstances which were beyond the control of the concerned parties.

iii) The impossibility should not be self-induced by the promisor or due to his negligence.

Subsequent or supervening impossibility may occur in many ways, some of which are explained below:

1) Distruction of subject matter :

When the subject –matter of a contract subsequent to its formation, is destroyed, without the fault of the promissor or promisee, the contract is discharged. In the case, Taylor Vs Caldwell (1863),. Black burn observed as follows . "In contracts in which the performance depends on the continued existence of a given person or thing, a condition is implied that the impossibility of performance arising from the perishing of the person or thing shall excuse the performance".

Example :- Taylor Vs Caldwell (1863)

A music hall was let for a series of concerts on certain days. The hall was burnt down before the date of the first concert. The contract becomes void.

2. Death or personal Incapability:

A promise may become physically incapable of performance by reason of the death or incapacity of some person whose life and health are necessary for the performance of the contract. Such impossibility discharges the promisor from liability.

Example:- Robinson Vs Davison(1871):

An artist undertook to sign at a theatre on a particular day. On the day in question, the dependent was unable to perform owing to illness. It was held that the artist was not liable to damages.

2. Change of law:

A contract is discharge by impossibility of performance by the subsequent charge in the law. The parties are also excused from performing their obligations if the performance of the contract becomes impossible by delegated legislation of powers under an Act or delegated legislation. Impossibility created by law is valid excuse for non-performance.

Example :- Re shipton, Anderson & Co (1915)

A agreed to sell to B a specific quantity of wheat lying in his godown before the delivery could be made, the godown was sealed by the government and it requisitioned the whole quantity of wheat under statutory powers. It was held the contracts is discharged as the delivery of the wheat become impossible.

4. Declaration of War

A contract entered into before the commencement of war remains suspended during the war. However, such a contract may be revived and may be enforced at the end of the war. If the performance of the contract goes to help the enemy it becomes void.

Example : A contracts to take in cargo for B at a foreign port. A's government after wards declares war against the country in which the port is situated. The contract becomes void when the war is declared.

5. Failure of pre-condition:

When certain things necessary for performance cease to exist the contract becomes void on the ground of impossibility. If a contract depends on the occurrence of an event, which does not in fact happen the contract is discharged.

Example : Krell Vs Henry (1903):-

A contract was to hire a flat for viewing the coronation procession of the king. The procession had to be cancelled on account of kings illness. In a suit for the recovery of the rent, it was held that the contract become impossible of performance and that the hirer need not pay the rent.

8.6 Discharge by performance :

Performance is the usual mode of discharge of a contract. The contract is said to be discharged when parties to a contract, perform their respective obligation which they have agreed to do. That is, when the parties to a contract fulfill their obligations arising out of the contract within the time and in the manner prescribed, the contract is said to have been discharged by performance.

8.7.1. Cases not covered by supervening Impossibility:-

"He that agrees to do an act must do it or pay damages for not doing it" is the general rule of the law of contract some of the circumstances in which a contract is not discharged on the ground of subsequent below:-

1. Difficulty of performance :

A contract is not discharged by reason of the fact that the performance is more difficult, more expensive or more burdensome or less profitable than the parties anticipated. Difficulty does not excuse performance.

Example : Black burn Bobbin co. Vs. Allen & sons (1918).

A sold B a certain quantity of Fnland timber to be supplied between July and September. Before any timber was supplied war broke out in the month of August and transport was disorganised. So that A could not bring any timber from Finland. It was held that the difficulty in getting the timber from Finland did not excuse A from performance.

2. Commercial Impossibility:

The impossibility contemplated in section 56 is a physical and legal impossibility and not a commercial impossibility . Commerical impossibility means that the situation has so changed that if the contract is performed. It will result in a loss to the promisor. Such a situation may arise on account of higher price of raw materials, increase in wages, increase in taxes etc,

Commericial impossibility does not discharge a contract.

Example :- Kart Enlinger Vs chagards & co (1915)

The defendant agreed to supply goods to the plaintiff, to be sent from Bombay to Antwerp owing to the outbreak of war before the shipment there was a sharp increase in the shipping rates. When the defendant contended frustration. It was held that the increase in freight rates did not excuse performance.

3. Failure of a third party:

The doctrine of supervening impossibility does not cover cases where the contract could not be performed because of the impossibility created by the failure of a third person on whose work the promise relied.

Example : Ganga saran Vs Ram charan R gopal (1952)

The respondent agreed to supply to the appellant 61 bales of cloth to be manufactured by the New Victoria mills kanpur, "as soon as they are supplied to him by the said mill". In a suit for damages for non-delivery of goods the defendant pleaded impossibility on the ground that the goods were not supplied to him by the Mill. Held, that the words " as soon as they are supplied to him by the mill" simply indicate the process of delivery and did not convey the meaning that the delivery was contingent on their being supplied by the mill. Hence the case did not fall within the provisions of sec.32 and 56 as the default was due to the fault of the defendant.

3. Self induced impossibility:

When the impossibility is due to the default of the contracting party himself sec.56 would not apply. In such cases the contract is not discharged on the ground of frustration. That is, a contract is not discharged in case of self-induced impossibility.

4. Failure of one of the several objects :

When a contract is entered into for several objects, failure of one of the objects does not terminate the contra. That is, when the contract is for multiple objects, failure of any one or more of them does not make the contact discharged.

Example : Herne Bag Steamboat Co. Vs. Hulton (1903)

X Agreed to let out a boat to Y for the purpose of viewing a naval review to be held on the occasion of the coronation of Edward, VII and to cruise round the fleet. Owing to the king's illness the naval review was aboandoned but the fleet was assembled and the boat could have been used to cruise round the fleet. Held the contract was not terminated.

6. Strikes Lockouts and civil Disturbances :-

These events do not discharge a party from a providing that in such cases the contract is not to be performed or that the time of performance is to be extended .

Example : Jacobs Vs credit Lyonnais (1884)

A agreed to supply B certain goods to be produced in Algeria. The goods could not be produced because of riots and civil disturbances in that country. Held, there was no excuse for non-performance of the contract.

8.7.2. The Effects of supervening Impossibility :-

1. Contract becomes void:

According to para 1 of section 56 "an agreement to do an act impossible in itself is void".

According to para 2 of section 56 "A contracts to do an act which after the contract is made becomes impossible or by reason of some event which the promise, could not prevent, unlawful becomes void when the act becomes impossible or unlawful.

2. Benefits to be Restored :

Section65 provides that "when an agreement is discovered to be void or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it. Or to make compensation for it to the person from whom be received it".

3.Compensation for Non-performance :

Sec 56, para 3 provides that "when one person has promised to do something which he knew or with reasonable deligence might have known, and which the promisee did not know to be impassible or unlawful, such promisor must make compensation to such promise for any loss which such promisee sustains through the non-performance of the promise".

Example : A pays B Rs. 1000 in consideration of B's promising to marry C, A's daughter, C dies before marriage. B must repay A Rs.1,000.

8.8 Discharge by lapse of time :

A contract is discharged by lapse of time. The limitation Act 1940 lays down that in case of breach of a contract legal action should be taken within a specified period. If it is not performed and if no action is taken by the promise in the court of law within the specified period, he is debarred from enforcing the contract. Lapse of time terminates a contract. The period of limitation for simple contract is three years. If the three years expire and creditors fails to file a suit to recover his amount, the debtor is discharged from his liability.

8.9 Summary:

When the rights and obligations arising out of a contract are cancelled, the contract is said to be discharged or terminated. This termination may be, with mutual agreement of the parties; by operation of law, by breach of contract, by performance or by impossibility, by lapse of time.

8.10 Self Assessment Questions :

1) In how many ways a contract may be terminated ?
2) What is Novation, alteration ?
3) What is the difference between novation and alteration ?
4) When does discharge of contract by rescission take place ?
5) When does merger take place ?
6) When does a contract terminate by operation of law ?
7) What is an anticipatory breach of contract ? How the damages are meassured ?
8) Discuss the effect of supervening impossibility on the performance of a contract ?

8.11 Reference Books :

1. **Bank Act** - **Indian Contract Act, 1872**
2. **Elements of Mercantile Law** - **N.K. Kapoor**
3. **Mercantile Law** - **V.K. Batra, N.K. Batra**
4. **Business Law** - **P.C. Tulsian**
5. **Business Law** - **K.C. Garg, Mukesh Sharma, V.K. Sareen R.C. Chawla**
6. **Business Law**

Dr. Ch. Suravinda

LESSON -9

BREACH OF CONTRACT - REMEDIES FOR BREACH OF CONTRACT

9.0. Object : In the previous lesson you learned what is Breach of contract. After going through this lesson the student can know what are the Remedies for Breach of contract under law"

Structure :

9.1. Introduction :

Parties to a lawful contract are expected to perform their respective promises. When one of the parties refuses to perform his promise, he is said to have committed a breach of the contract. Whenever there is breach of contract, the injured party is entitled to bring an action for damages. They are as follows.

1. Suit for Rescission
2. Suit for Damages
3. Suit upon Quantum Meruit
4. Suit for specific performance.
5. Suit for injuction.

9.2. Suit for Rescission

Rescission means setting aside or cancelling. When a contract is broken by one party, the other party may treat the breach as discharge and refuse to perform his part of the contract.

Example : A promises B to sell his car for Rs.60,000 on certain date. B agreed to pay the price on receipt of the car. A refused to sell his car to B. B need not pay the price.

According to Sec.75 of the Indian contract Act, 'A person who rightly rescinds a contract is entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract".

Example : A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her Rs.100 for each nights' performance. On the sixth night A willfully absents herself from the theatre, and B in consequence, rescinds the contract , B is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract.

Sec.66 of the contract Act provides that such rescission may be communicated in the same manner as the communication of revocation of a proposal.

2.1. Grant of Rescission :

The court may grant rescission of the contract in case :

a. The contract is voidable or terminable by the plaintiff.

b. The contract is unlawful for causes apparent on its face and the defendent is more to blame than the plaintiff.

2.2. Refusal of Rescission :

The court may refuse to grant rescission of the contract in case :

a. The plaintiff has expressly or impliedly ratified the contract.

b. Owing to the change of circumstances, the parties cannot be restored to their original posting.

c. The third parties have, during the subsistence of the contract acquired rights in good faith and for value.

d. Only a part of the contract is sought to be rescinded and such part is not severable from rest of the contract.

9.3. Suit for Damages

The damages are a monetary compensation allowed to the injured party for the loss or injury suffered by him as a result of the breach of contract. In the event of a breach of contract, the other party earns certain rights including the right to claim damages or loss arising there from. The term 'damages' is used to mean compensation in money as a substitute for the promised performance. The fundamental principle underlying damages is not punishment but compensation. Damages are to be awarded for losses which naturally arose from the breach. The law of contract does not seek to punish the guilty. The guilty party is liable to pay damages to the aggrieved party. The court will compel the party in breach to make good the loss by paying to the other party.

3.1. Kinds of Damages :

Damages are of the following kinds :

1) Ordinary Damages

2) Special Damages

3) Exemplary or punitive or vindictive Damages.

4) Nominal Damages

3.1.1. Ordinary Damages :

Ordinary damages are those which naturally arose in the usual course of things from such breach. Damages, awarded to compensate the injured party for the actual amount of loss suffered by him consequent upon the breach, are known as general damages. General damages are assessed on the basis of actual loss. The measure of ordinary damage is the difference between the contract price and market price, on the date of breach.

Example : A contracts to deliver 100 bags of rice at Rs.1,000 a bag on a future date. On the due date he refuses to deliver. The price on that day is Rs.1,100 per bag. The measure of damages is the difference between the market price on the date of breach and the contract price i.e. Rs.10,000 (100 x Rs.100).

3.1.2. Special Damages :

Special damages are those resulting from a breach of contract under some special or unusual circumstances. These damages constitute the indirect loss suffered by the injured party due to the breach of contract. These are the damages which are known to the parties whey the made the contract, as likely to arise from the breach of the contract. When a special or extraordinary circumstance present, and it is communicated to the promisor, the non-performance of the promise entitles to the promise to not only the ordinary damages but also special damages that may result there from. It is important to note that notice to this effect must have been given to the other party. If he had no knowledge, he is not answerable, subsequent knowledge of special circumstances will not create any special liability on the guilty party.

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

3.1.3. Exemplary or punitive or vindictive Damages :

These are such damages which are awarded by way of compensation for the loss suffered and not by way of punishment. Exemplary damages are granted for injured feeling, sufferings etc. Exemplary damages have no place in the law of contract and are not recoverable for a breach of contract. But there were two exemptions.

a) Breach of a contract to marry : In this case the amount of the damages will depend upon the extent of injury to the party's feelings.

b) Dishonour of a cheque by a banker when there are sufficient funds to the credit of the customer. In this case the rule of ascertaining damages is, "the smaller the cheque, the greater the damage". Of course, the actual amount of damages will differ according to the status of the party.

3.1.4. Nominal Damages

These are the damages which are very small in amount. In some cases there may be a breach of contract but no material loss would have been caused thereby. Thus nominal damages are awarded only for the name sake.

3.2. Rules Regarding Damages :

According to Sec.73 of the Indian contract Act, "When a contract has been broken, the party who suffer by such breach is entitled to receive from the party who have broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of thing from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it".

"Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach."

Explanation to Sec.73 provides that "In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by non-performance of the contract must be taken into account." The principles regarding the measure of damages is based on the decision given in "Hadley Vs Baxendle. The rules are summarised as follows :

3.2.1. General Damages :

A party who suffers by breach of a contract is entitled to only such damages which arise naturally in the usual course of things as a result of such breach. Rest of the damages will be deemed to be a remote consequence and are not recoverable.

Example : A agreed to sell B two bales of cotton at Rs.10,000 per bale, the delivery to be given on 15th January. A failed to give delivery. The remedy for B would be to claim the difference between the market price and the contract price for the same quality of cotton in case the market price is higher than the contract price.

3.2.2. Special Damages :

Special damages are recoverable only if the special circumstances were brought to the notice of the defaulting party. That is where a party claims special damage for any loss sustained he must prove that the other party knew at the time of the making of the contract that special loss was likely to result from the breach of the contract.

Example : Pinnock Bros. Vs. Lewis & Peat Ltd. (1923)

P bought from L. some Copra cake. P sold the cake to B, who sold it to various dealers who in turn sold it to farmers; who used it for feeding cattle. The copra cake was poisonous and the cattle fed on it died. The various buyers filed suits against P and obtained damages. P claimed from L damages and costs he had to pay. Held, as it was within the contemplation of the parties that the copra cake was to be used for feeding cattle. L. was liable to pay damages.

3.2.3. Remote Damages :

The remote or indirect damages are not due to natural and probable consequences of the breach of the contract. In other words, these are the damages which arise indirectly from the breach. The injured party is not entitled to any remote or indirect loss.

Example : Hobbs Vs London & S.W. Railway Co. (1875)

Mr. Hobbs and family travelled from Hampden to Wimbledon. But the train went in wrong direction and the family had to get down at a place, where there was no conveyance and no place to stay. The

result that they had to walk home several miles at midnight on drizziling night. Mrs. Hobbs got ill. Mr. Hobbs filed a suit i) for damages for inconvenience and ii) also damages for wife's illness. The court awarded damages in respect of the first claim. But the second claim did not arise in the usual course of things and was too remote a consequence.

3.2.4. Restitution and compensation :

Damages are paid as restitution and compensation and not as punishment. If a contract is broken, law will endeavour, so far as money can do it, to place the injured party in the same position as if the contract had been performed.

Example : In a contract of sale of goods, the damages are measured equal to the profit i.e. the difference between the contract price and market price of such goods on the date of breach.

3.2.5. Mitigation of Loss :

The injured party has to take all reasonable steps to minimise the loss caused by the breach. The damages which results due to the negligence of the aggrieved party, are not recoverable.

Example : Neki Vs Prabhu.

The plaintiff took a shop on lease and paid an advance. The defendent could not give him possession and the plaintiff chose to do no business for 8 months though there were other shops available in the vicinity. Held, he was entitled only to a refund of his advice, and nothing more, as he had failed in his duty to minimise the loss by not taking another shop in the neighbour hood.

3.2.6. Nominal Damages :

Nominal damages are small amount awarded by the court when the aggrieved party cannot prove any substantial loss suffered by him. These are neither awarded by way of compensation to the aggrieved party nor by way of punishment to the guilty party. If instance if the contract price is Rs.100 and after a breach the party obtained the goods from the market also for Rs.100, he may get only nominal damages for his worries and in convenience.

3.2.7. Actual loss :

Ordinarily, to aggrieved party is entitled to recovery by way of compensation, only the actual loss suffered by him. In a breach of contract for the sale of goods, the damages payable would be the difference between the contract price and the market price at the date the breach takes place.

3.2.8. Vindictive or Exemplary Damages :

Vindictive or exemplary damages are not usually awarded for breach of contract except in case of breach of contract of marriage or wrongful refusal by the bank to honour the customer's cheque. Such damages are awarded by way of lesson to the wrongdoer.

3.2.9. Liquidated Damages :

When the parties to a contract mutually agreed that in the event of a breach, the one shall pay to the other a specified sum of money; called liquidated damage. When such an amount has been mentioned in the contract, under Sec.74 of the Indian Contract Act, the injured party is entitled to get reasonable compensation not exceeding the amount mentioned.

Example : A contract with B to pay B Rs.10,000 if he fails to pay B Rs.5,000 on a given day. A fails to pay B Rs.5,000 on that day. B is entitled to recover from A such compensation exceeding Rs.10,000 as the court considers reasonable.

3.2.10. Damages in Quasi contracts :

According to Sec.73, Para 3, "When an obligation resenblin those created contract has been incurred and has not been discharged, any person injured by the failure to discharge it is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge if and had broken his contract".

3.2.11. Difficulty of Assessment :

Difficulty in calculating damages is no ground for refusing damages. The court must make an assessment of loss and pass a decree for it.

3.3. Other types of Damages :

The other types of damages are as follows :

a) Damages for loss of Reputation :

Generally such damages are not recoverable. An exception to this rule arises in case of a banker, who wrongfully refuses to honour a customer's cheques. If the customer is a business man, he can recover damages in respect of any loss to his business reputation by such breach.

b) **Cost of Decree :** The aggrieved party is entitled, in addition to the damages, to get the cost of getting the decree for damages. However, the cost of suit for damages is at the discretion of the court.

c) **Damages from carriers :** Damages can be claimed from the carriers even without notice for deterioration caused to goods by delay in transit.

3.4. Liquidated Damages and penalty :

A contract sometimes mentions that in case of breach of contract, a particular sum is payable by the party committing the breach. The sum so stipulated or agreed upon, may either be liquidated damage or penalty.

3.4.1. Liquidated damage :

It is a sum fixed or ascertained by the parties to the contract, which is a fair and genuine pre-estimate of the probable loss that might occur as a result of breach of contract. Thus, liquidated damages are an assessment of loss, which in the opinion of the parties, will occur due to breach. Such damages are effective and recoverable by the aggrieved party from the other.

3.4.2. Penalty :

It is a sum mentioned in the contract at the time of its formation which is disproportionate to the damage likely to occur as a result of the breach of the contract. Penalty is fixed with a view to getting the contract performed, but it has no concern with the probable loss likely to occur to the parties due to the breach of the contract.

Thus the liquidated damages are the fair assessment of the amount which will compensate the aggrieved party for the loss suffered due to breach of the contract. Whereas, the penalty is not a fair

assessment of the loss for breach. It is fixed with a view to prevent the party from committing to breach of the contract, that is, to compel the other party to perform the contract.

9.4. Suit upon Quantum Meruit

The Phrase 'Quantum Meruit means "Payment in proportion to the amount of work done" or "Reasonable value of work done". A person can, under certain circumstances, claim payment for work done or goods supplied without any contract and in cases where the original contract has terminated by breach of contract by one party or has become void for some reason. This is known as the Doctrine of Quantum meruit. This doctrine is applied where there is no express promise to definite remuneration to a person.

9.4.1. Claim for Quantum Meruit Arises in the following cases :

4.1.1. When a contract is found to be void :

Section 65 lays down that when a contract is discovered to be unenforceable for some technical reason, any person who has done something under the contract, is entitled to reasonable technical reason, any person who has done something under the contract, is entitled to reasonable compensation.

Example : Craven Ellis Vs Canons Ltd. (1936) C was employed as managing director of a company by the board of directors of the company under written contract. The contract was found to be void because the directors who constituted the board were unqualified. C actually worked as a managing director for sometime. It was held that he was entitled to remuneration on the basis of quantum meruit.

4.2. When something is done without any intention to do so gratuitously.

4.3. When one party Abondons or Refuses to perform the contract :

Sometimes, a party performs a part of the contract, but abandons it without completing, or refuses to perform the remaining part. In such cases, the compensation for the work done may be recovered on the basis of quantum meruit.

Example : Planche Vs Colburn (1831)

P was required by C to write a story for a children's magazine, and the story would be published serially. After P had written a few chapters and delivered them to C, the publication of the magazine was stopped by C. It was held that P could recover remuneration proportionate to his work from C.

4.4. When a contract is Divisible :

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

Example : A contract with B to deliver to him 250 mounds of rice before the Ist May. A delivers 130 mounds only before that day, and none after. B retained 130 mounds of rice. He is bound to pay A for them.

4.5. When an indivisible contract is performed Badly :

When an indivisible contract for a lump sum is completely performed but badly, the person who has performed the contract can claim the lump sum; but the other party can make a deduction for bad work.

Example : Hoeing Vs Isaacs (1952)

P agreed to decorate D's flat for a lump sum of *L* 750, certain requirements having been laid down. P did the work but D complained of faulty work man ship. It cost D*L* 204 to remedy defect. Held, P could recover from D*L* 750 less *L*204.

9.5. Suit for specific performance :

Specific performance means the actual carrying out of the contract as agreed where damages are not an adequate remedy for breach of the contract, the court may direct the party in breach to carry out his promise according to the terms of the contract. This is called "Specific Performance" of the contract. Specific according of the contract cannot be claimed as a matter of right. Rules regarding the granting of this relief are contained in the specific Relief Act.

Some of the causes in which specific performance of the contract may be enforced are as follows :

1) Where monetary consideration is not an adequate remedy for the breach of a contract.
2) Where there exists no standard for ascertaining the actual damage caused by the non-performance of the act.
3) When it is probable that compensation in money on non-performance of the contract cannot be obtained.

5.1. Specific performance is not granted in the following cases, when :

1. Damages are an adequate remedy,.
2. The contract is not certain.
3. The contract is inequitable to either party.
4. The contract is of revocable nature.
5. The contract is made by the trustee in breach of trust.
6. The contract is of personal nature (contract to marry).
7. The contract made by a company ultra vires of its memorandum of Association and
8. The court cannot supervise its carrying out.

9.6. Suit for Injuction

Injuction is an order of a court restraining a person from doing a particular act. It is a mode of securing the specific performance of the negative terms of the contract. That is, it is order of the court restraining a person from doing something which he promised not to do. This type of order is generally issued in cases where the compensation in terms of money is not an adequate relief. Thus, injuction is a preventive relief.

Example : Metropolitan Electrical supply Co.Vs. Ginder (1901)

G. Agreed to take the whole of his electricity from a certain company. The agreement was interpreted as a promise not to buy electricity from any other company. He was, therefore, restrained by an injuction from buying electricity from any other company.

9.7. Summary

Parties to a lawful contract are bound to perform their respective obligations. When one of the parties failed to perform his obligations he is said to have committed a breach of contract. In case of breach of contract, the law provides certain remedies as 1. Cancellation or Rescission 2. Restitution 3. Specific Performance 4. Injuction 5. Quantum Meruit and 6. Damages.

9.8. Self Assessment Questions :

1. What are the various remedies available to a party in case of breach of contract ?
2. Explain fully the principles on which the court would award damages for a breach of contract.
3. Distinguish between liquidated damages and penalty.
4. When do a claim on quantum meruit arise ?
5. Under what circumstances is a party entitled to specific performance.
6. What is meant by injuction ?
7. What are liquidated damages ?

9.9. Reference books.

1. **Bank Act** - **Indian Contract Act, 1872**
2. **Elements of Mercantile Law** - **N.K. Kapoor**
3. **Mercantile Law** - **V.K. Batra, N.K. Batra**
4. **Business Law** - **P.C. Tulsian**
5. **Business Law** - **K.C. Garg**
   Mukesh Sharma
   V.K. Sareen
   R.C. Chawla

- Dr. Ch. Suravinda

LESSON -10

QUASI CONTRACTS
(SECTIONS 68-72)

10.0. Object : After going through this lesson the student can know what is a Quasi contract ? What is the Basis of Quasi contracts ? and different types of Quasi contracts.

Structure :

10.1. Introduction :

We have discussed that a contract can be enforced only when it has the essential elements of contracts, viz., offer and acceptance, free consent, lawful object and consideration and capacity of the parties to contract. A contract is the result of an agreement enforceable by law. However, in certain cases the law creates and enforces legal rights and obligations when no real contract exists. That is under certain circumstances obligations resembling those created by a contract are imposed by law although the parties have never entered into a contract.

For Ex : A, trader leaves certain goods at B's shop by mistake. B treats the goods as his own. But he is bound to return them to A. This kind of contractual relations are known as quasi contracts. They are also called implied contracts under English law. Indian contract Act deals with them as "certain relations resembling those created by contracts".

10.2. Definition :

Winfield has defined the term as "Liability not exclusively referable to any other head of the law, imposed upon a particular person to pay money to another particular person on the ground of unjust benefit". It does not arise from any agreement of the parties concerned, but is imposed by the law; so that in this respect a quasi contract resembles a tort.

Similarly, in an American case, Miller Vs Schloss, observed that "A quasi or constructive contract rests upon the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another. In truth, it is not a contract at all. It is obligation which the law creates, in the absence of any

agreement, when and because the acts of the parties or other have placed in the possession of one person money, or its equivalent, under such circumstances that is equity and good conscience he ought not to retain it, and which ex acquo to bone belongs to another. Duty, and not a promise or agreement or intention of the person sought to be charged, define it".

A Quasi contract may be defined as "a transaction in which there is no contract between the parties; the law creates certain rights and obligations between them which are similar to those created by a contract.

10.3. Basis on Quasi contracts :

Quasi contracts is a kind of contract by which one party is bound to pay money in consideration of something done or suffered by the other party. These contracts are based on the maxim "nemo debet locu platari ex liena justua" i.e., no man must grow rich out of another person's cost. Again quasi contract is to prevent unjust enrichment, or unjust benefit i.e. no one should grow rich out of another person's loss.

According to Sec.73, a suit for damages for the breach of the contract can be filed in the case of a quasi contract in the same way as in the cause of a completed contract.

10.4. Types of Quasi contracts :

The different types of quasi contractual obligations which the Indian contract Act deals with are contained in section 68 to 72. They are as follows :

4.1. Claim for necessaries supplied (Sec.68)

"If a person, incapable of entering into a contract or anyone whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person" (Sec.68).

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

This section covers the case of necessaries supplied to a person incapable of contracting, say a minor, lunatic etc, and to persons whom the incapable person is bound to support , say his wife and minor children. However, following points should be noted :

1. The goods supplied must be necessaries. What will constitute necessaries shall vary from person to person depending upon the social status he enjoys.
2. It is only the property of the incapable person that shall be liable. Where he does not own any property, nothing shall be payable.

4.2. Payment by an interested person (Sec.69)

According to Section 69 of the Act, "A person who is interested in the payment of money which another is bound by law to pay and who, therefore, pays it, is entitled to be reimbursed by the other".

Example : B holds land in Bengal , on a lease granted by A, the Zamindar. The revenue payable by A to the government being in arrears, his land is advertised for sale by the Government. Under the revenue law, the consequence of such sale will be annulment of B's lease. But to prevent the sale and the consequent

annulment of his own lease, pays to the Government the sum due from A. A is bound to make good to B the amount so paid.

The applicability of this section is subject to the following conditions :

1. The defendent should be bound by law to pay.
2. The plaintiff should be interested in making the payment in order to protect his own interest and the payment should not be voluntary one.
3. The payment must not be such as the plaintiff himself was bound to pay.

Example : Tulsa Kunwar Vs Jageshar Prasad (1901)

X's goods were wrongfully attached in order to realise arrears of Government revenue due by Y. X pays the amount to save the goods from sale. X is entitled to recover the money from Y.

4.3. Benefit of Non-gratuitous Act (Sec.70)

According to Sec.70, "Where a person lawfully does anything for another person, or delivers anything to him not intending to do so gratuituously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered".

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

For application of this section, the following conditions must be fulfilled :

1. The thing must have been done lawfully,
2. The person doing the act must not have intended to do it gratuitiously, and
3. The person for whom the act is done, must have enjoyed the benefit of the act.

Example : Damodar Mudalliar Vs Secretary for state of India (1894).

The Government carried out repairs to an irrigation tank, owned by the government jointly with a Zamindar, Government sued the Zamindar, for contribution in respect of expenses incurred for repairs. It was held that Government is carrying out the repairs had acted lawfully and had not intended to carry them out gratuituously and that the Zamindar who enjoyed the benefit of the repairs was liable to pay compensation.

4.4. Responsibilities of Finder of goods (Sec.71)

According to Sec. 71, "A Person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee." Thus an agreement is also implied by law between the owner and finder of the goods and the latter is deemed to be a bailee. This obligation is imposed on the basis of quasi contract. A finder of goods is bound to take as much care of goods found as a man of ordinary prudence would take of his own goods under similar circumstances.

a) Responsibilities of Finder of Goods :

1. He is bound to take as much care of the goods as a man of ordinary prudence does under the same circumstances.
2. He has to take all necessary measures to trace the true owner, otherwise he will be guilty of wrongful conversion of property.
3. The property will vest in the finder, till the true owner is found out.
4. He can retain the goods against the whole world except the true owner.

b) Rights of Finder of goods :

1. He is entitled to receive from the true owner, all expenses incurred by him for preserving the goods or finding the true owner.
2. The finder has the right to sell the goods in the following cases :
   - i) Where the thing found is in danger of perishing or losing the greater part of their value.
   - ii) Where the owner cannot, with reasonable deligence, be found out.
   - iii) Where the owner is found out, but he refuses to pay the lawful charges to the finder.
   - iv) Where the lawful charges of the finder, in respect of the thing found, amount to two-third of the value of the thing found.

4.5. Money paid or Things Delivered by mistake or under coercion (Sec.72)

According to Sec.72, "A person to whom money has been paid, or anything delivered by mistake or under coercion, must repay or return it. "Payment by mistake under this section must refer to a payment which was not legally due.

Example : A and B jointly owe Rs.1000 to C. A alone pay the amount to C and B not knowing this fact, pays Rs.1000 to C. C is bound to repay the amount to B.

In Hollins Vs. Fowler, H picked up a diamond on the floor of F's shop and handed over to F to keep it till the owner appeared. Inspite of the best efforts the true owner could not be searched. After some time H tendered to F the lawful expenses incurred by him for finding the true owner and asked him (F) to hand over the diamond to H. F refused. It was held that F must return the diamond to H as H was entitled to retain it against the whole world except the true owner.

10.6. Summary :

A contract is result of an agreement enforceable by law. It comes into existence from the action of the parties. But sometimes there is no intention on the part of the parties to enter into a contract but obligations resembling those created by a contract are imposed by law. These are known as quasi contracts. Sec.68 to 72 the Indian contract Act deals with different types of quasi contracts.

10.7. Self Assessment Questions

1. Define quasi contracts. State the circumstances in which quasi contractual obligations arise.
2. State the legal position of a finder of goods.
3. A Quasi contract is not a contract at all. It is an obligation which the law creates. Discuss.
4. What are quasi – contracts ? Explain briefly the quasi – contracts provided for by the Indian contract Act.
5. "Under the Indian contract Act, there are certain relations resembling those created by a contract". Explain.
6. A minor is liable to pay for the necessaries of life supplied to him. Discuss.

10.8. Reference books.

1. **Bank Act** - **Indian Contract Act, 1872**
2. **Elements of Mercantile Law** - **N.K. Kapoor**
3. **Mercantile Law** - **V.K. Batra, N.K. Batra**
4. **Business Law** - **P.C. Tulsian**
5. **Business Law** - **K.C. Garg**
   Mukesh Sharma
   V.K. Sareen
   R.C. Chawla

- Dr. Ch. Suravinda

LESSON -11

CONTRACT OF INDEMNITY & GUARANTEE

11.0. Object : After going through this lesson the student can know what is indemnity and what is guarantee ? Different kinds of guarantee, Nature and extent of surety's Liability and Surety is discharged ? etc.

Structure :

11.1. Introduction :

The contract of indemnity and guarantee are the special kinds of contracts. The legal provisions relating to these contracts are contained in section 124 to 147 of the Indian contract Act, besides the general rules of contract.

11.2. Meaning of Indemnity :

To indemnify means to compensate or make good the loss. The contract of indemnity is entered into with the object of protecting the promisee against anticipated loss. Section 124 of the Indian contract Act defines a contract of indemnity thus :

"A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of any other person, is called a contract of Indemnity (Sec.124).

Example : A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of Rs.2,000. This is contract of indemnity.

In simple words, a contract of indemnity is a contract in which one person promises to protect or compensate the other for the loss suffered by him due to the conduct of the promisor or any other person.

A contract of indemnity has tow parties. Viz the promisor or the indemnifier and the promisee or the indemnified or the indemnity – holder. The object of contract of indemnity is essentially to protect the promisee from the anticipated future loss.

11.3. Essentials of a valid contract of indemnity

The analysis of the definition of contract of indemnity, the following are the essentials for a valid contract of indemnity.

1. The contract of indemnity must contain all the essentials of valid contract – competency of the parties, free consent, consideration, legality of the objects etc.
2. It is a contract between two parties, one person promises to save the other from any loss, which he may suffer.
3. The loss may be caused by the conduct of the promisor himself or any other person.
4. The contract of indemnity may be express or implied.

An express promise is one where a person promises in express terms to compensate the other from the loss. That is an express contract is by words or by writing.

Example : Policy of Insurance is a good example for express contract of indemnity. An implied promise is one where the conduct of the promisor shows that he promised to indemnify the other party against the loss suffered by him.

For instance :

1. As a general rule, Section 69 of the contract Act provides that 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.
2. By virtue of section 222 of the Indian contract Act, "the employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him".
3. On the sale of shares in a company the transferee is bound to indemnify the tranferor against future calls, whether made by the company or by the liquidator.

11.4. Rights of Indemnity holder : (Sec.125)

The promisee is a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor :

1. All damages which he may be compelled to pay under the contract in any suit.
2. All costs he may be compelled to pay in any such suit.

3. All sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor and was one which it would have been prudent for the indemnity holder to make.

An indemnity holder shall be entitled to all these rights provided he acts within the scope of his authority.

11.5. Rights of Indemnifier :

The Indian contract Act is silent regarding the rights which the indemnifier has, on carrying out his promise to indemnify. It has been held, however, that his rights, in such cases are similar to the rights of a surety under section 141 on the contract Act.

11.6. Commencement of Indemnifier libaility :

Regarding the commencement of the liability of the indemnifier, the Act is silent. There have been diversified views held regarding the time of commencement of the indemnifier's liability. There is difference of opinion. Some of the High Courts, have held that the indemnifier can be made liable only when the indemnity – holder has incurred actual loss i.e., discharged the liability and some other have held that the indemnified can compel the indemnifier to make good his loss even before he has actually discharged his liability.

The liability of the indemnifier commences as soon as the liability of the indemnity – holder becomes absolute.

11.7. Contract of Guarantee (Sec 126) :

According to section 126, "a contract of guarantee" is a contract to perform the promise, or discharge the liability, of a third party in case of his default". A guarantee may be either oral or written.

Example : A and B go into a shop. A says to the shopkeeper, "Let him (B) have the goods, I will see you paid". This is a contract of indemnity. If he says, "If B does not pay you, I will pay." It is a guarantee.

In a contract of indemnity, there are two parties, indemnifier and indemnified. In case of guarantee, there are three parties the principal debtor, the creditor and the surety. In a contract of guarantee there are three separate agreements.

1. Between the principal debtor and the creditor.
2. Between the creditor and surety.
3. Between the surety and principal debtor.

The contract between the surety and the principal debtor is that of an indemnity and by which the principal debtor requests the surety to act as such and impliedly promises to indemnify the surety, incase surety is called upon by the creditor to pay-off the debt, due by the principal debtor.

11.8. Essentials of contract of guarantee :

The following conditions are to be fulfilled for a contract of guarantee.

1. A contract of guarantee must satisfy all the essential elements of a valid contracts; such as there must be lawful consideration and object, there must be free consent etc.

2. There must be atleast three parties : 1) Surety 2) Principal debtor 3. Creditor. All the parties must join the contract.
3. A contract of guarantee pre-supposes the existence of a liability enforceable at law.
4. Surety becomes liable only when principal debtor fails to perform his promise.
5. It is an undertaking to perform the promise of other on his failure to do so.
6. A contract of guarantee may be oral or written. The contract may be express or even implied from the conduct of the parties.
7. A contract of guarantee, like every other contract, must satisfy all the essential elements of a valid contract.

11.9. Consideration and capacity to contract :

Sec.127 of the Act clearly provides that "Anything done, or any promise made, for the benefit of the principal debtor may be a sufficient consideration to the surety for giving the guarantee". Here, the consideration received by the principal debtor is taken to be sufficient consideration for the surety. It is not necessary that there should be direct consideration between the surety and creditor. However, past consideration is no consideration for a contract of guarantees. But "a contract of guarantee without consideration is void."

Example : B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promises to deliver the goods. This is a sufficient consideration for C's promise.

Parties to a contract of guarantee must be competent to contract. However, the incapacity of the principal debtor does not affect the validity of a contract of guarantee. The creditor and the surety must be competent to enter into a valid contract. Incase, the principal debtor is a minor, the surety is regarded as a principal debtor and is personally liable to pay the debt, though the principal is not liable (Kashiba Vs. Sripat) it was observed that the contract between the surety and the creditor is not collateral but independent and the surety is held liable as principal debtor. The Bombay High Court considered the question is Manju Vs. Shivappa and held that "if a minor could not default, the liability of the guarantor, being secondary, does not arise at all".

11.10. Invalid Guarantee :

A contract of guarantee is invalid in the following cases :

1. Misrepresentation :

According to Sec.142, "any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid".

2. Concealment :

According to Sec.143, "Any guarantee which the creditor has obtained by means of keeping silence to material circumstances is invalid". The creditor should disclose to the surety the facts which are likely to affect the surety's liability.

Example : A guarantees to C payment for iron to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied is liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

3. Not Joining by co-surety :

According to Sec. 144, "Where a person gives a guarantee upon a contract that a creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join." The surety is discharged from his liability.

11.11. Distinction between contract of Indemnity and contract of guarantee.

The following are the points of distinction between the two.

Contract of Indemnity	Contract of Guarantee
1. There are two parties – the Indemnifier and the Indemity holder.	1. There are three persons the creditor the principal Debtor and the surety.
2. The liability of the indemnifier is primary.	2. The liability of the principal Debtor is primary. The liability s of the surety is secondary, that is the surety is liable only if the principal debtor fails.
3. There is only one contract i.e. between indemnifier and indemnified.	3. There are three contracts i.e. first between the creditor and the principal debtor, second between the creditor and the surety and third between the surety and the principal debtor.
4. Indemnifier need not act on the request of the indemnified.	4. Surety gives guarantee on the request of the principal debtor.
5. The liability of indemifier arises on the happening of contingent event.	5. There is an existing debt or duty, the performance of which is guaranteed by the surety.
6. An indemnifier cannot sue a third party for loss in his own name because there is no privity of contract. He can do so only if there is an assignment in his favour.	6. A surety on discharging the debt due by the principal debtor, can take action against the principal debtor for his own recovery.
7. It is for reimbursement of loss.	7. It is for the security of the creditor for ensuring his payment.
8. The promisor has some interest in the transaction, apart from indemnity.	8. The surety gets nothing substantial for his promise. He is not connected with the contract except by means of the promise to pay the debt.

11.12. Kinds of Guarantee.

A guarantee may usually be given for :

1. The repayment of a debt;
2. The repayment of the price of goods sold on credit; and
3. Good conduct or honesty of a person employed with a particular person.

Guarantee may either be retrospective or prospective. The former is given for an existing debt while the latter is given for some future agreement. Mainly, there are two types of contract of guarantee. They are

1) Simple or specific guarantee 2) Continuing guarantee.

11.12.1. Simple or specific guarantee :

Simple guarantee is one in which guarantee is given for a simple specific debt or transaction. It comes to an end as soon as the liability under that transaction ends. A specific guarantee once given is irrevocable.

11.12.2. Continuing guarantee :

According to Sec.129, "A guarantee which extends to a series of transactions is called a continuing guarantee". It is not confined to single transaction. Whether a guarantee is continuing or not depends on the language of the guarantee, the subject matter and the surrounding circumstances.

Example : A guarantees payment to B, a tea dealer to the amount of *L*100, for any tea he may from time to time supply to C. B supplies C with tea to the above value of *L*100 and C pays B for it. Afterwards B supplies C with the tea to the value of *L*200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of *L*100.

11.12.2.1. Revocation of continuing guarantee :

A continuing guarantee may be revoked as regards future transactions under the following circumstances.

2.1.a. By Notice :

"A continuing guarantee at any time, be revoked by the surety as to future transactions by notice to the creditor" (Sec.130).

2.1.b. By Death of surety :

"The death of the surety operates, in the absence of any contract to the contrary, as revocation of continuing guarantee, so far as regards future transactions Sec.131. The estate of the surety is liable for all transactions entered into prior to death, of the surety unless there was a contract to the contrary. His estate shall not be liable for the transactions entered into after his death, even if the creditor has no notice of the death.

11.13. Surety's Liabilities :

Sec 128 dealing with the surety's liability states that, "The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract". It means that that a surety is liable for what a principal debtor is liable.

Example : A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is not only for the amount of the bill but also for any interest and charges which may have become due on it.

2. The liability of the surety is only secondary, collateral or contingent. His liability arises only on default by the principal debtor. The surety's liability arises immediately on the default of the principal debtor unless there is an express provision in the contract that the creditor must in the first instance proceed against the principal debtor or must give a notice of default to the surety. If the contract is silent, notice of the default is not necessary to bring an action against the surety. If the surety becomes insolvent before default by the principal debtor, the creditor cannot prove against the surety's receiver in insolvency.

3. Surety is liable only when principal debtor does not pay. Surety is considered with favour both at law and equity. For this reason, the surety is sometimes called a favoured debtor.

4. A discharge of the principal debtor when insolvent by operation of law does not discharge the surety.

5. The liability of a surety does not come to an end upon the death of the principal debtor.

6. Where a creditor holds securities from the principal debtor for his debt, the creditor need not first resort to these securities before suing the surety, unless otherwise agreed.

7. We understand, the surety may, by special agreement, limit his liability to a fixed amount.

11.14. Right of Surety :

The rights of a surety can be discussed under the following three heads.

1) Against the creditor

2) Against the principal debtor

3) Against the so-sureties.

14.1. Rights of a surety against the creditor :

1. Right to benefit of creditor's securities :

According to Sec.141 of the Act, "A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract for surety ship is entered into, whether the surety knows of the existence of such security or not". The surety is entitled to all the securities which the creditor was holding at the time of contract of guarantee.

2. Right of subrogation :

According to Sec.140, "Where a guaranteed debt has become due, on default of the principal debtor to perform a guaranteed duty has taken place, the surety upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor". Such a right of the surety which the law vests in him, is known as the right of subrogation.

3. Right to File Quia Timet Action :

The surety has a right at any time after the guaranteed debt has become due and before he is called upon to pay, to require the creditor to sue for and recover the guaranteed debt.

4. In the case of fidelity guarantees like guarantee of conduct, honesty etc. of the principal debtor, the surety can call upon the creditor to discuss the principal debtor whose honesty he has guaranteed, in the event of proved dishonesty of the principal debtor and thus further loss can be avoided.

5. Right to set off :

The surety is also entitled to the benefit of any set-off or counter claim, which the principal debtor might possess against the creditor in respect of the same transaction.

14.2. Right against the principal debtor :

1. Right of subrogation :

When the surety is paid the guaranteed debt on the default of the principal debtor, the surety steps into the shoes of the creditor and will be able to exercise as against the principal debtor all these rights and remedies which could be exercised by the creditor. In otherwards, the surety is subrogated to all rights which the creditor had against the principal debtor.

2. Right to be indemnity :

According to Sec.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, but no sums which he has paid wrongfully".

14.3. Rights against co-securities :

When a debt is guaranteed by two or more sureties, they are called co-securities. In such a case all the co-securities are liable to contribute towards the payment of the guaranteed debt as per the agreement among them.

3.1. Right to contribution :

According to Sec.146 "Where two or more persons are co-sureties for the same debt or duty, either jointly or severally and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt or of that part of it which remains unpaid by the principal debtor".

3.2. Bound in Different sums :

According to Sec.147, "Co-securities who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit." Therefore, the liability when apportioned equally will be subject to the maximum each one has guaranteed.

11.15. Discharge of Surety from Liability :

A surety is to be discharged when his liability comes to an end. Circumstances in which a surety is discharged are discussed as follows :

1. Notice of Revocation (Sec.130)

A specific guarantee once given is irrevocable where as according to Sec130 a continuing guarantee may at any time be revoked by the surety by notice to the creditor. He remains liable for transactions entered into prior to the notice.

2. Death of surety (Sec.131)

Section 131 of the Act provides, "The death of the surety operates, in the absence of any contract to the contrary.

3. Novation (Sec.62) :

Novation means the substitution of a new contract either between the same parties or different parties for the old one. Thus novation of a contract of guarantee discharges it.

4. Variances in Terms of contract (Sec.133) :

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

Example : C contracts to lend B Rs.10,000 on first March. A guarantees repayment, c pays the amount of Rs.10,000 to B on first January. A is discharged from his liability, as the contract has been varied in as much as C might sue B for the money before the first of march.

5. Release or Discharge of the principal Debtor (Sec.134) :

According to Sec.134, "The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released.

6. Arrangement by creditor with principal Debtor (Sec.135).

"A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety unless the surety assents to such contract" If the creditor make an agreement with the third party to give time to the principal debtor then the surety is not discharged (Sec.136).

7. Impairing surety's Remedy :

According to Section 139, "If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the security requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

8. Loss of security (Sec.141) :

Section 141 Provides, "A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses with such security, the surety is discharged to the extent of the value of the security". The word 'loss' here means loss because of carelessness or negligence.

11.16. Summary

The contract of indemnity and guarantee are the special kinds of contracts. To indemnify means to compensate or make good the loss. A contract of guarantee is a contract to perform the promise, or discharge the liability, of a third party in case of his default. A guarantee may be either oral or written.

11.17. Self Assessment Questions

1. Define a contract of Indemnity ?
2. What is the object of a contract of Indemnity ?
3. What is a contract of guarantee ?
4. What is the nature of surety's liability ?
5. What are the rights of an indemnity holder when sued ?
6. What is a contract of guarantee ? What are its characteristics ? Distinguish between a contract of guarantee and a contract of indemnity.
7. What is continuing guarantee ? How can it be revoked ?
8. What is the nature of sureties liability ?
9. Briefly discuss the rights of a surety against 1) Creditor 2) principal debtor and co-sureties.
10. Define the contract of Indemnity. Distinguish it from a contract of guarantee. State the rights of indemnity holder when sued.
11. Define a contract of guarantee. What are the essentials of a contract of guarantee ?
12. What are the various kinds of a guarantees ? Define a continuing guarantee.
13. Explain the situations which make the contract of surety invalid and thereby surety is discharged.
14. When a surety is discharged from liability.
15. What is the nature of surety's liability ?

11.18. Reference Books

1.	**Bank Act**	**-**	**Indian Contract Act, 1872**
2.	**Elements of Mercantile Law**	**-**	**N.K. Kapoor**
3.	**Mercantile Law**	**-**	**V.K. Batra, N.K. Batra**
4.	**Business Law**	**-**	**P.C. Tulsian**
5.	**Business Law**	**-**	**K.C. Garg**
			Mukesh Sharma
			V.K. Sareen
			R.C. Chawla

- Dr. Ch. Suravinda

LESSON -12

CONTRACT OF BAIL MENT (SEC 148 - 181)

12.0. Object : After going through this lesson the student can know what is a contract of Bailment ? Kinds of bailment. Rights & Duties of Bailor, Rights & Duities of Bailee, Bailee's lean and Termination of Bailment.

Structure :

12.1. Introduction :

A bailment is the delivery of goods by a person to another for definite purpose on the condition that after fulfilment of the purpose, the goods have to be returned. Common examples of bailment are hiring of goods, furniture or cycle etc; delivering of cloth to a tailor for making suit, delivering a car or scooter for repairs, depositing luggage in clock room, delivering dresses to a dry cleaners etc.

12.2. Definition

According to section 148 of the Indian contract Act, "A bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them."

The person delivering the goods is called the BAILOR. The person to whom they are delivered is called the BAILEE. The transaction is called BAILMENT.

According to Halsbury a bailment is "a delivery of personal chattels in trust on a contract, express or implied, that the trust shall be duly executed, and the chattels re-delivered, in either their original or altered form, as soon as the time of use for, or condtion on which they were bailed, shall have elapsed or been performed".

12.3. Essentials of Bailment :

Sec.148 of the Act explains the characterstics of bailment. They are as under.

3.1. Contract

Bailment is based upon a contract between bailor and bailee. The agreement is that the goods are to be returned when the purpose is fulfilled. The condition is that the goods should be returned either in their original form or in altered form. The agreement may be express or implied.

3.2. Delivery of goods :

Bailment involves change of possession. It necessarily involves a temporary delivery of possession of goods by bailor to bailee for some specific purpose is the most important. The ownership of the goods is retained by the bailor.

Example : Kaliaperumal Vs Visalakshi (1938) :

A lady employed a goldsmith for the purpose of melting old and making new jewels. Every evening she used to receive the half-made jewels from the goldsmith and put then into a box which was left in a room in the goldsmith's house, of which she retained the key. On one night they were stolen. Held, there was a redelivery of the jewels to the lady and they were not in the possession of the goldsmith when stolen. No negligence on the part of the Goldsmith was proved. Therefore, the Goldsmith was not liable for the loss of jewellery.

3.3. Specific Purpose :

When goods are delivered by mistake without any purpose, there is no bailment with the meaning of Sec.148. Delivery of goods must be for some specific purpose.

3.4. Return of goods :

Bailment is made for some purpose, and after the accomplishment of the purpose, the goods should be returned to the bailor or to somebody according to the directions of the bailor, either in their original form or in an altered form.

The bailment is concerned with only movable goods. Money is not included in movable goods. A deposit of money into the bank does not constitute a bailment because there is no obligation to return the identical money.

12.4. Distinction between sale and Bailment :

Difference between sale and Bailement, in brief, are given below :

SALE	BAILMENT
1. The ownership in goods is transferred from seller to buyer.	1. Only possession is transferred and no ownership is transferred to bailee.
2. There is no return of goods from buyer to seller.	2. The bailee returns the goods to the bailor.
3. The buyer can use the goods in any way he likes.	3. The bailee can use the goods only according to the direction of the bailor.
4. The consideration for a sale is the price in terms of money.	4. The consideration is an understanding to return the goods after the purpose is accomplished.

12.5. Kinds of Bailment :

Bailment may be classified on the basis of 1. Benefit 2. Reward.

5.1. Kinds on the Basis of Benefit :

On the basis of benefits, bailment may be classified into three types .

a) Bailment for the exclusive benefit of bailor : It may be in the cause of safe custody, where goods are delivered to a neighbour or someone else for safe custody without any charge, while the bailor goes away.

b) Bailment for the Exclusive Benefit of Bailee : It may be in the case of for his use without any charge, for example, delivery of scooter to a friend to go somewhere.

c) Bailment for Mutual Benefit : In this type of bailement delivery of goods is done with some consideration, for example, delivering a scooter to a mechanic for repairs.

5.2. Kinds on the Basis of reward :

On the basis of reward, bailment is classified into two :

a) Gratuitous Bailment : It is one in which neither the bailor nor the bailee is entitled to any remuneration, for example, A gives his book to B for reading.

b) Non-gratuitous Bailment : It is a bailment for some charges. Either the bailor on the bailee is entitled to a remuneration, for example, cycle let our for hire.

12.6. Rights of Bailor :

Rights of a bailor are almost the same as the duties of a bailee.

1. Right to sue : The bailor has a right to sue the bailee for the enforcement of the bailee's duties and liabilities.

2. Right to terminate the Bailment (Sec.153) Sec.153 states that "A contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment".

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

3. Unauthorised use by the Bailee (Sec.154) Section 154 States, "If the bailee makes any use of the goods bailed, which is not according to the conditions of the bailment, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them".

Example : A lend a horse to B for his own riding only. B allows C, a member of his family to ride the horse, C rides with care, but the horse accidentally falls and is injured. B is liable to make compensation to A for the injury does to the horse.

4. Right against mixture of goods Bailed (Sec.155, 156 and 157) : The bailee should not mix the goods with his own goods.

5. Right to Demand Return of goods (Sec.159) In case of gratuitous bailment the bailor can, at any time, exercise his option to terminate the contract and take back the goods bailed.

6. He is entitled to claim Damages : Bailor can claim damages for loss, distruction of deterioration of the goods bailed, owing to bailee's negligence.

7. Right to claim Increase in value or profits (Sec.163) The bailor is entitled to get any increase or profit from the goods bailed.

8. Suit against wrongdoer (Sec.180) : The bailor can sue a third person who wrongly deprives the bailee of the use of the goods or does them any injury.

9. Share in the compensation Received (Sec.181) Compensation in any suit, under Sec.180, received shall be apportioned between bailor and bailee, in accordance with their respective interest.

12.7. Duties of Bailor

The duties of bailor can be listed as below.

1. To disclose the faults in the goods Bailed :

Sec.150 provides, "The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware and which materially interfere with the use of them, or expose the bailee to extraordinary risks; and if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

Example : A lend a horse which he knows to be vicious to B. He does not disclose the fact that the horse in vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

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

It is the duty of the bailor to supply goods as fit for the purpose for which they are hired.

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.

2. Repay necessary Expenses (Sec.158) :

According to Sec.158, "Where, by the conditions of the bailment, the goods are to the kept or to be carried, or to have work done upon them by the bailee for the bailor and the bailee is to receive no remuneration, the bailor is to receive no remuneration the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of bailment".

Example : If a horse is lent for journey, the expenses of feeding the horse would be borne by the bailee (ordinary expenses). But if the horse becomes sick and expenses have been incurred for its recovery, the bailor should have to pay it (extraordinary expenses).

3. To indemnify the Bailee (Sec .159)

If the borrower is compelled to return goods, in the case of gratuitous bailment before the specified time and suffers loss which exceeds the benifits derived by him, the bailor's duty is to indemnify the borrower for such loss.

4. Responsibility for any loss due to defect in the (Sec.164)

"The bailor is responsible for bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods, or to give directions respecting them".

5. To Receive back the goods :

When the bailee returns the goods after the purpose is fulfilled or the time is expired, it is the duty of the bailor to receive back the goods. In case, the bailor refuses to receive back the goods, he is liable to pay compensation to the bailee who incurs expenses in maintaining the same.

12.8. Rights of a Bailee :

The duties of the bailor are the rights of the bailee. The bailee has the following rights against bailor:

1. A Bailee is entitled to claim damages for any loss caused to him from the undisclosed faults in the goods bailed. (Sec.150)
2. In case of gratuitous bailment, bailee is entitled to recover from bailor all necessary expenses incurred by him for bailment (Sec.158) and of the extraordinary expenses in case of non-gratuitous bailment.
3. Right to indemnify, in case of gratuitous bailment, against premature termination of the contract by the bailor for any loss sustained (Sec.157)
4. A bailee is entitled to claim any loss sustained by him because of non-entitlement or defective entitlement of the bailor on goods bailed.
5. If a third person claims the ownership of the goods bailed, the bailee can ask the court to decide the ownership and can withhold the delivery to the bailor.
6. 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 such third party. (Sec.180)
7. According to Sec.165, in case of several joint bailors, the bailee can deliver the goods back to one of them without the consent of all.
8. Bialee enjoys the right of lien (Sec.170 and 171)

12.9. Duties of bailee :

To take Responsible care of the goods bailed (Sec.151).

According to Sec.151 "In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary providence would, under similar circumstances take of his own goods of the same bulk, quality and value as the goods bailed".

Sections 152 states "The bailee, in the absence of any special contract, is not responsible for the loss, distruction or deterioration of the thing bailed, if he has taken the amount of care of its described in section 151".

2. Not to make unauthorised use of goods Bailed (Sec.154)

If the bailee makes any use of the goods bailed, which is not according to the conditions of the bailment, he is liables to make compensation to the bailor for any damage arising to the goods from or during such use of them".

Example : A hires a horse is Calcutta from B expressly to march to Banaras. A rides with due care, but marches to Cuttack instead. The horse accidently falls and is injured. A is liable to make compensation to B for the injury to the horse.

3. Not to Mix the goods Bailed with his own goods (Sec.155, 156 and 157).

The bailee should not mix the goods bailed with his own goods. If he mixes, the following rules apply :

a) "If the bailee, with the consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced" (Sec.155).

Example : A bails one bag of sugar to B. B with the consent of A, mixes A's sugar with three bags of his own. Here A and B have interest in the mixture in proportion of 1 : 3.

b) "If the bailee, without the consent of the bailor mixes the goods of the bailor with his own goods, and the goods can be separated or divided, the property in the goods remains in the parties respectively : but the bailee is bound to bear the expenses of separation or division and any damage arising from the mixture" (Sec.156).

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

c) "If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver the back, the bailor is entitled to be compensated by the bailee for the loss of the goods". (Sec.157).

Example : A bails a barrel of cape flour worth Rs.45 to B. B without A's consent mixes the flour with country flour of his own, worth only Rs.25 a barrel, B must compensate A for the loss of his flour.

4. To return the goods bailed (Sec.160) :

According to Sec.160 . "It is according to the bailors directions, the goods bailed, without demand, as soon as the time for which they were bailed has expired or the purpose for which they were bailed has been accomplished."

According to Sec.165, "Where there are several joint bailors, the bailee may return the goods to any one of the joint owners".

According to Sec.161 "If by the default of the bailee, the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time".

5. To return Increase or profit accrued :

According to Sec.163, "In the absence of any contract to contrary the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accured from the good bailed."

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.

6. Not to set up an adverse title ;

Under Sec. 117 of the Indian Evidence Act, the bailee holds the goods on behalf of an d for the bailor, he cannot deny the title of the bailor. It is the duty of the bailee to return the goods only to the bailor even though any third party is claimed title over them.

12.10. Bailees Lien :

"Lien is a right available to a person to retain that which is in his possession and which belongs to another, until the demands of the person in possession are satisfied". Once the possession is lost, lien is also lost. This right is sometimes known as possessory lien.

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

Lien is of two types 1. Particular lien and 2. General lien.

Particular lien :

Particular or specific lien means the right to retain the particular goods until claims arising on those goods are satisfied. Particular lien is available under the following conditions :

1. The goods must be in the possession of bailee. If the possession is lost, the lien is also lost.
2. The bailee must have rendered some services involving the exercise of labour and skill in respect of goods bailed so as to confer additional value on he article.
3. The services must have been performed in full in accordance with the directions of the bailor, within the agreed time or a reasonable time.
4. The bailee can exercise this lien provided there is no contract to contrary.
5. The bailee must have rendered some service in relation to the thing bailed and must be entitled to some remuneration for it, which must have been paid.
6. The bailee retain only such goods on which he has expended labour or skill.

If all the above mentioned conditions are satisfied, the bailee can exercise his right of particular lien until he is paid for his services.

General lien : It means the right to retain goods not only for demands arising out of the goods retained but for a general balance of accounts in favour of certain persons.

General lien is a privilage and is given only to certain kinds of bailee, Viz 1) Bankers 2. Factors 3. Wharfingers 4. Atorneys of High court and 5. Policy brokers. Any of these persons can exercise general lien against any goods under their possession in respect of any sum legally due on a general balance of account.

9.1. Distinction between general lien and particular lien :

Particular lien	General lien
1. Particular lien can be exercised by all bailees.	1. General lien can be exercised only be bankers, factors, wharfingers, attorneys, and policy brokers.
2. Particular lien is available on those things only on which some skill or labour has been used or money incurred.	2. General lien is available on all the goods bailed.
3. It can be used for the remuneration of services rendered on anything.	3. General lien is used for any balance of account.

12.11 Termination of lien :

A lien may be extinguished by any of the following ways :

1. A gratuitous bailment is terminated by the death of either the bailor or the bailees (Sec.162)
2. In case, the bailment is for a specific purpose, it terminates as soon as the purpose is accomplished (Sec.148).
3. When the bailment is for a stipulated period, it comes to an end on the expiry of the specified period (Sec. 148).
4. If the bailee does any act, with regard to the goods bailed, which is inconsistent with the terms of the bailment, the bailment terminates (Sec.153).
5. A lien is lost by surrender of possession of goods.
6. Lien is terminated when the debt is satisfied.

12.12. Finder of lost goods :

A person who finds goods belonging to another and takes them into custody is called a finder of lost goods. Sec.71 of the Act, clearly states that a person who finds goods belonging to another and takes them into his custody, is subject to the same responsibilities as a bailee.

11.1. Duties of a Finder of lost goods :

His duties are the same as those of a bailee, In brief, the following are the duties of a finder of lost goods.

1. He must take reasonable care of the goods found (Sec.151)
2. He must try to find out the true owner of the goods, if he fails, he will be liable as a trespasser or a thief,
3. He must not mix up the goods with his own goods.
4. He should not use the goods found for his own purpose.

Rights of the Finder of Goods :

The finder has the right of lien over the goods for his expenses.

1. As such he can retain the goods against the owner, until the receives compensation for trouble and expenses for preserving the goods and finding out the owner. But he has no right to sue the owner for any compensation.
2. In case the owner has offered any specific reward for the return of goods, the finder may sue for such reward and he may retain the goods until such reward is paid.
3. A finder has the right to retain possession of the goods against the whole world, except the true owner.
4. According to Sec.169 of the Act, the finder of goods may sell if :
   a) the owner cannot, with reasonable deligence be found or
   b) he refuses, upon demand, to pay the lawful charges of the finder or
   c) the thing is in danger of perishing or of losing the greater part of its value or
   d) the lawful charges of the finder in respect of the thing found, amount to two thirds of its value.

12.13. Termination of Bailment :

A contract of bailment terminates in the following cases :

1. If the contract of bailment is for a specified period, the bailment terminates as soon as the specified period expires.
2. If the contract of bailment is for specific purpose, the bailment terminates as soon as the purpose is achieved.
3. Where a bailee does something which is inconsistent with the terms of the contract, the bailment is terminated (Sec.153)

Example : A lets to B for hire, a horse for his own riding. B drives the horse in his carriage. This is at the option of A, a termination of bailment.

4. Where the bailment is gratuitous, the bailor may terminate the bailment even before the specified time or before the purpose is fulfilled (Sec.159)
5. The death of bailor or bailee terminates a gratuitous bailment (Sec.162)

12.14. Summary :

Bailment means a delivery of goods on condition to re-deliver the goods when the condition is satisfied. Essentials of bailment are 1. Delivery of goods 2. Delivery of goods must be for some purpose. There must be a contract 4. The goods must be movable 5. Goods must be returned. The bailment may be for the exclusive benefit of Bailor or Bailee. Bailment on the basis of reward may be gratuitous or non gratuitous. A person who finds goods belonging to another and takes them into custody is called a finder of lost goods. His duties are the same as those of a bailee. The finder has the right of lien over the goods for his expenses.

12.15. Self Assessment questions :

1. Define a contract of bailment. What are its essentials ?
2. Discuss the rights and obligations of a bailee.
3. Who is a bailor ? State briefly his rights and duties.
4. Explain particular and general lien of bailee.
5. What is lien ? How does particular lien differ from general lien ?
6. What are the rights of a bailor against a bailee when the latter mixes his own goods with him?
7. Discuss the rights and obligations of a finder of goods.

12.16. Reference Books.

1.	**Bank Act**	**-**	**Indian Contract Act, 1872**
2.	**Elements of Mercantile Law**	**-**	**N.K. Kapoor**
3.	**Mercantile Law**	**-**	**V.K. Batra, N.K. Batra**
4.	**Business Law**	**-**	**P.C. Tulsian**
5.	**Business Law**	**-**	**K.C. Garg**
			Mukesh Sharma
			V.K. Sareen
			R.C. Chawla

- Dr. Ch. Suravinda

LESSON -13

CONTRACT OF AGENCY (SEC.182-238)

13.0. Object : After going through this lesson the student can know what is Agency ? Essentials of Agency. Kinds of Agents rights and duties of an agent and rights and duties of principal. Sub agent and substituted agent and termination of Agency.

Structure :

13.1. Introduction:

Modern business is becoming complex day by day. Due to vast expansion of the modern business, it is not possible for a person to carry on all the business transactions himself. A business man must necessarily depend on others for the efficient running of the business. He must delegate some of his power to another. The another person who acts on behalf of a business man is known as an agent. The person to whom such act is done is called the principal. The contract which creates the relationship of principal and agent is called an agency.

13.2. Definition :

Section 182 of the Act defines that "an agent is a person employed to do any act for another, or to represent another in dealings with third person. The person for whom such act is done, or who is so represented, is called the principal".

Agency is a relation between two parties created by an agreement express or implied. The relationship of agency arises whenever one person called the agent has authority to act on behalf of another called the principal. The concept of agency emphasises that one person brings two persons into a legal relationship. An agent is not a mere connecting link between the principal and third parties. He has the power to make the principal answerable to the third parties for his conduct.

13.3. Essentials of Agency:

A contract of agency has all the essentials of a contract, with some special features of its own. The essentials of agency are as follows :

1. There should be appointment by the principal of an agent.
2. The principal should confer authority on the agent to act to him.
3. The authority conferred should be such as will make the principal answerable to third parties.
4. The object of the appointment must be to establish relationship between principal and third parties.
5. The relationship of agency being based on confidence between the principal and agent, no consideration is necessary.

After observing the above points, we may say that every person who acts for another is not an agent. A domestic servant renders to his master a personal service; a person may tilt another's field in these examples he is not acting for another in dealings with third persons.

13.4. Rules of Agency:

To call a person as an agent there are two important rules of agency viz.

1. Agency exists whenever a person can bind another by acts done on his behalf. That is, when acted upon by the agent, it connects the principal with third persons. The acts of the agent are considered the acts of his principal. Sec. 226 provides that "contracts entered into through an agent and obligations arising from acts done by an agent may be enforced in the same manner; and will have the same legal consequences, as if the contracts had been entered into and the acts done by the principal in person".

2. Whatever a person can lawfully do himself, he may also do the same through an agent. In other words, "Qui facit per alium facit per se" is the principal of Agency, which means, "He who does through another does by himself. This rule is subject to certain exceptions, for example, contracts involving personal services or skill, such as marriage, singing, painting etc. A wife is not the agent of the husband, a guardian is not an agent of a minor.

13.5. Distinction between Agent and Servant:

The following are the distinctions between an agent and a servant.

Servant	Agent
1. A servant has no representative character. He has no authority to make contract on behalf of his master.	1. An agent is authorised to act on behalf of his principal and has power to create legal relations between the principal and third persons.
2. A servant acts under the direct control and supervision of his employer.	2. An agent is not subject to the direct control and supervision of the principal.
3. A whole time servant serves only one master.	3. An agent may work for several principals.
4. The master has the right to direct not only "what work is to be done" but also "how the work is to be done".	4. The principal directs an agent "as to what is to be done".
5. A servant is paid by way of salary or wage.	5. An agent may be paid by way of commission on the basis of work done.
6. An employer is liable for the wrongful acts of the servant, if such acts are committed in the course of employment.	6. The principal is liable for only those acts of his agent which are done within the scope of authority and is not liable for those acts

13.6. Distinction between agent and an independent contractor.

Agent	Independent contractor
1. An agent represents his principal and has the authority to create contractual relationship between his principal and third parties.	1. An independent contractor does not represent his employer, and no authority to create contractual relationship between his master and third parties.
2. An agent is not personally liable in ordinary cases.	2. Independent contractor is personally liable for all acts done by him.
3. The question of authority arises in case of agency.	3. The question of authority does not arise in the case of independent contractor.
4. An agent is bound to act in the matter of agency subject to the directions and control of his principal.	4. An independent contractor undertakes to perform a certain specified work, the manner and means of performance being left to his discretion.

13.7. Distinction between agent and bailee :

Agent	Bailee
1. An agent may not have possession of any goods or property of the principal.	1. A bailee has possession of goods of the bailor.
2. An agent has authority to contract on behalf of his principal.	2. A bailee does not have such authority.

13.8. Kinds of Agents :

The term agent applies to any one who by authority performs an act for another. There may be various types of agents whose powers and duties are settled by usage and custom of trade recognised by the court of law. The important one are classified as under :

1. Express or implied agents :

An express agent is one who is appointed verbally of by writing. An implied agent is one whose appointment is to be inferred from the conduct of the parties.

2. General, special or universal agents :

A general agent is one who is employed to transact generally all the business of the principal in regard to which he is employed. A special agent has only authority to do some particular act or represent his principal in some particular transaction. A universal agent is one who is authorised to transact all the business of his principal of every kind and to do all the acts which the principal can lawfully do and can delegate.

3. Agent or sub-agent :

An agent derives his authority directly from the principal. A sub-agent derives his authority from the agent who has been appointed to do the act.

Another classification is on the basis of the nature of work performed, into Mercantile and Non-mercantile agents. Mercantile agents may assume any of the following.

1. Broker: A broker makes contracts in the name of his principal and not on his own name. He is an agent. He is primarily employed to negotiate between two parties. He is usually employed for sale of goods. He has no possession of goods to be sold as in the case of factor. Unlike as factor he is not entrusted with the custody and apparent ownership of the goods, but is a mere negotiator to effect business. He is paid commission for his services.

2. Factor: A factor is a mercantile agent to whom the possession of the goods is given for the purpose of selling the same. He has authority to sell in his own name. He has got discretionary powers to enter into contracts of sale with third parties. He has a general lien on the goods of his principal for all charges and expenses due from the principal.

3. Commission Agent : A commission agent is mercantile agent who buys and sells the goods on behalf of his principal and receives commission for his labour. He may or may not be in actual possession of goods. His position sells goods on behalf of his principal on the most favourble terms. He is paid commission for his services.

4. Del credere Agent : He is an agent who guarantees the solvency of the buyer. He occupies the position of a guarantor as well as an agent.

Non – mercantile agents include advocates, insurance agent, solicitor, guardian, wife etc.

13.9. Creation of Agency :

An agency may be constituted in the following ways.

1. Agency by Express agreement(Sec. 187):

A contract of agency may be created by an express agreement. When principal appoints an agent either by words spoken or written to represent and act for him, an express agrency is created.

2. Agency by implication :

The relationship of principal and agent need not be expressly constituted, and can arise by implication of law as well.

Example: A owns a shop in Serampur, living himself in Calcutta and visiting the shop occasionally. The shop is managed by B and he is in the habit of ordering goods from C in the name of A for the purpose of the shop and of paying for them out of A's funds with A's knowledge. B has an implied authority from A to order goods from C in the name of A for the purpose of the shop.

Implied agency includes :

1. Agency by estoppel 2. Agency by holding out 3. Agency by necessity

2.1. Agency by estoppel :

Estoppel means to prevent a person from denying a fact. When a person has by his conduct or statements induced others to believe that a certain person is his agent, he is estopped from subsequently denying it.

Example :- A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of B's instructions enters into a contract with B to buy the goods at a lower price than the reserved price. A is bound by the contract.

2.2. Agency by holding out:

Agency by holding out is a branch of the agency by estoppel. Here an agency by holding out requires some affirmative or positive act or conduct by the principal to establish agency subsequently. Thus, A who is a domestic servant of B, generally purchase goods on credit from C and pays them regularly. C can assume that A is B's implied agent. Subsequently A uses B's authority to purchase goods for his own use. C files as suit against B to recover the cost of the goods which were actually consumed by A. In this case, B is bound by his prior conduct is holding out that A was his agent. C can recover the price from B.

2.3. Agency by necessity :

Sometimes extraordinary circumstances require that a person who is not really an agent should act as an agent of another. In such a case though there might not have been an express or implied authority to do an act, the law implies such an authority in favour of that person on account of the necessity that had arisen.

Example : A consignee did not take delivery of a horse sent by rail and the railway company had to feed the horse, it was held that the railway company was an agent of necessity and was entitled to recover the money from the owner.

Before an agency of necessity can be inferred, the following conditions should be fulfilled.

1. There should be real and definite necessity for the creation of the agency.
2. It should be impossible to obtain the principal's instructions.
3. The person acting as an agent should act bonafide and in the interest of parties concerned.

The impossibility of communication with the principal appears to be the foundation of the doctrine of necessity. Thus, where the consignment of butter was in complete danger of becoming useless due to delay in transmit, and the railway company had to sell it away for the best possible price, the sale was held valid because there was no time to get principal's instructions. Sims Vs. Midland Railway company (1913).

2.3 Agency by operation of law :

An agency is also constituted by operation of law. For example, a partner is the agent of the firm and the act of the partner to carry on the business of the firm in the usual way binds the firm and its partners.

2.4. Agency by Ratification :

Ratification means subsequent acceptance by the principal in respect of an act done by the agent without authority. For Example: - A buys certain goods on behalf of B. B did not appoint A as his agent. B may, upon hearing of the transaction, accept or reject if B accepts it, the act is ratified and A becomes his agent with retrospective effect. On ratification, the principal is bound by the acts already done on his behalf.

Ratification has got retrospective effect. That is, the agency comes into existence from the moment the agent acted and not from the time when the principal ratified.

2.4.1. Essentials of valid ratification:-

Ratification becomes valid only if the following conditions are satisfied:

a) Act must have been done on behalf of the person ratifying :

When an act is done on behalf of the ratifier, such act can be ratified by him. The person who has the right to ratify is the person in whose name or on whose behalf the contract was entered into. A person can not ratify an act unless it was purported to be done on his behalf.

b) The principal must be in existence at the time of contract.

Another condition to ratification is that the principal claiming the ratification must have been in existence on the day. The act sought to be ratified was done. This is because rights and obligations can not attach to a non-existent person. For example, a company after incorporation can not ratify an act done by its promoter on its behalf before incorporation as the company was not in existence when the act was done.

3. The principal must have contractual capacity :

The principal must be competent to contract both at the time of original contract and the time of ratification. For example, A company can not ratify the acts done in its name before its incorporation.

4. The principal must have full knowledge of material facts:

The ratification must be made with the full knowledge of all the material facts.

5. Whole transaction must be ratified:

A person can not ratify a part of the transaction which is beneficial to him and reject the rest. There can not be partial ratification and partial reduction.

6. Ratification must be made within reasonable time:

The ratification becomes valid only if it is made within a reasonable time after the act to be ratified is done.

7. Act to be ratified should not be void or illegal :

Ratification can be made only of valid and lawful acts. An act which is void from the very beginning can not be ratified. But a voidable contract may be ratified because it is not void from the very beginning.

8. Ratification must not injure a third person:

Any act which would become injurious to others by ratification, can not be ratified.

Example:- A holds a lease from B, terminable on three months notice. C, an unauthorised person, gives notice of termination to A. The notice cannot be ratified by B, so as to be binding on A.

9. Ratification may be Express or Implied :

According to sec. 197, "Ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done.

Example : A, without authority, buys goods for B. Afterwards B sells them to C on his own account. B's conduct implies a ratification of the purchase made for him by A.

Ratification must be communicated to the other party. Ratification of acts not within he principal's authority is ineffective.

Implied Authority between husband and wife: Between husband and wife, the authority may be expressed or implied. As a general rule, husband can be held liable only for what he has expressly or impliedly sanctioned. Wife has an implied authority by necessity to pledge her husband's credit under the following circumstances:

a. When she is living with her husband.

b. The wife is living separate and claiming maintenance.

c. The wife pledges her husband's credit to a reasonable extent and in reasonable manner for ordinary household express.

d. Wife can pledge her husband's credit only for necessaries.

The wife has no implied authority, under the following circumstances:

a) To borrow money to pay her previous debts.

b) When husband has expressly forbidden his wife to pledge his credit.

c) He had given sufficient money to his wife for purchasing necessaries.

d) Where the wife lives apart under no justifiable circumstances.

13.10. Agents Authority :

No man can become an agent of another person except by the will of that person. It is only by the will of the principal that an agency may be created. Sec. 186 of the contract act defines the scope of an agent's authority.

Express and Implied authority :

An authority is said to be express, when it is given by words spoken or written. Express authority is that which the principal directly grants to the agent. A power of attorney given to an agent is an example of express authority.

An authority is said toe be implied when it is to be inferred from the circumstances of the case. An advocate who has filed vakaltnama has implied authority to compromise unless expressly prohibited by his clients.

13.10.1. Extent of agent's authority -

The extent of an agent's authority whether express or implied is determined by

1. The nature of the act or business he is appointed to do.

2. Things which are incidental to the business.

3. The usage of trade or business.

Sec. 188 of the contract act lays down that an agent having authority to do an act has authority to do every lawful thing which is necessary in order to do such an act. Further an agent has authority to do every lawful thing necessary in the course of conducting such business.

When a person is appointed as an agent for a particular purpose, persons dealing with him are entitled to presume that he has authority to do all such lawful acts as are necessary to such a business. Such authority is called 'ostensible authority of agent'. If a particular transaction though in excess of the actual authority, is still in ostensible authority, the transaction will be binding upon the principal, unless the third party enforcing that contract has knowledge of the limitation imposed on the agent's ostensible authority.

Agent's authority is always includes an authority to do :-

1. Every lawful thing necessary for the purpose of carrying it into effect.

2. Every lawful thing justified by the various customs of trade.

3. In an emergency, all such acts for the purpose of protecting the principal from loss as will be done by a person of ordinary prudence in his own case under similar circumstances (sec. 189).

13.10.2. What happens when the agent exceeds his authority:

When authority is separable :- when an agent does more than he is authorised to do, and it can be separable from the part of which he is authorised, then the principal is binding to that part of which he is authorised (sec. 227).

13.11. Sub-Agent:

According to sec. 191 of the act which states that "A sub-agent is a person employed by and acting under the control of the original agent in the business of the agency". The original agent acts as principal for

the sub-agent. An agent who employs a sub-agent has the duties and the liabilities of a principal to him. Such agent acts under the control of the original agent and the principal is bound by his acts as there is no privity of contract between as sub-agent and principal.

11.1. Relationship between principal and sub-agent:

The effect of sub-agency is to be seen from two different aspects.

1. A sub-agent may be appointed by the agent properly under sec. 190 in cases in which he is entitled to make the appointment or 2. Improperly i.e.; without legal justification for such appointment.

11.1.a. When a sub-agent is properly appointed (sec. 192) :

Following are the effects of proper appointment of a sub-agent :

a) The principal is bound by and responsible for the acts of a sub-agent.

b) The agent is responsible to the principal for the acts of the sub-agent.

c) The sub-agent is responsible for his acts to the agent, but not to the principal except in case of fraud or willful wrong.

11.1.b. When a sub-agent is improperly appointed (sec.193):

Following are effects of improper appointment of sub-agent:

a) As between the principal and the third parties the principal is not bound by the acts of such sub-agent.

b) The sub-agent is responsible to the agent as if the agent were the principal.

c) The agent is responsible to the principal as well as third parties for the act of the sub-agent.

d) The sub-agent is not responsible to the principal.

13.12. Substituted Agent (Sec. 194) :

A substituted agent is a person appointed by the agent to act for the principal in the business of the agency with the knowledge and consent of the principal. A substituted agent is deemed to be the agent of the principal and not his sub-agent. A privity of contract is established between the principal and the substituted agent. The agent is not concerned about the work of the substitute agent.

Sec. 195 states "In selecting such agent for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case.

13.13. Difference between a Sub-Agent and a Substituted Agent:

Both, a sub-agent and a substituted agent are appointed by the agent. However, the following are the points of distinction between the two :

Sub-Agent	Substituted Agent
1. He is appointed by the agent and works under the control of agent.	1. He is appointed by the agent. The substituted agent works under the control of principal.
2. There is no privity of contract between the principal and the sub-agent.	2. Privity of contract is established between a principal and substituted agent.
3. The agent is responsible for the acts of his sub-agent.	3. The agent is not liable for the acts of a substituted agent.
4. A sub-agent is appointed by an agent only when he finds it necessary as per the custom of trade or the nature of agency.	4. A substituted agent is appointed by the agent when he has express or implied authority to do so from the principal.
5. Sub-agent is liable to the agent.	5. Substituted agent is liable to the principal.
6. Remuneration or commission to a sub-agent is paid by the agent.	6. Such payments are made by the principal.
7. Principal is not responsible to the third parties for the acts committed by the sub-agent.	7. The principal is bound to will the acts of a substituted agent.

13.14. Duties of Agent towards the principal :

An agent has the following duties towards the principal.

1. Duty to conducting Principal's Business (sec.211) :

The primary duty of an agent is to act within the scope of his authority and conduct the business of his principal according to directions, given by him. If he acts otherwise, he will be liable for any loss suffered by the principal. Where there are no express instructions, the agent has to perform his duty according to the custom of the business in the particular locality he works.

2. Duty to act with responsible skill and diligence (sec. 212):

An agent is bound to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business. The standard of care and skill which an agent has to observe depends upon the nature of his profession. A stock broker should know the regulations of the stock exchange.

3. Duty to render accounts (sec. 213):

An agent is bound to render accounts to the principal. When the principal demands such an account, it is obligatory on his part to promptly place before the principal the entire accounts.

4. Duty to communicate (sec. 214) :

It is the duty of an agent, in cases of difficulty to use all reasonable deligence in community with his principal and obtain his instructions. But in case of emergency where there is no time to communicate with the principal, the agent may act in good faith without consulting the principal.

5. Duty not to deal on his own account (sec. 215) :

An agent cannot deal on his own account in the business of the agency without obtaining the consent of the principal and without acquainting the latter with all material facts within his knowledge.

6. Duty not to make secret profit (sec. 216) :

Section. 216 states that "If an agent, without the knowledge of his principal, deals in the business of agency on his own account and make any profit, the principal is entitled to claim that profit from the agent.

7. Duty not to use information obtained in the course of the agency against a principal :-

An agent cannot use against his principal any information obtained by him in the course of his agency. If he does use, the principal can restrain him from doing so by an injunction from the court.

8. Duty not to set up adverse title :

The agent must not set up his own title or the title of third parties to the goods received by him from the principal.

9. Duty to pay sums Received for principal (sec. 218) :

Sec. 218 states that the agent is bound to pay to his principal all sums received on his own account after deducting there from his dues on account of remuneration and expenses.

10. Not to Delegate (sec.190) :

An agent cannot delegate his authority or employ another to perform acts which he has expressly or impliedly undertaken to perform personally. It is based on the rule that a delegate cannot further delegate.

Delegation made by an agent to a sub-agent is lawful in the following cases.

1. Where the principal has expressly permitted,

2. Where by the ordinary custom of trade, a sub-agent may be employed,

3. where unforeseen emergencies arise.

11. Duty to protect the interest of the principal (sec. 209) :

When an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take on behalf of the representatives of his late principal.

13.15. Rights of an Agent :

1. Right to Remuneration (sec. 219) :

Following are the rights of an agent

1. Right to Receive Remuneration (sec.219) :

In the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act, but an agent may detain moneys received by him on account of goods sold, although the whole of the goods consigned to him for the sale may not have been sold.

2. Right of retainer (sec. 127) :

The agent has a right to retain his principal's money until his claims in respect of his remuneration or Advances made or expenses properly increased in conducting the business of agency are paid.

3. Right of lien (sec. 221) :

In the absence of any contract to the contrary, an agent is entitled to retain goods, papers and other property, whether movable, of the principal received by him, until the amount due to himself for compensation, disbursements and services in respect of the same has been paid or accounted for to him. The agent can only retain the goods. He has no power to sell them.

4. Right to be identified against consequences of lawful acts (sec. 222) :

A principal is bound to indemnify an agent against losses sustained by an agent in the force of his agency business. An agent can claim indemnity only in respect of lawful acts done by him in exercise of the authority.

5. Right to be indemnified against consequences of acts done in good faith (sec. 223) :

When an agent does the act in good faith, the employer is liable to indemnify the agent against the consequences of that act even though such act causes injury to the rights of third persons. But the agent can not claim indemnity, in respect of acts which he knows to be unlawful. Thus, where the buys smuggled goods for the principal, the principal is not liable to pay.

6. Right to compensation (sec.225) :

The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.

13.16. Rights of Principal :

The rights of principal are indirectly duties of an agent. The duties of an agent have been discussed. However, the rights of the principal are given below:

1. The principal is entitled to enforce on the duties of the agent. This is because the agent's duties are the principal's right.
2. He may repudiate the transaction if it shows either that any material fact has been dishonestly concealed from him by the agent or that the dealings of the agent have been disadvantageous to him (sec.215).
3. If an agent, without the knowledge of the principal, deals in the business of the agency on his own account instead of an account of his principal, the principal is entitled to claim from the agent any benefit which may have resulted to him from the transaction(sec.216).
4. He is entitled to compensation in respect of the direct consequences of the agents negligence, want of skill are misconduct (sec.212).
5. The principal is entitled to demand proper accounts from the agent (sec.213).
6. The principal has right to refuse remuneration if the agent is guilty of misconduct (sec.220).
7. The principal may revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal (sec.203).
8. The principal has the right to give instructions in cases of difficulty when contacted by the agent (sec. 214).

13.15. Duties of principal:

Duties of the principal towards his agent are the rights of the agent against the principal. The following are the duties, in brief :

1. Agent to be indemnified (sec.222) :

The employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise authority conferred upon him.

2. Against consequences of the Acts done in good faith (sec.223) :

"Where one person employs another to do an act, and the agent does not act in good faith, the employer is liable to indemnify the agent against the consequences of that act, though it causes an injury to the right persons".

3. Non-liability of employer of agent to do a criminal act (sec.224):

"Where one person employs another to do an act which is criminal, the employer is not liable to the agent either upon the expenses or an implied promise, to indemnify him against the consequences of that agent".

4. Duties to Indemnify the loss for principal's neglect (sec. 225) :

"The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill".

5. To pay Remuneration and Dues :

It is the duty of the principal to pay the agent all of his dues, remuneration, commission etc; and also to reimburse all advances and expenses incurred by him in exercise of his authority.

13.18. Principal's Liability for the Acts of the Agent:

The rights and liabilities of a principal in relation to third parties under contracts made by agent depend upon whether,

a) An agent contracts as agent for named principal.

b) An agent contracts for a principal whose name he does not disclose.

c) An agent contracts in his own name but in reality for a principal whose existence he does not disclose.

d)Agent acting for a named principal when an agent acts within the scope of his authority (sec. 226).

a) Where an act is done by an agent within the scope of his authority, his acts are binding on the principal. The principal will be bound by the acts of the agent provide a) the act is lawful b) within the scope of agent's authority.

b) **When the agent exceeds his authority (sec. 227 228) :**

Ordinarily, the principal is liable for those acts of the agent which are within the scope of his authority. According to sec. 227, where an agent has done more than he is authorised to do, and it is separable, the principal is bound by the part which is within his authority. When such act cannot be separated from that which is within his authority, the principal is not bound by the transaction (sec. 228).

c) **Principal bound by notice given to agent (sec.229):-**

A notice given to agent is as effectual as notice given to principal as otherwise notice might be avoided in every case by employing agents. The principal is bound by notice given to the agent in the course of the business. The rule contained in this section will not apply if the agent is out of commit a fraud on the principal.

d) **Liability of principal by estoppel (sec.237):**

A principal is liable where he had by words or conduct induced a belief in the contracting party that the act of the agent was within the scope of his authority.

c) **Liability for misrepresentation or fraud by an agent (sec. 238):**

The principal is liable for the fraud of his agent acting within the scope of this authority whether the fraud is committed for the benefit of principal or that of the agent.

B. Agent acting for an unnamed principal :-

Where an agent, discloses the fact, that he is an agent, but at the same time does not disclose his principal's name, the contract made by the agent binds the principal. But the unnamed principal should be in existence at the time of the contract. Where an agent singed the contract as a broker "to my principal", but did not disclose the name of the principal, it was held that the broker was not personally liable.

C. Agent acting for an undisclosed principal:

The doctrine of undisclosed principal comes into operation when an agent enters into a contract with a person without disclosing the name and existence of his principal. In such a case,

1) The agent is personally liable for the contract.

2) Once the third party knows of the existence of the principal as well as of the agent, he has a right to sue both or either of them.

13.19. Agents Liability to third parties:

An agent does all acts on behalf of the principal. So principal can be held liable on a contract except where there is a contract to the contrary (sec. 230). The term in the absence of a contract to the contrary means that if there is such a contract, both the principal and the agent may sue or be sued on the contract.

The rule stated in section 230 namely, that an agent cannot personally sue or be sued, has got the following exceptions:

1. Where the agent acts for a foreign principal :

Where a merchant resident abroad buys goods here through an agent, the seller contracts with the agent and there is no contract between him and the foreign principal. In such a case, it is only the agent for the principal, who can sue or be sued.

2. Where the agent acts for an undisclosed principal:

Where an agent does not disclose the principal, he is personally liable for such a contract.

3. When the agent acts for a disclosed principal who cannot be sued:

An agent incurs personal liability where contracts on behalf of a principal who through disclosed cannot be sued. Thus, an agent who contracts for a minor, the minor being not liable, the agent becomes personally liable.

4. Where agents authority is coupled with interest :

Where an agent himself has interest in the agency, then the contracts in his own name and so he can sue and be sued in his own name.

5. Where an agent receives or pays money by mistake or fraud:

An agent has a right to sue for money paid by him under mistake or fraud. Similarly, where a third party pays to an agent under a mistake can sue the agent personally.

6. Where the agent signs the negotiable instrument in his own name :

Where an agent who signs his name to a promissory note, bill of exchange or cheque without indicating thereon that he signs as agent, he is personally liable on the instrument.

7. Where the agent exceeds his authority :

Where the agent holds out that he has an implied authority from the principal, the third party can hold the agent personally liable for lack of any authority.

8. Where the contract expressly provides :

At the time of entering into a contract with an agent, the third party may stipulated that the agent should make himself personally liable on the contract. If the agent agrees to this stipulation, he will be personally liable for any breach of the contract.

9. Where an agent acts for a non-existing principal:

Where an agent enters into a contract on behalf of a non existing principal such a person is presumed to have contracted personally.

10. Where according to trade usage agent if personally liable :

Where the agents has the custom or usage of a particular trade provides that the agent shall be personally liable for his acts, the agent incurs personal liability.

13.20. Termination of Agency :

The legal provisions relating to the termination of agency are contained in the sections 201 to 210 of the Indian Contract Act. An agency may be terminated a) by the act of the parties b) by the operation of law.

a) Termination of Agency by the Act of parties :-

1) **Agreement:** The relation between the principal and agent, like any other agreement, may be terminated at any time, and at any stage by the mutual agreement between the principal and the agent.

2) **Revocation by the principal:**

A principal has power to revoke the authority of the agent whenever he likes. It put an end of the agency relationship. It may be express or implied. But where the agency is a continuous one, notice of its termination to the agent and also to the third parties is essential.

3. **Renunciation by the Agent :**

The agent may renounce the business of agency in the same manner in which the principal has right of revocation. Reasonable notice must be given such renunciation otherwise the damage thereby resulting to the principal must be made good to the principal by the agent.

b) Termination of Agency by operation of law:-

An agency comes to an end automatically by operation of law in the following cases:-

1. Completion of Agency Business:

When the business of the agency is completed, agency comes to an end (sec.201). ex:- when the agency is for the sale of a house, the agency terminates on the completion of the sale.

2. Expiry of Time :

When agency is created for a period of time, the agency is terminated on the expiry of that time, even though the business of the agency may not have been completed.

3. Death of Either Party :

An agency is automatically terminated on the death of the principal or agent. However, the death of the principal cannot contract of agency until it comes to the knowledge of the agent.

4. Insanity of the Party :

An agency is terminated by either principal or agent becoming of unsound mind.

5. Insolvency of the principal :

The agency is terminated by the principal become insolvency.

6. Destruction of the subject matter:

An agency which is created to deal with certain subject matter will be terminated by the destruction of that subject matter. For example, if an agent is asked to sell a car and the car is destroyed by fire, then the agency comes to end.

7. Principal or Agent becomes Alien Enemy :

Where the principal or the agent belong to different countries and a was breaks out between the two countries, the contract of agency is terminated.

8. Dissolution of a company:

When the company, which is either principal or agent, is wound up, the agency is terminated.

9. Termination of sub-agent's Authority :

Sec. 210 of Act has laid down that termination of the authority of an agent causes the termination of the authority of all sub-agents appointed by him.

13.21. Summary:

For efficient running of the business man must necessarily depend on others. The person to whom some powers are delegated is called agent. The person who is delegating the powers is called principal.

The contract between them is called an agency. An agency is resulted with an agreement. If an agent is appointed verbally or by writing he called express agents. If his appointment is inferred from the conduct of the parties then he is called as implied agent.

A person employed by and acting under the control of the original agent is known as sub-agent. If the sub-agent is properly appointed then the principal is bound by acts of the sub-agent. If an agent appointed a person to act for the principal in the business of the agency with the knowledge of principal then he is called as a substituted agent. He is deemed to be the agent of the principal and not a sub-agent.

13.22. Self Assessment Questions:

1. Define an agent and a principal. What are the essentials of the relationship of agency ?
2. Who is an agent ? How does he differ from a sub-agent ?How is an agency created ?
3. Briefly explain the various modes by which an agency may be created ?
4. Who is a sub-agent ? When may an agent appoint a sub-agent ?
5. Explain the distinction between a sub-agent and a substituted agent.
6. What are the rights and duties of an agent towards his principal ?
7. To what extent is the principal liability for an act done by the agent in excess of his authority ?
8. Explain the term 'pretended agent' and discuss his liability.
9. Describe the various modes by which an agency may be terminated.
10. Who is an agent ? How does he differ from a servant ?
11. Distinguish between sub-agent and substituted agent.
12. What is meant by 'Agency by Estoppel' and agency by necessity ?

13.23. Reference Books:

1.	**Bank Act**	**-**	**Indian Contract Act, 1872**
2.	**Elements of Mercantile Law**	**-**	**N.K. Kapoor**
3.	**Mercantile Law**	**-**	**V.K. Batra, N.K. Batra**
4.	**Business Law**	**-**	**P.C. Tulsian**
5.	**Business Law**	**-**	**K.C. Garg**
			Mukesh Sharma
			V.K. Sareen
			R.C. Chawla

Dr. Ch. Suravinda

LESSON -14

SALE OF GOODS ACT - 1930

14.0. Object : After going through this lesson the student can know the law relating to the sale of goods or movables in India.

Structure :

14.1. Introduction :

The law relating to the sale of goods or movables in India is contained in the sale of goods Act, 1930. Before the passing of the present Act, the law relating to the sale of goods was contained in chapter VII of the Indian Contract Act, 1872. The Act came into force in Ist July 1930. It contains 66 Sections and extends to the whole of India except the state of Jammu and Kashmir. It is based mainly on the English Act.

14.2. Contract of Sale :

Section 4 of the sale of goods Act defines a contract of sale as under.

"A contract of sale of goods is a contract where by the seller transfers or agrees to transfer the property in goods to a buyer for a price".

A contract of sale consists of the following :

1. Sale

2. Agreement to sell

1. Sale :

Where the ownership of the goods is immediately transferred from the seller to the buyer and nothing is left on the part of the seller, then it is called sale or absolute sale.

2. Agreement to sell :

Where the transfer of property or ownership of goods shall take place in future or on the fulfilment of certain conditions, it shall be an agreement to sell or a conditional sale The property or ownership in goods shall not be transferred from the seller to the buyer until and unless some condition is fulfilled for the completion of the contract of sale.

14.3. Essentials of a contract of sale :

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

1. Contract :

The word contract means an agreement enforceable at law. It presumes free consent on the part of the parties who should be competent to contract. Thus, a compulsory transfer of goods under a Nationalisation Act is not a sale. The agreement must be made for a lawful consideration and with a lawful object. In other words all the essential elements of a valid contract must also be present in a contract of sale.

2. Two parties :

In a contract of sale there must be two persons, one the seller and the other the buyer. These parties must be competent to contract.

3. Transfer the property :

In a contract of sale, there should be a transfer or agreement to transfer the absolute or general property in the goods sold or agreed to be sold. The sale of goods Act contemplates the transfer of general property in goods from the seller to the buyer.

4. Goods :

The subject – matter of the contract of sale must be the goods, the property in which is to be transferred from the seller to the buyer. Goods of any kind except immovable goods may be transferred. The seller must be the owner of the goods.

5. Price :

To constitute a valid contract of sale, consideration for transfer must be money paid or promised. Where there is no money consideration the transaction is not a contract of sale.

14.4 Distinction between sale and agreement to sell :

The distinction between sale and an agreement to sell is very necessary to determine the rights and the liabilities of the parties to the contract. The main points of distinction are :

Sale	Agreement to sell
1. A sale is an executed contract.	1. An agreement to sell is an executory contract.
2. The property in the goods passes from the seller to the buyer immediately so that the seller is no more the owner of goods sold.	2. The transfer of property in the goods is to take place at a future time or subject to certain conditions to be fulfilled.
3. If the goods are destroyed, the loss falls on the buyers even though they were in the possession of the seller.	3. If the goods are destroyed, the loss falls on the seller, even though they were in the possession of the buyer.
4. It creates a right in rem i.e. against the whole world.	4. If creates a right in personam i.e. against a specified person only.
5. Performance of sale is absolute and without any condition.	5. Performance is conditional and is made in future.
6. The property is with the buyer and as such the seller cannot resell the goods. If he does so, the buyer can recover the goods, sometimes, even from third parties.	6. The property in the goods remains with the seller and he can dispose of the goods as he likes, although he may there by commit a breach of his contract.
7. If the buyer is declared insolvent before making the payment of the price for goods, the seller in the absence of lien are goods, will have to deliver the goods to the official receiver and can claim only the reteable dividend.	7. If the buyer who is declared insolvent, has not paid the price, the seller is not bound to deliver the goods as the property in goods has not passed to him.
8. If the seller is declared insolvent, the buyer is entitled to recover the goods from the official receiver as the buyer has the ownership of the goods sold.	8. The buyer who has paid the price, cannot claim the title of goods from the seller, if he is declared insolvent. He can only claim a rateable dividend.
9. If the buyer wrongfully neglects or refuses to pay the price of the goods, the seller can sue for the price, even though the goods are still in his posession.	9. If the buyer fails to accept and pay for the goods, the seller can only use for damages and not for the price, even though the goods are in the possession of buyer.

14.5. Sale Distinguished from other Transactions :

There are some transactions which bear a close resemblance to a contract of sale, but which are quite different from sale of goods. Therefore, it is necessary to point out the distinguishing features of such transaction.

5.1. Sale sand Hire purchase

Under hire-purchase agreement the owner of the goods let them out on hire for a periodic rent on the terms on completion of the agreed number of payments, the hirer is to have the option to buy the goods. On payment of the full amount, the property in the goods passes to hum but the owner have the

right to resume possession of the goods on the hires failure to pay any of the instalments of rent. The difference between a contract of sale and hire purchase agreement are as follows.

Sale	Hire purchase agreement
1. A sale is an executed contract in which the ownership is transferred from the seller to the buyer as soon as the contract is entered into.	1. In a hire purchase agreement it becomes the property of the buyer only after a certain agreed number of instalments is paid.
2. The buyer in this case cannot terminate the contract and as such is bound to pay the price of the goods.	2. The hire purchaser can terminate the contract at any stage and cannot be forced to pay the remaining instalments.
3. In a sale the seller takes the risk of any loss resulting from the insolvency of the buyer.	3. In a hire purchase the owner is not at any risk because if the hirer does not pay any instalment the seller has a right to take back the goods.
4. A sale is subject to the implies conditions and warranties provided under the sale of goods Act 1930.	4. A hire purchase agreement is not subject to such implied warranties and conditions. It is however, subject to the implied conditions provided in the hire purchase agreement.
5. In a sale even if the payment is made by the buyer in instalments, it is towards price of the goods.	5. The instalments paid by the hire purchaser are not regarded as payment towards the price of the goods. It is treated as hire charges till the lost instalment paid.
6. The buyer in a sale can resell the goods.	6. The hire purchaser cannot resell unless he has paid all the instalments of hire.

5.2. Sale and bailment :

Bailment is the delivery of goods by one person to another for some purpose upon a condition. After the condition is accomplished they must be returned. Sale is the transfer of property in goods from the seller to the buyer for a price. The following are the main points of difference between the two.

Sale	Bailment
1. In a sale, the property in the goods is transferred from the seller to the buyer and the buyer can deal with the goods in any way he likes.	1. In a bailment, there is only transfer of possession of goods from the bailor to the bailee upon a condition. The bailee can only deal with the goods according to the directions of the bailor.
2. Goods once sold normally cannot be returned unless there is a breach of some condition.	2. In bailment the bailee must return the goods to the bailor on the accomplishment of the purpose for wich the bailment was made.
3. In a sale the consideration is the price in terms of money.	3. In a bailment the consideration is an undertaking to return the goods after the accomplishment of purpose.

5.3. Sale and gift :

Where goods are transferred by one person to another person without any price or consideration, the transaction is called a gift not a sale. Sale is always for a consideration.

5.4. Sale and Barter :

Where the consideration for transfer of property in goods from one person to another consists of delivery of other goods, it is a contract of barter. But where property in the goods is transferred from the seller to the buyer against a price is called a sale.

5.5. Sale and mortgage :

A mortgage differs from a contract of sale in the following respects.

Sale	Mortgage
1. In a sale, there is a transfer of the whole interest of the seller in the goods.	1. In a mortgage there is a transfer of a limited interest.
2. The buyer becomes the absolute owner of the goods sold.	2. The ownership of the goods remains vested in the mortgagor.
3. The consideration in the case of sale is the price.	3. The consideration in a mortgage is the advance of the loan and the securing of the debt.

5.6. Sale and contract for work and labour :

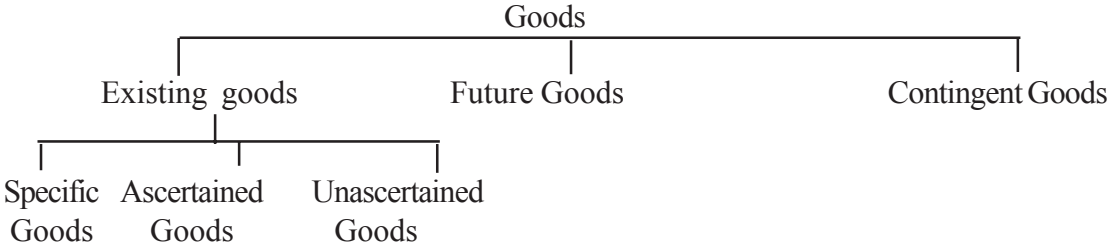
A contract of sale involves the delivery of goods whereas a contract for work and materials involves exercise of skill and labour by one party in respect of materials supplied by another the delivery of goods beings subsidiary or incidental to the contract.

14.6. Goods :

Section 6 provides that "goods" form the subject matter of a contract of sale. "Goods" means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the lan which are agreed to be severed before sale or under the contract of sale. The interest of a partner in partnership also comes with in the definition of goods.

14.7. Classification of goods :

Goods which form the subject matter of a contract of sale may be divided as under :



7.1. Existing goods :

Goods owned and possessed by the seller at the time of making the contract of sale are called existing goods. Sometimes, the seller may be in possession but may not be the owner of the goods. The existing goods may be of the following types :

a) Specific goods : Goods identified and agreed upon at the time of the making of the contract of sale are called specific goods.

b) Ascertained goods : 'Ascertained goods' has not been defined in the Act. These are the goods which are ascertained subsequent to the formation of contract of sale. Ascertained goods mean goods identified in accordance with the agreement after the contract of sale is made. The identification takes place at a later date. For example : if a merchant agreed to supply one bag of rice from his godown to a buyer; it is a sale of unascertained goods because it is not known which bag will be delivered.

c) Un ascertained goods : The goods which are not specifically identified at the time of contract of sale, are known as unascertained goods. Unascertained goods are not definite and specific.

7.2. Future goods :

"Future goods" means goods to be manufactured on produced or acquired by the seller after making the contract of sale" These are the goods which are not in existence at the time of contract of sale. The seller acquires such goods after the making of the contract of sale. It is important to note that the future goods are neither in existence nor in possession of the seller at the time of contract of sale.

7.3. Contingent goods :

Contingent goods are future goods. There may be a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen. It is important to note that a contract of sale of contingent goods is enforceable only if the event on the happening of which the performance of the contract is dependent happens; otherwise the contract becomes void. Such contracts give no right of action if the contingency does not happen.

14.8. Effects of Destruction of subject matter :

Section 7 and 8 of the sale of goods Act 1930 deal with the effect of perishing of goods on the rights and obligations of the parties to a contract of sale. Goods are said to perish when they physically or commercially cease to exist before and after the contract. The effects of perishing of goods may be discussed under the following heads:

8.1. Goods perishing before making of the contract :

According to Sec.7 of the Act, "Where there is a contract for the sale of specific goods, the contract is void if the goods without the knowledge of the seller have, at the time when the contract was made perished or become so damaged as no longer to answer to their description in the contract".

To make a contract void under this section the following conditions must be fulfilled.

1. The contract must be for the sale of specific goods.

2. The goods must have been perished before the contract is made.

3. The seller must not have the knowledge of the destruction of the goods.

8.2. Goods perishing before sale but after Agreement to sell (Sec.8) :

Sec.8 of sale of Goods Act reads as "Where there is an agreement to sell specific goods, and subsiquently the goods, without any fault on the part of the seller or buyer, perish or become so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement thereby avoided" In such cases, the contract of sale becomes void if the contract is for the sale of specific goods and the goods and destroyed without any fault of the seller or buyer. The provision is based on the ground of supervening impossibility of performance which makes a contract void.

To make a contract void under this section, the following conditions must be fulfilled.

1. The contract is an agreement to sell and not an actual sale.
2. The contract should be for specific goods and not for unascertained goods.
3. The goods must have been perished without the fault of seller or buyer.
4. The goods must have perished or damaged before the property or the risk passes to the buyer.

14.9. The price :

Price is an essential element of sale. Price means the money consideration for the sale of goods. No valid sale can take place without a price. The price constitutes the essence of a contract of sale as no sale can take place without a price. The price may be money actually paid or promised to be paid depending on whether the agreement is for cash or credit sale.

14.10. Modes of fixing the price :

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

1. The price may be expressly stated in the contract. The parties may fix such price for the goods as they may please.
2. The contract may provide for the manner in which the price is to be fixed.
3. The price may be determined by the course of dealing between the parties.
4. Where the price is not determined in accordance with the above three modes, the buyer shall pay the seller a reasonable price, if nothing is said as to price when the goods are sold, the law implies an intention that it is to be paid for at what is reasonably worth. What is a reasonable price is a question of fact dependent upon the circumstances of each particular case.
5. The agreement may provide that the price is to be fixed by the valuation of a third party. When such third party makes the valuation, there is a determination of the price and the agreement becomes a contract of sale.

14.11. Summary :

A contract of sale of goods is a contract where by the seller transfers or agrees to transfer the property in goods to a buyer for a price. All the essential elements of a valid contract must be present in a contract of sale.

14.12. Self Assessment questions :

1. What is contract of sale ?
2. What is an agreement to sell.
3. Distinguish between a sale and an agreement to sell.
4. What is a contract of sale ? State its essential characteristics.
5. Distinguish between a sale and a hire purchase agreement.
6. Define the terms 'goods'. Distinguish between specific and unascertained goods.
7. Explain the rules regarding ascertainment of price in a contract of sale.

14.13. Reference Books :

1. **Bank Act** - **Indian Contract Act, 1872**
2. **Elements of Mercantile Law** - **N.K. Kapoor**
3. **Mercantile Law** - **V.K. Batra, N.K. Batra**
4. **Business Law** - **P.C. Tulsian**
5. **Business Law** - **K.C. Garg**
   Mukesh Sharma
   V.K. Sareen
   R.C. Chawla

- Dr. Ch. Suravinda.

LESSON - 15

THE ESSENTIAL SERVICES MAINTENANCE ACT - 1955

15.0 OBJECTIVES

After studying this lesson, you should be able to understand

- the definition of the term "essential commodity".
- Identify the powers of the central Government regarding control of production and distribu tion of essential commodities.
- confiscation of essential commodities.
- define the penalties in case of contravention of the provision of the Act and
- explain the powers available to the court under the act.
- key terms
- important questions.

Structure

15.1 INTRODUCTION

The Essential Commodities Act 1955 has been enacted to provide, in the interest of the general public for the control of production, supply and distribution of trade and commerce in certain commodities. The act has come into effect from 1-4-1955 and extends to the whole of India.

The main purpose of the Essential Commodities Act is to ensure that the common man gets the supply of the essential commodities without hindrance of the part of the trade. The act seeks to achieve the following objectives.

1. To control the production, supply and distribution of essential commodities.
2. To check the inflationary trends in price.
3. To ensure equitable distribution of essential commodities.

For this purpose essential commodities are divided into two categories, namely the items of industrial consumption and the items of general consumption. The first type consists of coal, textile, iron and steel etc., and the second type consists of food stuffs, cattle fodder and others.

The distribution of the term 'essential commodity' as given in the Act is inclusive, it includes certain items of commodities as mentioned in Section 2(a).

The following commodities are essential commodities as per the definition.

1. Cattle fodder, including oil cakes and other concentrates.
2. Coal including coke and other derivatives.
3. Component parts and accessories of automobiles.
4. Cotton and Woollen textiles.
5. Drugs.
6. Food stuffs including edible oil seeds and oils.
7. Iron and steel including manufactured products of iron and steel.
8. Paper including newsprint, paper board and straw board.
9. Petroleum and petroleum products.
10. Raw cotton, whether ginned and unginned and cotton seed.
11. Raw jute.
12. Any other class of commodity which the Central Government may, by notified order, declare to be an essential commodity for the purpose of the Act, being a commodity with respect to which parliament has power to make laws by virtue of entry 33 in list III in the seventh schedule to the Constitution. Cement has been notified by the Central Government under the powers as an essential commodity.

15.2 POWERS OF CENTRAL GOVERNMENT

As stated earlier, the object of the Essential Commodities Act, is to control the production, supply and distribution of essential commodities. The Central Government is responsible for achieving the objectives of the Act. For this purpose, the Central Government is given wide powers. These powers can be discussed under the following heads.

1. General power of making order
2. Power to fix prices
3. Power to appoint controller
4. Power to recover certain accounts as areas of Land revenue.

I. General power of making order : Section (1) of the Act empowers the Central Government to issue orders providing for regulating or prohibiting the production, supply and distribution of any essential commodity and trade and commerce therein under one or more of the following circumstances.

1. Where the Central Government is of the opinion that it is necessary for maintaining or in creasing supplier of any essential commodity.
2. For securing their equitable distribution and availability at fair prices.
3. For securing any essential commodity for the defence of India or for the efficient conduct of military operations.

Nature of orders : Section 3 (2) enumerates the nature of orders which the central government is empowered to make without prejudice to the generality of the powers confered by Section 3 (1).

The Central Government may make an order which may provide for the following.

1. for regulating by licences, permits or otherwise the production or manufacture of any essential commodity.
2. for controlling the price at which any essential commodity may be bought or sold.
3. for regulating by licences, permits or otherwise the storage, transport, distribution, disposal, acquisition use or consumption of any essential commodity.
4. for prohibiting the withholding from sale of any essential commodity ordinarily kept for sale.
5. for requiring any person (whether a stockist, producer, or dealer) to sell to the Govern ment or its agent or to a Government Corporation or to any other person whole or part of the quantity held in stock or produced or received or which is likely to be produced or received.
6. for requiring persons engaged in the production supply or distribution of or trade and commerce in any essential commodity to maintain and produce for inspection such books, accounts and records relating to their business and to furnish such information as may be specified in the order.

II. Power to fix prices :

(a) Fixing of prices of essential commodities being sold to Government : Where the Govern-ment orders the sale of essential commodity to central or State Government or its agent or any person, the price to be paid to the seller will be decided on the following basis.

1. Agreed Price : The price can be agreed upon by the Government and the seller, consistently with the controlled price, if any fixed under this section, the agreed price is to be paid.

2. Controlled Price : Where no agreement as to the Price is reached, the price calculated with reference to the controlled price is to be paid.

3. Market Price : Where there is neither an agreed price nor a controlled price, the price calcu-lated at the prevailing market rate is to be paid.

(b) Fixing of prices of essential commodities for sale to the general public : Sometimes the Central Government is faced with the specific situation of rising prices or hoarding in any of the food stuffs in any locality which has tended to create some kind of an artificial scarcity in the

locality, there by depriving the residents of the advantage of a free supply of the commodities for prices at reasonable market rates.

(c) Fixing of prices of food grains and edible oils : The procurement price should be fixed by the State Government with the previous approval of the Central Government after considering.

(a) controlled price of that item, if any
(b) the general crop prospects
(c) the need for making such items available at reasonable prices to the consumers particularly the vulnerable sections of the consumers and
(d) the recommendation, if any, of the Agricultural price commission.

(d) Fixing fair price of sugar for the producer : Section 3 (3-C) makes special provisions for the determination of price of sugar to be paid to the producer who is required by an order of the Government or to any Officer or Agent of such Government or to any other person or class of persons. Such a producer will be paid a price which will be fixed by the Central Government having regard to

(a) the minimum price, if any fixed for sugarcane by the Central Government
(b) the manufacturing cost of sugar
(c) the duty or tax if any paid or payable there on
(d) the securing of a reasonable return on the capital employed in the business of manufacturing sugar.

Different prices may be fixed from time to time for different areas, or for different factories or for different kinds of sugar.

The objective behind enacting Section 3 (3-C) is four fold -

a) to provide an incentive to increase production of sugar
b) to encourage expansion of the industry
c) to secure to the consumer distribution of atleast a reasonable quantity of sugar at a fair price.

III Power to appoint authorised controller :

The Central Government is empowered to authorise any person to exercise with respect to any undertaking engaged in the production and supply of essential commodity, such functions of control as may be provided by the order and which are necessary for maintaining or increasing the production and supply of the commodity. Such a person shall be called the authorised controller.

IV Power of Central Government to recover certain amounts as arrears of land reforms. (Section 7 -A)

Section 7 - A inserted by the Amendement Act 1988 empowers the Central Government to recover certain amounts as arrears of land revenue. It provides that where any person liable to :

1. pay any amount is pursuance of any order made under Section 3, or

2. deposit any amount to the credit of any Account or Fund constituted by or in pursuance of any order made under that section.

15.3 CONFISCATION OF ESSENTIAL COMMODITIES

Section 6 - A provides that where any essential commodity is seized by the Government in exercise of its powers to control production, supply or distribution etc. of essential commodities under Section 3 of the Act, the matter will be reported without any unreasonable delay to the Collector of the District or of the Presidency Town in which the siezure took place. Collector has been empowered to direct that the essential commodity so seized would be produced for inspection before him.

No Confiscation : No order of confiscation under this section shall be made if the seized essential commodity has been produced by the producer.

Sale of confiscated commodity : Section 6 - A (2) disperses with the physical production of the seized commodities before the Collector. The Collector has also been empowered in order the distribution of the seized food grains through fair price shops at the price fixed by the Government.

Show cause notice before order of confiscation : A Collector has to take some essential preliminary steps which are in the nature of condition precedent before making an order of confiscation. These are

1. He has to give a notice in writing to the owner of the essential commodity in question or the person from whom it is seized informing him of the grounds on which it is proposed to confiscate.

2. The owner of the commodity or vehicle is given an opportunity for making a representation in writing against the grounds of confiscation.

3. The owner of the commodity or vehicle is given a reasonable opportunity of being heard in the matter.

15.4 PENALTIES

Section 7 provide for the imposition of penalities where any provisions of the Act. These penalties are as follows.

Imprisonment and fine : Section 7 lays down that if any person contravences any order under section 3 (2) (h), and section 3(2) (1), he shall be punishable with imprisonment for a term which may extend to one year and shall also be liable to fine.

Forfeiture of property : If any person contravenes any order made under Section 3 any property in respect of which the order has been contravened shall be forfeited to the Government. Similarly, any

package, covering in which the property is found and any animal, vehicle, vessel or other conveyance used in carrying the property shall be forfeited to the Government.

Non - compliance with the directions : Where any person to whom a direction is given under Sec 3(4) (b) fails to comply with the directions, he shall be punishable with imprisonment for a term which shall not be less than three months but which may extend to seven years and shall also be liable to fine provided that the count may for any adequate or special reasons impose a sentence of imprisonment for a term of less than three months.

Repetition of offence : If any person convicted of an offence under this Act, is again convicted of an offence under the same provision he shall be punishable with imprisonment for the second and for every subsequent offence for a term which shall not be less than six months but which may extend to seven years, and shall also be liable to fine.

Punishment for false statement : It lays down that if any person willfully makes any false statement or furnishes any false information in matters relating to the control of production, supply or distribution of essential commodities he shall be punishable with imprisonment for a term upto 5 years or with fine or with both.

15.5 POWERS OF THE COURT

Sections 10 B to 15 of the Act contains provision regarding powers of the court under the Act. The relevant provisions are being summarised below,

1. Power of court to publish name, place or business of companies convicted under the Act (Sec - 10 B) : The court has been given following powers regarding publishing name, place or business etc. of companies convicted under the Essential Commodities Act.

a) Where any company is convicted under their Act, it shall be competent for the court convicting the company to cause the name and place of business of the company, nature of the contravention the fact that the company has been so convicted and such other particular as the court may consider to be appropriate in the circumstances of the case, to be published at the expense of the company in such newspapers or in such other manner as the court may direct.

b) The expenses of any publication under clause (a) above shall be recoverable from the company as if it were a fine imposed by the court.

2. Grant of injunction (Sec - 12 B): No civil court shall grant injunction or make any order for any other relief, against the Central Government or any State Government or a public officer, in respect of any act done or supporting to be done by such Government, or such officer in his offical capacity, under this act or any order made there under, until after notice of the application for such injunction or other relief has been given to such Government or officer.

3. Presumption as to orders Sec - 13 : Where an order purports to have been made and signed by an authority in exercise of any power conferred by or under this Act, a court shall presume that such order was so made by that authority within the meaning of the Indian Evidence Act 1872.

4. Prosecution of Public Servants Sec - 15 (A) : Where any person who is a public servant is accused of any offence alleged to have been committed by him while acting or purporting to act in the discharge of his duty in pursuance of an order made under Section 3 no court shall take organise of such offence expect with the previous sanction -

a) of the Central Government in the case of a person who is employed or as the case may be, was at the time of commission of the alleged offence employed, in connectiion with the affairs of the union.

b) of the State Government, in the case of a person who is employed or, as the case may be, was at the time of commission of the alleged offence employed, in connection with the affairs of the state.

15.6 KEY TERMS :

1. Food Crops: Food Crops include Crops of Sugar cane.
2. Sugar : Sugar means
(a) any form of sugar containing more than ninety percent of sugarcane, including sugar candy,
(b) khandsari Sugar or burasugar, or crushed sugar or any sugar in crystalline or powdered form or
(c) Sugar in process in vaccum pan sugar factory or raw sugar produced there.

15.7 SELF ASSESSMENT QUESTIONS

1) Explain the powers of the Central Government to control production, supply, distribution etc. of essential commodities under the Essential Commodities Act 1955.

2) Write short note on 'offences and penalties under the Act'.

3) Discuss the authorities responsible to administer the provisions of the Essential Commodities Act 1955.

15.8 REFERENCE BOOKS

1) The Law of Essential Commodities - Central & A.P. Control orders

2) Mercantile Industrial Law - R.C. Chawla and K.C. Garg

Dr. M. VIJAYA LAKSHMI

LESSON - 16

THE CONSUMER PROTECTION ACT 1986

16.0 OBJECTIVES :

After studying this chapter, you should be able to understand :

* Introduction
* Consumer rights
* The objectives and functions of Consumer Protection Councils.
* Understand the meaning of certain important terms associated with the Consumers Protection Act.
* State Commission
* National Commission... etc.,
* Important questions.

STRUCTURE :

16.1 INTRODUCTION :

India is a vast country where a majority of consumer are poor, helpless and disorganised. Further the market in India is generally a seller market and it is very easy to dupe the innocent consumers. It is now realised that a common consumer is neither knowledgeable nor well informed. He needs support and protection from unscrupulous seller. A common consumer is not in a position to approach Civil Court. Quick, cheap and speedy justice to his complaints is required. The biggest help in this direction has come from the government. The Central Government enacted a law in the year 1986 for the protection of consumers known as "The Consumer Protection Act 1986".

When the Consumer Protection Act (COPRA) was legislated in 1986 it was hailed as the Magna Carta consumers. For, it not only recognised consumer rights but also established a redless system, unique in the world.

16.2 CONSUMER RIGHTS :

The consumer Protection Act is no doubt a revolutionary piece of legislation which can grown into an important tool for development. The act seeks to provide for better protection of the interests of consumers. For this purpose, it makes provision for the establishment of consumer councils and other authorities for the settlement of consumer disputes. The Consumer Protection Act recognises six consumer rights. These rights are :-

a) The right to be protected against marketing of goods which are hazardous of life and prop erty.

b) The right to be informed about the quality, quantity, potency, purity, standard and price of goods to protect the consumer against unfair trade practices.

c) The right to be assured, whereever possible access to a variety of goods at competitive prices.

d) The right to be heard and to be assured that consumers interests will receive due consider ation at appropriate forums.

e) The right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers.

f) The right to consumer education.

The Act provides a more accessible and speedily legal avenue for consumer - no fees, no lawyers, judgement to be delivered in 90 days. A redressal machinery is provided for in the Act for the enforcement of the rights of the consumer.

Extent, commencement and application : The Consumer Protection Act extends to the whole of India except the state of Jammu and Kashmir. The Act received the presidents assent on 24-12-86. However, all the provisions of the Act except thsoe relating to establishment, composition and jurisdiction of the consumer disputes redressal agencies came into force on 15-4-87. This act shall apply to all goods and services. It covers all sectors whether private, public or Co-operative. The provisions of the Act are compensatory in nature.

Amendment : The Consumer Protection Act was last amended in the year 1993. These amendments were quite drastic and comprehensive in nature. The Amendment Act of 1993 gave more teeth to the consumer counts and widened their scope. The main highlights of the amended Consumer Protection Act are -

1. Restrictive trade practices brought within the ambit of the Act.
2. Class action suits allowed.
3. Goods bought by self-employed persons for earning their livelihood not covered under definiton of 'commercial use'.
4. Housing construction specifically brought within Act.
5. Complaints can also be made about deficiency in goods or services which have been agreed to be bought or availed of.
6. Monetary jurisdiction of consumer courts increased.

How to file a complaint : Procedures for filing complaints and seeking redressal are simple and speedy. There is no fee for filing a complaint before the District Forum, the State Commission or the National Commission.

*The complainant or his authorised agent can present the complaint in person.

* The complaint can be sent by post to the appropriate Forum / Commission.

* A complaint should contain the following information -

a) The name, description and the address of the complainant.

b) The name, description and address of the opposite party or parties, as far as they can be ascertained.

c) The facts realting to complaint and when and where it arose.

d) Documents, if any, in support of the allegations contained in the complaint.

e) The relief which the complainant is seeking

f) The complaint should be signed by the complainant or his authorised agent.

Relief available in consumers : Depending on the nature of relief sought by the consumer and facts, the redressal forums may give orders for one or more of the following relief's,

a) Removal of defects from the goods.

b) Replacement of the goods.

c) Refund of the price paid or

d) Award of compensation for the loss or injury suffered.

16.3 CONSUMER PROTECTION COUNCILS :

The interests of consumers are sought to be promoted and protected under the Act by establishment of consumer protection councils at the central and state levels. These councils are advisory bodies.

Central Consumer Protection Council : Section 4 provides that the central government may by notificaiton establish a council to be known as the central consumer protection council which shall consist of the following memebrs viz.

a) The Minister In - charge of consumer affairs who shall be its Chairman.
b) Such number of other official or non-offical members representing such interests as may be prescribed.

Section 6 states the objects of the central council as being promotion and protection of the rights of the cousumers. These rights are -

a) The right to be protected against the marketing of goods which are hazardous to life and property.

b) The right to be informed about the quality, quantity, potency, purity, standard and price of goods so as to protect the consumer against unfair trade practices.

c) The right to be assured, wherever possible, access to a variety of goods at competitive price.

d) The right to be heard and to be assured that consumers interests will receive due consider ation of appropriate forums.

e) The right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers, and

f) The right to consumer education.

State Consumer Protection Council :

Section 7 provides for the establishment of state consumer protection councils by any state government to be known as consumer protection council for the state. The state council shall consist of a Minister In - charge of consumer affairs in the State Government who shall be its Chairman and such number of other official or non - official members representing such interests as may be prescribed by the State Government.

Where to file a complaint ? : In the case of the goods and services and compensation asked for, is less than rupee five lakhs, then the cpmplaint can be filed in the District Forum which has been notified by the State Government for the District where the cause of action has arisen or where the opposite party resides.

In the cost of the goods or services and compensation for is more than rupees five lakhs but less than rupees twenty lakhs, the complaint can be filed before the state commission notified by the state government or the union territory concerned. If the cost of goods or services and compensation asked for, exceeds rupees twenty lakhs, the complaint can be filed before the National Commission at New Delhi.

REDRESSAL MACHINERY UNDER THE CONSUMER PROTECTION ACT 1986

16.4 DISTRICT FORUM :

Section 9 of the Act inter alia provides for the establishment of a District Forum by the State Government in each district of the State by notification. The State Government may establish more than one District Forum in a district if it deems fit to do so.

Section 10 (1) provides that each District Judge Forum shall consist of -

a) a person who is, or who has been or is qualified to be, a District Judge who shall be its President.

b) two other members who shall be persons of ability, integrity and standing and have adequate knowledge or experience of or have shown capacity in dealing with problems relating to economics, law commerce, accountancy, industry, public affairs or administration, one of whom shall be woman.

Every appointment to District Forum shall be made by the State Government on the recommendation of a Selection Committee consisting of the President of the State Commission, the Secretary law department of the State and the Secretary incharge of Consumer Affairs in the State.

Every member of the District Forum shall hold office, for a term of five years or up to the age of 65 years which ever is earlier and shall not be eligible for re- appointment.

A member may resign his office in writing under his hand addressed to the State Government and on such resignation being accepted, his office shall become vacant and may be filed by the appointment of a person possessing any of the qualificaitons mentioned above in relation to the category of the member who has resigned.

The salary or honororium and other allowances payable to and the other terms and conditions of service of the members of District Forum shall be such as may be prescribed by the State Government.

Jurisdiction of the District Forum :

Section II provides for the Jurisdiction of the District Forum under two criteria,

* Pecuniary

* Territorial

Pecuniary Limits :

According to Sec II (2) the District Forum can entertain complaints where the goods or services and the compensation, if any claimed is less than rupees five lakhs.

Territorial Limits :

Under Sec II (2) the complaint shall be instituted in a District Forum within the local limits of whose jurisdiction -

a) the opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain, or

b) any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally work for gain provided that in such case either the permission of the District Forum is given, or the opposite parties who do not reside or carry on business or have a branch officer, or personally work for gain, as the case may be, acquisue in such institution,

c) The cause of action, wholly or in part arises.

16.5 STATE COMMISSION :

The Act provides for the establishment of the State Consumer Disputes Redressal commission by State Government in the State by notification.

Section 16(1) provides that each state commission shall consist of -

a) a person who is or has been a judge of a High Court appointed by the State Government who shall be its President.

b) two other members who shall be persons of ability integrity and standing and have adequate knowledge or experience of, or have shown capacity in dealing with, problems relating to economics, law, commerce, accountancy, industry, public affairs or administration one of whom shall be a woman.

The provision to their clause states that every appointment made under this clause shall be made by the State Government on the recommendation of a Selectionn Committee consisting of the president of the State Commission Secretary - Law Department of the State and Secretary in charge of consumer Affairs in the State.

Under Section 16(2) the State Government has the power to decide on the salary or honorarium and other allowances payable to the members of the State Commission and the other terms and conditions of service.

Every member of the State Commission shall hold office for a term of five years or up to the age of sixty seven years, which ever is earlier and shall not be eligible for re-appointment.

Jurisdiction : Section 17 of the Act provides that the State Commission shall have jurisdiction to entertain.

a) complaints where the value of the goods and services and compensation if any claimed exceeds rupees five lakhs but does not exceed rupees twenty lakhs.

b) appeals against the orders of any District Forum within the State and

c) to call for the records and pass appropriate orders in any consumer dispute, which is pending before or has been decided by any District Forum within the state, where appears to the State Commission that such District Forum has exercised an jurisdiction not vested in it by law, or has failed to exercise a jurisdictionn not vested or has acted to exercise of its jurisdiction illegally or with material irregularity.

16.6 NATIONAL COMMISSION :

Section 9 provides for establishment of the National Consumer Disputes Redressal Commission by the Central Government by notification in the official gazette.

Section 20 (1) Provides that the National Commission shall consists of -

a) a person who is or has been a judge of the Supreme Court, to be appointed by the Central Government (in consultation with the Chief Justice of India) who shall be its President.

b) four other members who shall be persons of ability, integrity and standing and have adequate knowledge or experience of, or have shown capacity in dealing with, problems relating to economics, law, commerce, accountancy, industry, public affairs or administration, one of whom shall be a woman.

Every appointment made under their clause by the Central Government shall be made on the recommendation of a Selection Committee consisting of a judge of the Supreme Court to be nominated by the Chief Justice of India, the Secretary in the department of Legal Affairs and the Secretary incharge of Consumer Affairs in the Government of India.

Section 20 (2) gives power to the Central Government to fix the salary honororium and other allowances payable to the members as well as the other terms and conditions of their service. Every member of the National Commission shall hold office for a term of the five year or upto sixty seven years of age, which ever is earlier and shall not be eligible for re-appointment.

Jurisdiction :

Section 21 provides that the National Commission shall have jurisdiction -

a) to entertain complaints where value of the goods or services and the compensation if any, claimed exceeds rupees twenty lakhs.

b) to entertain appeals against the orders of any State Commission, and

c) to call for the records and pass appropriate orders in any consumer dispute which is pending before, or has been decided by the state commission where it appear to the National Commission that such State Commission has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested, or has acted in the exercise of its jurisdiction illegally or with material irregularity.

Complaints before the District Forum and State Commission :

Section 12 provides that a complaint in relation to any goods sold or delivered or agreed to be sold or delivered or any service provided or agreed to be provided may be filled with the District forum by -

a) the consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided

b) any recognised consumer association, whether the consumer to whom the goods sold or delivered or agreed to be sold or delivered or service provided or agreed to be provided, is a member of such association or not, or

c) one or more consumers, where there are numerous consumers having the same interest with the permission of the District Forum, on behalf of, or for the benefit of all consumers so interested, or.

d) The Central or the State Government.

The explanation thereto provides that a 'recognised consumer association means any voluntary consumer association registered under the Companies Act 1956 or any other law for the time being in force.

Limitation period for filing of complaint :

Section 24 A of the Consumer Protection Act provides that the District Forum, the State Commission or the National Commission shall not admit a complaint unless it is filed within two years from the date on which the cause of action has arisen.

However, where the complainant satisfies the Forum Commission as the case may be that he had sufficient cause for not filing the complaint within two years, such complaint may be entertained by it after recording the reasons for condoning the delay.

16.7 KEY WORDS :

1. Complaint : any allegation in writing made by a complainant that -

a) an unfair trade practice or a restrictive trade practice has been adopted by any trader.

b) the goods bought by him or agreed to be bought by him suffer from one or more defects.

c) the services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect.

2. Defect : It means, any fault, imperfection or short coming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or as is claimed by the trader in any manner what so ever in relation to any goods. Sec 2 (1) (f).

3. Person :

The term 'Person' includes.

a) a firm whether registered or not.

b) a Hindu undivided family.

c) a Co-operative society.

d) every other association of persons whether registered under the Societies Registration Act 1860 or not (Sec 2(1) (m)).

4. Service : It means, service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, board or lodging or both, housing construction, but does not includes the rendering of any service free of charge or under a contract of personal service (Sec 2(1) (o)).

5. Trader : Trader in relation to any goods for sale and includes the manufacturers thereof and where such goods are sold or distributed in package form, includes the packer thereof [Sec(1)(q)].

6. Restrictive Trade Practices : Restrictive Trade Practices means, any trade practice which requires a consumer to buy, hire or avail of any goods, or as the case may be services as a condition precedent for buying, hiring or availing of other goods or services.

7. Unfair Trade Practices : Unfair trade practice means, a trade practice which for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice.

8. Consumer dispute :

Sec (1) (e) it means a dispute where the person against whom a complaint has been made, denies, or disputes the allegations contained in the complaint.

9. District Forum :

Sec (2) (1) (h), it means a Consumer Disputes Redressal Forum established under Sec.9

10. State Commission :

Sec 2 (1) (d) it means a Consumer Disputes Redressal Commission established under Sec. 9.

11 National Commission :

Sec (2) (k) it means the National Consumer Disputes Redressal Commission established under of Sec. 9.

16.8 SELF - ASSESSMENT QUESTIONS :

1. Explain the provisions of the Consumer protection Act regarding establishment, objectives and meetings of the Central and State Consumer dispute redressal agencies established under the Consumer Protection Act 1986.

2. Write short notes on the following as per the provisions of the Consumer Protection Act :

a) Consumer

b) Restrictive Trade practices.

c) Complainant

d) Penalties.

3. What is the jurisdiction of the various Forums Commission for the purpose of the Consumer Protection Acct 1986 ?

4. Explain the provisions of the Consumer Protection Act regarding establishment, objectives of the Central and State Consumer Protection Councils.

16.9 REFERENCE BOOKS :

1. Gulshan S.S & Kapoor GK : A Hand Book of Business Law.

2. R.C.Chawla & K.C. Garg : Industrial Law.

3.: N.D.Kapoor. : Elements of Mercantile Laws

Dr. M. VIJAYA LAKSHMI

LESSON - 17

THE COMPANIES ACT - 1956

17.0 OBJECTIVES

After studying this chapter, you should be able to understand

* Introduction
* define the term Company
* explain the different kinds of Companies.
* explain the advantages and disadvantages of a company.
* differentiate between a Public Company and a Private Company
* state the privileges of a Private Company.
* explain the meaning of certain key terms.

Structure

17.1 INTRODUCTION

Joint Stock Companies represent the third stage in the evolution of forms of business organisation. Unlike sole proprietorship and partnership firms, a company enjoys a separate legal status. The ownership is here divorced from the management. The shareholders contribute towards the finances of the company but all of them do not and cannot participate in the management of the company. The company is managed by a Board of Directors elected by share holders.

Companies in our country are governed by the provision of the Companies Act - 1956. The Act came into effect from 15th April 1956. The Companies Act has been amended several times. Some of the important amendments have been in 1960, 1966, 1969, 1974, 1977, 1985, 1988, 2000 and 2001.

17.2 COMPANY - ITS MEANING

"A company is an association of many persons who contribute money or moneys worth to a common stock and employ it for a common purpose. The common stock so contributed is denoted in money and

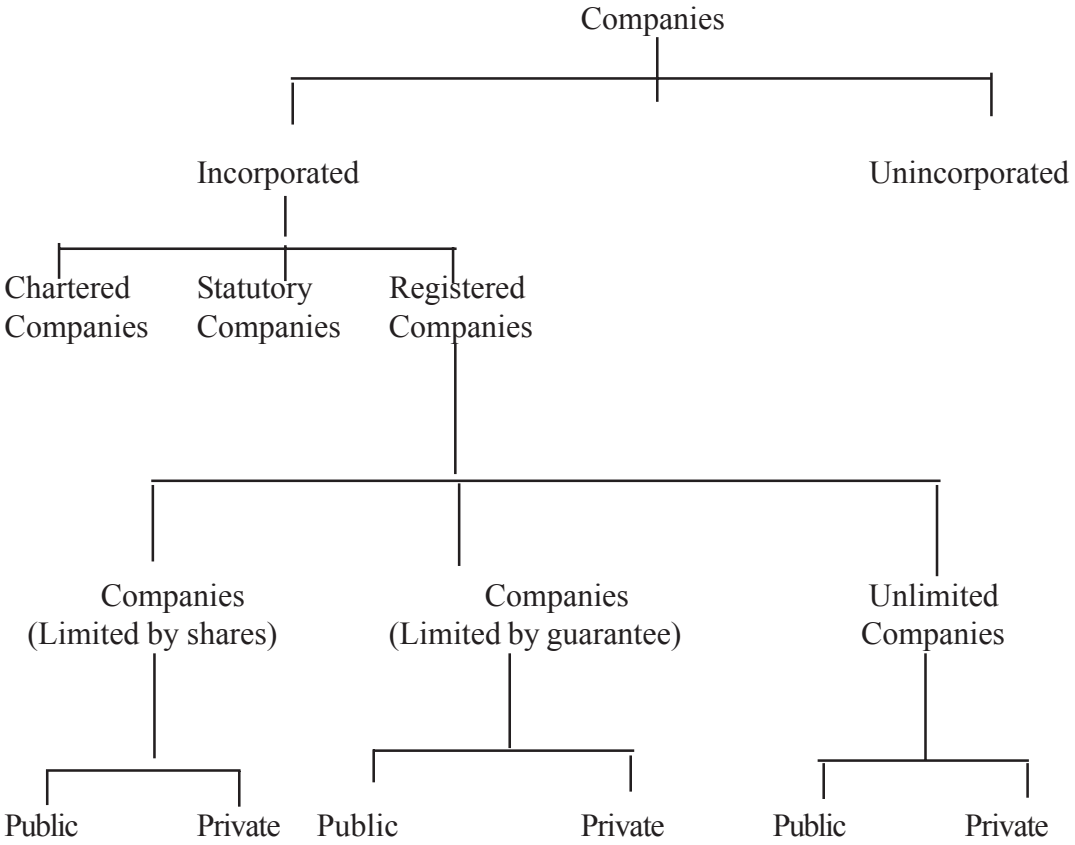
is the capital of the company. The persons who contribute to it whom it belongs are its members. The proportion of capital to which each member is entitled in his share". **- Justice Lindley**

"A company is a person, artificial, invisible, intangible and existing only in the eyes of the Law. Being a mere creature of Law, it possess only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence". **- Former Chief Justice Marshall of U.S.A.**

"A company formed and registered under this Act or an existing company". **- Sec 3 (1) (1) of the Companies Act**

In common practice company means an association of persons formed for some common object such as the economic gain of its members. In Law, any association of persons for any common object can be registered as a company. The object need not be the economic gain of its members e.g. a company can formed for purposes such as charity, research, advancement of knowledge etc.

17.3 THE FOLLOWING CHART GIVES THE CLASSIFICATION OF COMPANIES INTO VARIOUS CATEGORIES



Chartered Companies :

'The Grown' in the exercise of the royal prerogative has power to create a corporation by the grant of a charter to persons assenting to be incorporated. Examples of this type of companies are Bank of England, East India company. Charters are mainly issued to non trading corporations. After the country attained independence, these type of companies do not exist in India.

Statutory companies :

A company may be incorporated by means of a special Act of the parliament or any state Legislature. Such companies are called Statutory Companies. Such companies are generally formed to carry out some special public undertaking, for example railway, water works, gas, electric generations etc., Instances of statutory companies in India are Reserve Bank of India, the Life Insurance Corporation of India, the Food Corporation of India, Unit Trust of India, State Trading Corporation etc., Statutory companies are governed by the Acts creating them. They are not required to have any memorandum or articles of association.

Registered companies :

Companies registered under the companies Act 1956, or the earlier companies Act are called Registered Companies. Such companies come into existence when they are registered under the companies Act and a certificate of incorporation is granted to them by the Registrar. Section 12 (2) provides that company registered under the Act may be
(a) a company limited by shares
(b) a company limited by guarantee
(c) an unlimited company

(a) Companies Limited by Shares : The vast majority of registered companies are companies limited by shares. They are so numerous that the word 'company' has come to mean a Company Limited by Shares. Such companies must have share capital where as companies limited by guarantee and unlimited companies may or may not have a share capital. The liability can be enforced during existence of the company as well as during the winding up.

(b) Companies Limited by guarantee : A company Limited by guarantee may or may not have a share capital. If it has a share capital, the liability of the members is two fold, (a) Liability to pay the share amount (b) The amount guaranteed.

A guarantee company may not be suitable for ordinary business purposes. Clubs, trade associations, research associations and societies for promoting various objects are the examples of guarantee companies. Every company limited by guarantee must have its memorandum and articles of association. Where a company limited by guarantee has no share capital, the memorandum and articles must be in the form set in Table C in Schedule I. If such a company has a share capital, the memorandum and articles must be in the form set out in Table D in schedule I.

(c) Unlimited Companies : A company not having any limit on the liability of its members is termed as unlimited company. In such a company the liability of each member extends to the whole amount of the company's debts and liabilities, but he will be entitled to claim contribution from other members. An unlimited company can get itself re-registered as limited liability company under Section 32 of the Act.

Holding Company and Subsidiary Company : A company which controls another company is known as the 'holding company' and the company so controlled is termed as 'subsidiary company'.

Section 4 of the Companies Act 1956 provides that a holding company is one, if it
(I) controls the composition of board of directors of another company or
(II) holds more than half of the nominal value of equity share capital of another company, or
(III) is a subsidiary of any company which is in turn a subsidiary of another company.

The following illustration will make the definition of holding and subsidiary company clear.

A company (say X) is a subsidiary of another company 'Y' and 'Y' is 'X's holding company if

1. 'Y' is a member of X and controls the composition of 'X's Board of Directors; or
2. 'Y' holds more than half of X's equity share capital (or)
3. 'X' is a subsidiary of a third company 'Z' which is itself a subsidiary of 'Y'

Private and Public Company :

Private Company : Its means a company which by its articles

a. restricts the right to transfer its shares
b. limits the number of its members to fifty
c. prohibits any invitation to the public to subscribe for any shares or debentures of the company. A private limited company is required to add the words 'private limited' at the end of its name.

Public Company : A public company means a company which is not a private company.

Advantages and Disadvantages of a Company :

The company form of business organisation offers the following benefits:

(1) Financial strength: A public limited company can accumulate huge financial resources. Its capital is divided into shares of small denomination so that people with limited mean can be attracted to buy them. There is no limit on the number of members.

(2) Economies of scale : With continuous expansion and large financial resources at its command, a joint stock company can fully obtain the economies of large scale operations.

(3) Limited liability : The personal assets of a member are safe and he knows well in advance the extent

of his liability. This encourages people to invest money in the shares and debentures of a company.

(4) Efficient Management : A company can employ specialists in different areas of business. Centralisation of management helps in ensuring unity of action and continuity of policy.

(5) Stability : A joint stock company enjoys perpetual existence. Changes in its ownership and management do not affect the continuity of business.

(6) Transferability of Interest : Shares of a public limited company are freely transferable. Promotion of investment habit facilitates capital formation and industrial development of the country.

(7) Diffused Risk : In a company the risk of loss is spread over a large number of share holders. Ownership is also diffused.

(8) Tax receipt : A company is required to pay income tax at a flat rate. At higher levels of income, the tax liability is comparatively low. Several tax incentives are available for export promotion, development of backward areas etc.

(9) Good will : Due to strict statutory control and wide publicity of affairs, a joint stock company enjoys reputation and prestige in the society.

Disadvantages of Company :

(1) Legal formalities : Formation of a company is a difficult, time consumed and expensive process. Several legal formalities, a large number of documents have to be prepared and filed with the Registrar.

(2) Lack of personal interest : A company is managed by directors and paid officials who cannot be expected to take personal interest in business. There is no direct link between effort and reward. There is lack of personal touch with customers and employees.

(3) Corrupt Management : There is scope for fraudulent management in a company. The frequent securities scams are glaring examples of how corrupt officials can exploits a company for selfish gains.

(4) Delay in decisions: There appears a lack of flexibility and prompt decisions in a joint stock company. All important decisions require the conducting of meetings and passing of resolutions. As a result decisions may be delayed. Due to redtapism and bureaucratic procedures, there is little scope for individual initiative.

(5) Unhealthy speculation : The shares of a public company are dealt on stock exchange. Directors and officials are tempted to manipulate share prices to make easy personal gains.

(6) Conflict of Interest : There are chances of conflicts between the various interest groups i.e. equity

share holders, preference share holders etc. continuous conflict may affect the efficiency of management and the morale of employee.

(7) Oligarchy : Company management is the worst example of oligarchy i.e. rule by a few. Share holders of a company are scattered and disunited. They donot take much interest in company meetings.

17.4 DISTINCTION BETWEEN A PUBLIC COMPANY AND A PRIVATE COMPANY

(1) Minimum number of members : The minimum number of persons required to form a public company is seven, whereas in a private company it is only two.

(2) Maximum number of members : There is no limit on the maximum number of members of a company, but a private company cannot have more than fifty members excluding past and present employees.

(3) Restriction on Name : The name of public company must end with the work 'Limited'. But a private company must add the words 'Private Limited' at the end of its name.

(4)Commencement of Business : A private company can commence its business as soon as it is incorporated. But a public company shall not commence its business immediately unless it has been granted the certificate of commencement of business.

(5) Invitation to Public : A public company by issuing a prospectus may invite public to subscribe to its shares whereas a private company cannot extend such invitation to the public.

(6) Transferability of Shares : There is no restriction on the transfer of shares in the case of a public company whereas a private company by its articles must restrict the right of members to transfer the shares.

(7) Issue of Share Warrants : A public company can issue share warrants but such a right is denied to a private company.

(8) Further issue of Capital : A public company proposing further issue of shares must offer them to the existing members. A private company is free to allot new issue to outsiders.

(9) Number of Directors : A public company must have at least three directors whereas a private company may have two directors.

(10) Statutory Meeting : A public company must hold a statutory meeting and file with Registrar a statutory report. But a private company has no such obligations.

(11) Quorum : If the articles of a company do not otherwise provide the Quorum is five members person-

ally present in the case of public company. The Quorum in the case of private companies is two members personally present.

(12) Restrictions on the appointment of Directors : A director of a public company shall file with the register consent to act as such. He shall sign the memorandum and enter into a contract for qualification shares. He cannot vote or take part in the discussion on a contract in which he is interested. Two thirds of the directors of a public company must retire by rotation. These restrictions do not apply to a private company.

(13) Managerial Remuneration : Total managerial remuneration in the case of a public company cannot exceed 11% of net profits, but in the case of inadequacy of profits a minimum of Rs. 50,000 can be paid. These restrictions do not apply to a private company.

Privileges of Private Company :

The special exemptions and privilege enjoyed by a private company are as follows:

(1) A private company can be formed only by two members
(2) It needs to have two directors.
(3) It can commence its business immediately after incorporation i.e. it is not necessary to obtain the certificate of commencement of business.
(4) There is no restriction on the allotment of shares of a Private Limited Company.
(5) A private company is not required to issue or file a prospectus or statement in lieu of prospectus with Registrar of Companies.
(6) It can appoint the first directors without any public notification.
(7) It can grant loans to its directors without the permission of the Central Government.
(8) The directors of a private company need not retire by rotation.
(9) There are no restrictions on the number and appointment of directors.
(10) Only two persons can constitute the Quorum for the meetings of a private company.
(11) It can issue deferred shares.
(12) It may provide financial assistance for purchase of its own shares.

Government Companies : Sec - 617 of the Companies Act defines a 'Government Company' as a company in which not less than fifty one percent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments. Shares held by municipal and other local authorities or public corporations are not to be taken into consideration. For example, State Trading Corporation of India Limited and Minerals and Metal Trading Corporation of India Ltd., are Government companies.

Certain special provisions have been laid down in the Act regarding Government Companies.

(1) The auditor of a Government company shall be appointed or re-appointed by the Central Government on the advice of the Controller and Auditor General of India.

(2) The auditor will submit a copy of a report to the Controller and Auditor General of India who may comment upon or supplement the audit report in such manner as he may think fit.

(3) Where the Central Government is a member of the Government Company it shall cause an annual report on the working and affairs of the company to be prepared and laid before both houses of Parliament along with the audit report and the comments if any of the Controller and Auditor General of India.

Foreign Company : It means a company incorporated outside India and having a place of business in India. A Foreign Company may be a private company or public company. A company will be regarded as an Indian company when it is incorporated in India by promoters of foreign nationality.

The Companies (Amendment) Act 1974, provides that where not less than 50% of the share capital is held by Indian citizens and or companies incorporated in India it shall have to come with such of the provisions of the Act as may be prescribed as if it were a company incorporated in India.

One-man Companies or Family Companies : A private company can be formed with two members and a public company with seven. A man may take only one other person with him to constitute the minimum number required in a private company or six other so as to constitute the required seven in a public company. He may keep with himself a substantial number of shares so as to have controlling power over the company. Such a company may be regarded as one-man company. Sometimes, a company may be formed by a person by involving other family members such a company can be regarded as a 'Family Company'. Even in such cases the company will be regarded to have a separate entity as distinct from the majority shareholders. (Saloman Vs Saloman & Co. Ltd.).

Multinational Companies : Multinational corporations refers to an organisation which is having its head-quarters in one country and have business operations in other countries. This means, this type of organisation will have business across many countries. Some suggest that a multinational organisation should be atleast operating in six countries with minimum of 20% of its business in those countries. For our purpose we will consider a company with business in more than one country as a multinational company. For example, Sandoz India Limited, Hindustan Lever, Ranbaxy etc. can be called as Multinational Organisations.

17.5 KEY TERMS

1. Company : An association of persons formed and registered under the Companies Act.

2. Government Company : A Company of which not less than 51% of the paid-up share capital is held by the Central Government or by the State Government or by any two or more of them together.

3. Holding & Subsidiary Company : A company which controls another company is known as holding company and the company so controlled is termed as subsidiary company.

17.6 SELF ASSESSMENT QUESTIONS :

1. Define a joint stock company, List the different types of joint stock companies.
2. Narrate advantages and disadvantages of a joint stock company.
3. Discuss the exemptions and privileges enjoyed by a private company.
4. What is a joint stock company ? Distinguish between a public limited company and a private limited company.
5. Write short notes on :
   a) Government company
   b) Holding & subsidiary company
   c) Foreign company
   d) Multinational companies.

17.7 REFERENCE BOOKS

Commercial and Industrial Law - Sen Mitra

Mercantile and Industrial Law - R.C. Chawla and K.C. Garg

Elements of Mercantile Law - N.D. Kapoor

- Dr. M. VIJAYA LAKSHMI

LESSON - 18

APPOINTMENT OF DIRECTORS

18.0 OBJECTIVES : companies are managed by the Board of Directors. This lesson is intended to learn the provisions of company's Act regarding their appointment, qualifications, powers and duties.

Structure :

18.1 INTRODUCTION : A company, though a legal entity in the eyes of the law, is an artificial person. It has no physical existence. As such, it cannot act in its own person. It can do so only through some human agency. The persons who are incharge of the management of the affairs of a Company are termed as Directors. They are collectively known as Board of Directors or the Board [Sec 252(3)].

18.2 DEFINITION : The Directors are the brain of a Company [Sec - 2(13)] defines a 'Director', as any person occupying the position of Director by whatever name called. A director may be defined as a person having control over the direction, conduct, management or superintendence of the affairs of a company. No body corporate, association of firm can be appointed director of a company. Only an individual can be appointed.

18.3 NUMBER OF DIRECTORS : Every public company shall have atleast three directors and every other company atleast two directors, subject to this statutory minimum limit, the articles of a company may prescribe the maximum and minimum number of directors for its Board of Directors. The number so fixed may be increased or reduced within the limits prescribed by the articles by an ordinary resolution of the company in a general meeting [Sec - 258].Any increase in number of directors beyond the maximum permitted by the articles shall be approved by the Central Government. But where the

increase in number does not make the total number of directors more than twelve, no approval of the Central Government shall be needed [Sec - 259].

18.4 APPOINTMENT OF DIRECTORS [Sec - 254] :

According to [Sec - 254] of the Company's Act, the articles of a company usually name the first directors by their respective names or prescribe the method of appointing them. If the directors are not named in the articles, the number of directors and the names of the directors shall be determined in writing by the subscribers of the memorandum who are individuals shall be deemed to be the directors of the company.

They shall hold office until directors are duly appointed in the first annual general meeting. Subsequent directors shall be appointed in accordance with the provisions of Sec-255. Directors must be appointed by a company in a general meeting.

In the case of a public company or a private company which is a subsidiary of a public company atleast two thirds of the total number of directors shall be liable to retire by rotation. This means only one third of the total number of directors can be permanent directors. The remaining directors shall be appointed in a general meeting [Sec - 255(2)].

The appointment or re-appointment of directors by a company in a general meeting is governed by the following provisions.

18.4.1 First Appointment : At the first annual general meeting of a public company the first directors are appointed and at every subsequent annual general meeting, one third of them should be retired by rotation from the office. The directors to retire by rotation at every annual general meeting shall be those who have been longest in the office since their last appointment. And such a vacancy may be filled by the company by appointing the retiring director or some other person.

18.4.2 Re-appointment : If the vacancy of the retiring was not filled in the general body meeting,

(a) The retiring director shall be deemed to have been re-appointed unless the retiring director in writing given his unwillingness to be re-appointed to the company or to the board,

(b) Where a resolution for the re-appointment of such director is put to the meeting and is lost,

(c) Where he is not qualified or is disqualified for appointment.

18.4.3 Appointment of additional directors by Board [Sec-260] : The board of directors can appoint additional subject to the maximum number, fixed by the articles of the company. These additional directors are entitled to be in the office only upto the date of the next annual general meeting.

18.4.4 Appointment of Directors by the Central Government [Sec - 408] : The Central Government has the power to appoint such number of persons as it deems fit as additional directors for a period of not more than three years to effectively safeguard the interests of the company. They are not liable for retirement. They are not required to hold any qualification shares. The Government may appoint the directors on its own or on the application or 100 members, holding 10 percent or more of the voting power.

18.4.5 Appointment of directors by third parties : The articles under certain circumstances given power to debenture holders or other creditors. Eg. Banks financial institutions who have advanced loans to the company to appoint their nominees to the board. The number of such directors should not exceed one third of the total number of directors. These directors are not required to retire by rotation.

18.4.6 Appointment of alternate directors : The Board of Directors may, if authorised by the Articles of Association or by a resolution passed by the company in a general meeting appoint an alternate director. He is to act for a director during his absence for a period of not less than 3 months from the state in which the board meeting are ordinarily held. The alternate directors must vacate office when the original directors returns to the state in which meeting of the board are generally held.

18.4.7 Filling up the casual vacancy : When the office of a director falls vacant prematurity, the casual vacancy thus created may be filled up according to the provisions of the articles. If articles are silent the board of directors may fill up such a vacancy. The person appointed in this way will hold office until the expiry of the period for which the outgoing director would have been in the office.

A person shall not act as director for more than 20 public limited companies [Sec 275 and 276]. Persons having less than 65 years alone are eligible for appointment of directors in public limited company's. The age restriction does not apply to a private company.

18.5 QUALIFICATION OF A DIRECTOR : [Sec - 270] :

The company's act does not prescribe any qualifications for a director. The articles of association usually contains the minimum number of shares to be possessed by a shareholder to qualify himself to the post of director. The minimum number of shares to be possessed by a shareholder is known as qualification shares.

Sec 270 lays down that a director unless already qualified must obtain the qualification shares within two months from the date of his election. The nominal value of these qualification shares must not exceed Rs. 5,000/- or the nominal value of one share where it exceeds Rs. 5,000/-. The bearer of the share warrants shall not be deemed holder of shares for the purpose of qualification shares.

If a director fails to acquire his qualification shares within two months from the date of his appointment, shall have to vacate his office. If he acts as director after the expiry of two months without taking qualification shares, he is liable to pay upto Rs. 50 for every day until he stops acting as director.

The above provisions apply only to public limited company.

18.6 DISQUALIFICATIONS OF A DIRECTOR [Sec - 274] :

The following persons cannot be appointed as directors of a company.

1. An undischarged insolvent
2. An adjusted lunatic

3. A person who has applied to be adjudicated as an insolvent and his application is pending
4. A person convicted of an offence involving moral turpitude and sentenced to atleast six months imprisonment and five years have not elapsed from the date of the expiry of the sentence.
5. A person whose calls are in arrears for six months.
6. A person who has been convicted of an offence in connection with the promotion, formation or management.
7. A person who is disqualified by the court. The Central Government may by notification in the official gazette can remove the disqualifications as regards the payment of call money and sentence of imprisonment before six months.

18.7 REMUNERATION OF DIRECTORS :

Directors are not entitled to any remuneration as a matter of right. If the articles permits a company may pay remuneration to the directors. When directors attended the board meeting they will be paid setting fee. A whole time director can be paid remuneration either by way of monthly payment or at a specified percentage of the net profits of the company. According to Sec - 198 of the act, a public limited company cannot pay more than 11% of its profits by way of managerial remuneration. When a company makes inadequate profits in any financial year, it may with the approval of central government pay a sum not exceeding Rs. 50,000 to its directors.

No whole time director or a managing director who is in receipt of any commission from the company can receive any commission from any subsidiary of the company. With the approval of central government the remuneration of any director may be increased.

18.8 REMOVAL OF DIRECTORS [Sec - 284] :

Directors may be removed by shareholders, the central government or the court. The rules regarding the removal of directors are furnished below.

18.8.1 Removal by shareholders : Sec - 284 of the act provides that the members of a company by ordinary resolution remove a director before the expiry of his period of office.

The following directors cannot be removed from office under this section.

- Those directors appointed by the central government under Sec -408 to prevent mismanagement.

- A director of a private company holding office for life on April 1, 1952.

- Director appointed according to proportional representation under Sec - 265. Special notice is required under this section to remove a director or to appoint some body in his place. A copy of such notice must be given to the director concerned. A statement relating to the matter may be sent by the director concerned to the company. Such statement shall be circulated among the members if received in time or read out in the meeting.

18.8.2 Removal by Central Government :

The Central Government can make a reference to High Court to remove managerial personnel including directors under the following circumstances.

- When any person is guilty of fraud misfeasance, persistent negligence or default etc.

- When the business of a company is not following sound business principle or prudent commercial practices or both.

- When the business of the company is causing damage to the interest of the trade industry or business pertaining to it.

- When any person of the company is trying to defraud creditors, members etc.

The Company's Act empowers the central government to remove managerial personnel from the office on the recommendation of the High Court.

18.8.3 Removal by Court :

When an application has been made to the court against the directors of oppression and mismanagement of a company affairs, the court may, if satisfied order for the termination of the director. The court can remove the directors under the following circumstances.

- conduct prejudicial to the public interest.

- A material change in the management or control of the company.

- The court is of opinion that the circumstances do not justify the winding of the company under the just and equitable clause.

When the court is terminated or set a side the appointment of managerial personnel, he cannot sue the company for damages or compensation or loss of office.

18.9 POWERS OF THE DIRECTORS :

A company is an artificial person created by law. Hence it cannot act on its own. It has neither a mind nor a body of its own. It has to function only through human agency. Since the number of shareholders are innumerable and scattered throughout the country, it is not possible for them to look after day to day management of the company. Therefore the shareholders delegate their powers to a few persons elected by them known as Directors.

18.9.1 Powers of the Directors :

Directors conduct, control, manage and supervise the affairs of the company. Directors derive their powers and authority from two sources namely,

- the articles of association of the company
- the company's act

The articles generally contain a list of the powers which may be exercised . The articles also contain a list of those matters which are to be decided by the members.

The powers to be exercised by the Board of Directors may be broadly grouped into three categories, namely,

- Powers to be exercised at the board meeting
- Powers to be exercised with the consent of general meeting.
- Powers to be exercised with the approval of the central government.

18.9.1 (a) Powers to be exercised at the Board Meeting : [Sec - 292] :

The Board of Directors may exercise the following powers as per Sec - 292 only at the board meetings.

1. to make calls on shares
2. to issue debentures
3. to borrow money otherwise than debentures
4. to invest funds of the company
5. to take loans
6. to delegate powers to others
7. to fill up casual vacancy
8. to sanction a contract in which a director is interested

18.9.1(b) Powers to be exercised with the consent of general meeting : [Sec - 293] :

The Board of Directors may exercise the following persons as per Sec - 293 with the consent of the company in general meeting.

1. to sell, lease the whole or part of the undertaking.
2. to grant remission or to give time for repayment of a debt due by a director
3. to invest other than trust securities, the sale proceeds of any of its undertaking, premises or properties.
4. to borrow money in excess of paid-up capital and the free reserves of the company.
5. to contribute the charitable trusts or other funds in excess of Rs. 50,000/- in any financial year or 5% of the average net profits of the three preceeding financial years which ever is greater.

Sec - 293(A) imposes a restriction on the powers of the Board of Directors to contribute funds to any political party or for any political purpose to any individual or an organisation.

18.9.1.3 Powers to be exercised with the approval of Central Government :

1. To amend any provision relating to appointment or re-appointment of managing director.
2. To appoint a managing director for the first time.

3. To increase the remuneration of the managing director.
4. To invest the funds of the company in any other company in excess of statutory limit.

18.9.2 Duties of Directors :

Duties of Directors depend on the nature of the business, provisions in the articles and other regulations. They may also depend upon the division of work between them and the officials. Apart from general duties, the directors have to discharge certain duties under the Company's Act. The duties of the directors are summarised as follows :

- Directors must be honest and deligent in the interest of the company.
- They must see that proper books and accounts are kept to record all transactions and final accounts are placed before the company in general meeting.
- They must see that annual general meeting is held within 18 months from the date of incorporation as per the provisions of the act.
- They must see that all the registers are maintained according to the provisions of the act.
- They have to submit a report on the company's affairs.
- They must arrange the delivery of share certificates and share warrants.
- Thay must keep a register of mortgages and charges.
- They have to file documents and returns with the registrar as required under law.
- They must prepare prospectus and file with the Registrar. Further they must see that the state ment included in the prospectus is not misleading.
- They must appoint bankers and officers of the company.
- They must enter contracts on behalf of the company.
- They must deposit share application amount in the Scheduled Bank till the receipt of Certificate of Commencement of Business.
- They must submit a statement of affairs at the time of liquidation of the company.
- They must disclose their interest in any contract proposed to be entered by the company.
- They must sign the bills of exchange and cheque arising in course of business.
- Every director must obtain qualification shares.
- They must file return of allotment with the Registrar.
- Every director must pay their call amount when called by the Board of Directors.

If a director fails to perform his duties as explained above he is guilty of negligence. If an account of such negligence, the company suffers any loss the directors must compensate the company.

18.10 RIGHTS OF DIRECTORS :

Every director who is validly appointed has a right to attend meetings of the Board. He has a right to participate in the affairs of the company. He is entitled to receive the remuneration fixed by the Articles subject to the provisions of the Act. A whole time director and Managing Director is entitled for compensation in case of premature termination of services.

18.11 LIABILITIES OF DIRECTORS :

The directors may under certain circumstances, liable to pay compensation to the company and outsiders. The liabilities of directors may be limited or unlimited liabilities of directors may be studied under two heads namely civil liability and criminal liability.

18.11.1 Civil Liability : As agent of the company, the directors are not liable on contracts made on behalf of the company. If they act without authority they will be held liable for damage for breach of implied warranty of authority.

The company is not liable on ultravires contracts and the directors too are not liable because outsiders are deemed to have notice of the powers of the company.

When outsiders subscribed for shares on the basis of statements in a prospectus the directors are liable for them.

The liabilities of directors towards company arises under the following circumstances.

18.11.1(a) Liability for Ultravires acts :

The directors are liable to the company for ultra-vires acts. For ex: if dividend is paid out of capital, the directors are bound to refund the money to the company out of their own pockets.

18.11.2 Liabilities for Negligence :

Directors are liable to pay damages to the company if they are negligent in discharging their duties.

18.11.3 Liability for breach of trust :

The directors also liable to the company for misappropriation of funds of the company. They are also liable for any act amounting to a breach of trust relating to the properties of the company. Directors are also liable for all secret profits made by them in-connection with the affairs of the company.

18.11.4 Criminal Liability :

The directors are liable to pay penalty for not compiling some provisions of the Company's Act.

- omission to keep a register of members [Sec - 150]
- untrue statement in the prospectus [Sec - 63]
- Falsification of books and reports.
- Omission to file return of allotment one month [Sec - 75]
- For default holding Annual General Meeting.
- Default in issuing share certificates and share warrants within the time prescribed by the provisions of the Act.

18.12 SUMMARY :

Company is an artificial person. It has no physical existence. As such it needs a human agency. The persons who are in charge of the Management of the affairs of a company are termed as directors the first Director is named in the Articles of Association. The subsequent Directors are appointed on general meeting. Their retirement is on rotation basis.

18.13 SELF ASSESSMENT QUESTIONS :

1. Explain the procedure for the appointment and removal of Directors
2. Discuss the provisions of the company Act in regard to qualification and disqualification of directors.
3. Directors are not only agents but are also in some sense trustees of the company. Discuss.

18.14 REFERENCE BOOKS :

1. Sen Mitra - Commercial and Industrial Law.
2. Gulshan, S.S. & Kapoor, G.K. - A Hand Book of Business Law.
3. M.P.Vijay Kumar - Business & Corporate Laws.

- Dr. M.Vijaya Lakshmi.

LESSON - 19

MEETINGS - RESOLUTIONS

19.0 OBJECTIVES

This lesson is intended to discuss about various types of Meetings and Resolutions.

Structure

19.1 INTRODUCTION

Every company limited by shares or guarantee have to conduct certain meetings according to the Provisions of Company's Act. Depending upon the nature and purpose the meeting called may be of different types. They are usually :

1. Statutory Meeting [Sec - 165]
2. Annual General Meeting
   - called by Company [Sec - 166]
   - called by NCLT [Sec - 167]
3. Extraordinary General Meeting [Sec - 169]
   - called by company
   - called by NCLT
   - called by Members

Now we will see the procedure of conducting these meetings and their objects according to the Act.

19.2 STATUTORY MEETING [Sec - 165] :

Every company limited by shares and every company limited by guarantee and having share capital is required to hold a meeting of the members of the company immediately after its incor- poration. Actually it is the first meeting of the members.

A statutory meeting is to be held once in the life time of the public limited company with share capital within a period of not less than month and not later than 6 monnths from the date of commencement of business.

All the members of the company shall be sent a report called 'Statutory Report" atleast 21 days before the date of meeting. The notice must say it is intended to be a statutory meeting.

Private companies, government companies and a company limited by guarantee and not having share capital are not required to hold a statutory meeting.

19.2.1 Contents of the statutory Report :

The following matters must be included in the statutory Report.

1. (a) Shares Alloted :

It should reveal the total number of shares alloted, distinguishing

- shares alooted as fully or partly paid-up otherwise than in cash and
- in case of partly paid-up shares,

The extent to which they are so paid-up

- in either case the consideration for which they have been alloted.

(b) Cash Received : The total amount of cash received on account of shares alloted.

(c) Summary of Receipts and Payments : An abstract of the receipts and payment of the company made upto a date within 7 days of the date of the report.

(d) Directors and Auditors : The names address and occupations of the Directors of the company and the charges if any, which have occurred since the date of incorporation of the company.

(e) Contracts : The particulars of any contract or the modification or the proposed contract which is to be submitted at the meeting for approval.

(f) Underwriting Contract : The extent, if any, to which each underwriting contract has not been carried out and the reasons thereof.

(g) Arrears of calls : Call money due from each Director and from the Manager.

(h) Commission and Brokerage : Particulars of commission or brokerage paid/payable in connection with the issue of shares / debentures to any Director / Manager.

The statutory report shall be certified as correct by not less than 2 Directors, one of whom shall be a Managing Director, where there is one.

2.2 Audit Certificate :

The auditors of the company shall certify as correct the following contents :
a. Total shares allotted by the company.
b. Cash received by the company in respect of all shares allotted.
c. Summary of receipts and payments.

After this the statutory report shall be delivered to the Registrar of companies for registration.

2.3 Procedure at the Meetings :

A list showing the names, addresses and occupations of the members of the company, and the number of shares held by them, has to be produced at the commencement of statutory meeting and has to remain accessible to any member during the continuance of the meeting. In any general meeting a member who intends to discuss any matter shall give previous notice to the company of his intention to discuss. Statutory meeting is an exception to this rule. The members present at the meeting may discuss any matter relating to the formation of the company or arising out of the statutory report, whether previous notice has been given or not. But no resolution can be passed for which notice has not been given as required by the Act.

2.4 Default :

If any default arises in holding the meeting or filing the statutory report, every Director or any other officer of the company who is in default shall be punishable with a fine which may extend to Rs. 5,000/-. Further default in holding the meeting or filing the report is one of the grounds for winding up the company.

19.3 ANNUAL GENERAL MEETING [Sec - 166] :

Every company shall, in each calendar year, hold in addition to any other meeting, a general meeting termed as an Annual General Meeting. The notice calling the meeting shall specify it as an Annual General Meeting.

According to [Sec - 171] a Annual General Meeting may be called by giving not less than 21 days notice in writing. The period is calculated from the date of receipt of the notice by the members. It excludes :

- the day of service of the notice
- the day on which meeting is to be held.

Notice is deemed to have been received by the members at the expiration of 48 hours after the letter containing it is posted.

A meeting may be called by a shorter notice, if it is agreed by all the members entitled to vote thereon. The concent for a shorter notice may be obtained either before or after the meeting.

3.1 Venue : Every Annual General Meeting shall be held 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 is situated and on a day which is not a public holiday and during the business hours.

3.2 Business to be transacted [Sec - 173] : In the case of an Annual General Meeting the business to be transacted may be of ordinary business or special business.

3.1.a. Ordinary Business [Sec - 173] : In case of an Annual General Meeting, the following is deemed as ordinary business:

- Consideration and adoption of annual accounts and the reports of the Board of Directors and auditors.
- Delcaration of dividend
- Appointment of Directors in place of those retiring.
- Appointment of Auditors and fixing of their remuneration.

3.1.b. Special Business [Sec - 173] : In case of an Annual General Meeting, any business other than the ordinary business, and in the case of any other meeting all business is deemed special.

It is to be noted that it is not the business, but it is the meeting which may make a business special some illustrations are given below.

- Appointment of a director other than a retiring director in an Annual General Meeting is a special business.
- An auditor is appointed in an extra-ordinary general meeting (i.e.due to casual vacancy caused by resignation), then it becomes a special business.
- Dividend may be declared in an extra-ordinary meeting, in which case it is a special business.

In case of a special business, the notice convening the meeting shall contain an explanatory statement giving the prescribed particulars.

3.2 Meeting Time :

The following are the provisions of the Act regarding the time, when an Annual General Meeting should be held :

- An Annual General Meeting must be held each year (calender year),
- The gap between two Annual General Meetings shall not exceed 15 months,
- As per Sec 210, the time gap between the end of the finanical year and the date of Annual General Meeting shall not exceed 6 months. Ex: The financial year of a company ends on 31st March, each year. The Annual General Meeting to adopt the accounts of the year ending 31-03-03 was held on 29-09-03. The last date for holding the meeting would be 30-09-03.

- A company may hold its first Annual General Meeting within 18 months from the date of its incorporation.

- It shall not be necessary for a company to hold a Annual General Meeting in the year of its in corporation or in the following year, if it holds an Annual General Meeting within 18 months from the date of its incorporation.

-The registrar of companies may, for any special reason, grant extension of time of hold an Annual General Meeting by a period not exceeding three months except in case of the first Annual General Meeting.

3.3 Default [Sec - 168] :

If any default is committed by the company in holding the Annual General Meeting in accordance with Sec 166, then the company and every officer of the company who is in default shall be punishable with a fine which may extend to Rs. 50,000/-. In the case of continuing default, a further fine which may extend to Rs. 2500/- per day during the continuance of default will be imposed.

3.4 Other points regarding an Annual Meeting :

The following are the provisions of Company's Act regarding the Annual Meeting.

-The Central Government may exempt any class of companies from the provisions of Sec 166.

- If any day is declared by the Central Government to be a public holiday after the issue of notice convening such a meeting, it shall not be deemed to be a public holiday in relation to the meeting.

- A public company or a private company which is a subsidiary of public company may by its articles fix the time for its Annual Meeting or by a resolution passed in one Annual Meeting fix the time for its subsequent Annnual Meeting.

- The purpose of Annual General Meeting is not only adoption of accounts. Even if the accounts are not ready the Annual General Meeting shall be held within the prescribed period and transact other businesses other than accounts, and a suitable day may be fixed when the accounts are likely to be ready. However it should be noted that such an adjourned meeting should also take place within the statutory limit laid down under 166 read with 210 of the Act.

- Two Annual Meeting can be held on the same day. There should be separate notices for each such meeting and shall be held at different time.

- Where all members of a company were also members of BOD, a meeting of Board could well be treated as a generall meeting of company (P.V.Damodara Reddy Vs Indian National Agencies Ltd).

19.4 EXTRA ORDINARY GENERAL MEETING [Sec - 169] :

Any General Meeting of a company other than the statutory meeting or the Annual General Meeting is the EGM of the company. An EGM is called for transacting some urgent or special business which cannot be postponed till the next AGM.

The EGM may be convened by the Board on its own, by the Board on the requisition of the members, by the requisitionists themselves on the failure of the Board to call the meeting or by the National Company Law Tribunal.

4.a. EGM by the Board on its own :

An EGM may be convened by the Directors if some business of special importance requires an approval from the members.

4.b. EGM on the requisition of members :

The Board of Directors of a company shall, on the requistion of such number of members of the company, forth with proceed duly to call an extraordinary general meeting of the company. The requisition shall be set out the matters for the consideration of which the meeting is to be called, shall be signed by the requistionists, and shall be deposited at the Registered office of the company.

4.c. Number of members Entitled to Requistion :

The rules regarding the number of members entitled to requistion of the EGM are as follows:

- In case of the company having share capital, members holding 1/10 th of paid up share capital of the company and having a right to vote on the date of deposit of requisition on the matter to be discussed at the meeting.
- In case of a company not having share capital, members holding 1/10 th of voting power on the date of deposit of requisition on the matter to be discussed at the meeting.

4.3 Power of National Company Law Tribunal to order calling of meeting [Sec - 186] :

If far any reason it is impracticable for the company to call an EGM of the company, the NCLT may either.

- of its own motion or
- on the application of any Director of the company or
- on the application of any member, entitled to vote at the meeting.
- order a meeting of the company to be called, held and conducted insuch manner as the NCLT thinks fit.

4.a. Notice [Sec - 171] :

21 clear days notice shall be given for calling a general meeting. A notice shorter than 21 days can be given in case of AGM with the concurrence of all the members entitled to vote at the meeting. In case of any meeting other than AGM, concurrence of atleast 95% of members having share capital with voting rights or 95% of voting power is required to give a notice less than 21 days.

4.b. Contents of the Notice :

Notice shall specify the place, day and an hour of the meeting and shall contain a statement of business to be transacted at the meeting, it may be noted that -

- A notice for a special business shall contain an Explanatory statement.
- If any item to be transacted at the General Meeting requires a special resolution then the intention to propose the resolution as a special resolution shall be stated in the notice.
- Companies having a share capital shall state with reasonable prominence in the notice that a member entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of himself and the proxy need not be a member.

The notice shall be served in the manner presented in Sec 53 viz, either personally or by ordinary post at the registered address in India.

4.c. Business at a meeting [Sec - 173] :
All business in the Meeting is of special nature.

4.d. Quorum [Sec - 174] :
Quorum refers to the minimum number of members required to transact a business in a meeting. The Articles can fix the quorum required for a meeting. According to Company's Act, if the company is public company the quorum required is 5 members. (personally present, excluding proxies). If the company is a private company the quorum required is 2 members (personally present, excluding proxies).

RESOLUTIONS

19.5 CIRCULATION OF MEMBER'S RESOLUTION : [Sec - 188]

A company shall on the receipt of the writte, requisition by such required members and at the expense of the requisitionists -

a. given to the members of the company who are entitled to received notice of the next Annual General Meeting, notice of any resolution which may be properly moved and is intended to be moved at that meeting.

b. Circulate to the members entitled to have notice of any general meeting, any statement of not more than 1000 words with respect to the matter referred to in any proposed resolution or any business to be dealt with at that meeting.

19.6 MEMBERS ELIGIBLE FOR MOVING RESOLUTION :

The members eligible for moving the above resolution are -

a. such number of members as represent not less than 1/20th (5%) of the total voting power of all the members at the date of resolution, having a right to vote on the resolution / business to which the requisition relates, or

b. Not less than 100 members having voting rights and holding shares in the company on which there has been paid-up an aggregate sum of not less that Rs. 1 lakh in all.

The notice of such resolution or the statement that is required to be circulated shall be sent in he same manner as the notice of the Annual General Meeting is sent. The notice or statement is sent at the expense of requisitionists unless otherwise resolved by the company.

19.7 CONDITIONS :

The following conditions shall be satisfied

(a) Copy of the requisition duly signed by the requisitionists is deposited at the registered office of the company -

- in the case of requisition requiring notice of resolution not less than 6 weeks before the meeting.
- in the case of any other requisition it is deposited not less than 2 weeks before the meeting.

(b) A sum of reasonably sufficient to meet the expenses is deposited along with the requisition. However, if after the requisition is deposited with the registered office, An Annual General Meeting is called for at a date 6 weeks or less after the copy has been deposited then the requisition is deemed to have been properly deposited thereof not withstanding that it does not satisfy the limit prescribed under this section.

The company is not bound to circulate in the following circumstances :
(a) If the NCLT makes an order on an application made by the company or any other person who claims to be aggrived and is satisfied that the power under this section is abused to secure needless publicity for defamatory matter.

(b) A banking company is not bound to circulate if in the opinion of the Board of Directors the circulation will injure the interest of the company.

19.8 RESOLUTION [Sec - 189] :

Resolutions are of two types

1. Ordinary resolution 2. Special resolution

19.8.1 Ordinary Resolution :

A resolution shall be an ordinary resolution when, at a General Meeting of which the notice required under this Act has been duly given, the votes cast in favour of the resolution exceed the votes, if any, cast against the resolution (> 50%) i.e. A resolution passed by a single majority of those present in person or any proxy, where proxies are allowed and voting upon the resolution. The emphasis is on the members present and voting at the meeting. The members not participating are not taken into account.

Few matters which require ordinary resolution are given below :

(a) To authorise an issue of shares at discount
(b) To increase the share capital if authorised by the articles
(c) To appoint auditors
(d) To appoint directors
(e) To adopt annual accounts
(f) To declare dividend

19.8.2 Special Resolution :

A resolution shall be a special resolution when -

(a) The notice calling the General Meeting specifies the intention to propose the resolution as a special resolution.

(b) The notice has been duly given of the General Meeting

(c) The votes cast in favour of the resolution are not less than 3 times the number of votes, if any, cast against the resolution (> =75%) i.e. even when the votes cast in favour is exactly three times the votes against the resolution, the resolution can be said to be a special resolution. Hence the casting vote of chairman is applicable only to ordinary resolution.

(d) The notice shall also annex an explanatory statement as required u/s 173, in which the shareholders are informed of the material facts concerning the resolution and the nature of the interest therein of the directors.

A special resolution is required for transacting business only where it is specially so required by the Act or said in the Articles. All other business can be transacted by an ordinary resolution. A copy of special resolutions should be filed with Registrar of Company [Sec - 192].

(e) A special resolution is required for the following : For example :

- To alter the objects clause and the situation clause in the memorandum
- To commence any new line of business
- To change the name of the company
- To to delete the word 'Limited' or 'Private Limited' from the name of the company
- To amend the Artilces
- To determine that any portion of the share capital not already called up shall not be called up except in the event of, and for the purpose of winding up of the company.
- To reduce the share capital.
- Approval of variation of rights of special classes of shares.
- To keep registers and returns at any place other than within city, town or village in which the registered office is situated.
- To request the government to investigate the affairs of the company and to appoint inspectors for the purpose.
- To fix remuneration of Directors, where the Articles require such resolution.
- To sanction remuneration to Directors other than managing or whole time Directors on percentage of of profit basis in certain instances.
- To consent to a Director or his relative or partner or firm or private company holding an office or place of profit, except that of Managing Director, Manager Bannker, or Trustee for debenture holders of the company.

- To make the liability of the Director or Manager unlimited when so authorised by Articles.
- To appoint auditors in the case of a company in which the central auditor any state Government or public financial instituionn together hold 25% or more of its subscribed capital.
- To appoint sole selling agent or sole buying agent in the case of companies having paid-up share capital of Rs. 50 lakhs or more.
- To alter the constitution of the company registered under part IX;
- To lend, extend guarantee, provide security or to invest in securities in excess of 372 A limits.

f. Special resolution cannot be amended in variance with the Explanatory statement annexed to the notice of the meeting unless from the point of view of the shareholders the amendment in any case only seeks to modify something in the resolution itself.

g. An amendement to an ordinary Resolution may be proposed and adopted at a meeting even where the notice sets out the exact terms of the proposed resolution.

h. A resolution whether special or ordinary, which has not been passed after giving sufficient notice or is otherwise irregular may be ratified or validated by a subsequently passed valid resolution. But there can be ratification or validation of a resolution only where the resolution originally passed was bonafide.

i. Where a resolution has been not validly passed but has been acted upon it is to be regarded as effective and the company and its members cannot set up its invalidity against its creditors.

19.9 RESOLUTION REQUIRING SPECIAL NOTICE [Sec - 190] :

It is a notice given by a member to the company. The following four resolutions under the Act require resolution with special notice.
a) To remove a Director before the expiry of the tenure.
b) To appoint a Director in place of the Director so removed.
c) To move a resolution that the retiring auditor shall not be reappointed.
d) To appoint as auditor a person other than a retiring auditor.

The Article of a company may provide additional situations where special notice is required.

The notice of intention to move a resolution, shall be given by the members to the company not less than 14 days before the meeting at which it is to be moved.

The company on receipt of notice of the intention to move the resolution should give its members notice of the resolution.

Where it is not practicable, the company may either, advertise in a newspaper having good circulation or in any other mode allowed by the Articles, not less than 7 days before the meeting. The notice shall be given 14 days before the date of original meeting and not before the date of original meeting and not before the adjourned meeting.

Here the student have to note that a special notice and special resolution are entirely different. There is just one situation where special notice and special resolution are necessary. viz., appointment of an auditor other than the retiring auditor of a company in which not less than 25% of subscribed capital is held by Central Government, State Government, public financial institutions etc. u/s. 224 A.

19.10 PASSING OF RESOLUTIONS BY POSTAL BALLOT [Sec - 192 A] :

Postal ballot is a means for ascertaining the views of the members considering that many members may not be able to attend the general meeting and vote at the meetings even on very important subjects (business) which affect their interest 'postal ballot' includes voting by share holders by postal or electronic mode instead voting by being present personally for transacting business in a general meeting of the company.

A company shall send notice and draft resolution by registered post to all shareholders explaining the reasons and requesting them to communicate within 30 days from the date of posting of letter.

If a resolution is assented to by a requisite majority of shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

19.10.1 Notified Resolutions Requiring Postal Ballot :

a) Alteration of objects clause,
b) Alteration of Articles of Association,
c) Buy Back of shares,
d) Issue of Equity shares with differential, voting rights,
e) Change of registered office,
f) Sale of undertaking,
g) Election of Director,
h) Variation in the rights attached to a class of shares or debentures.

19.10.2 Procedure to be followed for conducting business through postal ballot :

a) The Board of Directors shall appoint one scrutiniser who is not in employment of the company, may be a retired judge or any person of repute who in the opinion of the board can conduct the postal ballot voting process in a fair and transparent manner.

b) The scrutiniser shall be in position for 35 days (excluding holidays) from the date of issue of notice fro Annual General Meeting. He is to submit his final report on or before the said period.

c) The scrutiniser shall be willing to be appointed and he shall be available at the registered office of the company for the purpose of ascertaining the requisite majority.

d) The scrutiniser shall maintain a register to record the consent or otherwise received, including electronic media, mentioning the particulars of name, address, folio number, number of shares, nominal value of shares, whether the shares have voting, differential voting or non-voting rights and the scrutiniser shall also maintain record for postal ballot which are received in defaced or mutilated form.

e) The postal ballot and other papers relating to postal ballot will be under safe custody of the scrutiniser till the chairman considers approves and signs the minutes of the meeting therefore,the scrutiniser shall return the ballot papers and other related papers / registers to the company so as to preserve such ballot papers and other related papers / registers safely till the resolution is given effect to.

f) Consent or otherwise relating to issue maintained in the notice for Annual General Meeting received after 35 days from the date of issue will be strictly treated as if the reply from the members has not been received.

g) If default is made in following this procedure, a fine of Rs. 50,000/- will be levied for each default.

The companies (passing the resolution by postal ballot) Rules, 2001 read with section 192 A shall apply to notices calling meetings of the shareholders approved by the Board of Directors after 15th June 2001.

The voting right on postal ballot shall be in proportion to the shareholders share of the paid up equity share capital of the company.

19.11 MINUTES : [Sec - 193] :

Minutes represents a record of business transacted at a meeting. Every company is required to record the proceedings of every general meeting and of every meeting of the Board of Directors or of every committee of the Board.

It shall be recorded within 30 days from the conclusion of every such meeting in a book kept for that purpose with pages consecutively numbered.

19.11.1 Procedure :

Every page of the minutes book shall be initiated or signed and the last page of the record of the proceedings shall be dated and signed, in the case of -
- A Board Meeting by the chairman of the same meeting or in the event of his death or insanity, by a Director duly authorised by the Board for the purpose.

19.11.2 Contents :

a) Pasting or otherwise shall make no attachment to the minutes book.
b) The minutes book shall contain a fair and correct summary of the proceedings.
c) Appointment of officers made at a meeting should be included.
d) Minutes of meeting of the Board / Committee shall also contain the names of the Directors present and also those dissenting from or not concurring to the resolution.
e) The chairman need not include any matter in the minutes if he is of the opinion that it is defamatory of any person or is irrelevant or immaterial or is detrimental to the interests of the company.

The minutes book must be bound and must be hand written. However, DCA has stated that loose leaf minutes books are agreeable provided the company takes appropriate safeguards and they are bound into books at reasonable intervals of say 6 months.

If there is something recorded at an earlier meeting which is not acceptable at a later meeting, the proper procedure is to pass a subsequent minute rescinding the old one.

The minutes book shall be kept at the registered office of the company.

Minutes of meetings kept in accordance with the provisions of Section - 193 shall be conclusive evidence of the proceedings recorded therein. It does not require further proof of the facts stated therein.

19.11.3 Additional Points :

- A Director, who is present at a meeting at which the minutes of a prior Board Meeting is confirmed is not thereby made responsible for what was done at the prior meeting.

- A member has the right to inspect the books containing the minutes of General Meeting during, the business hours at the registered office of the company at free cost.

- On payment of the prescribed fee, he is entitled to be furnished with a copy of any such minutes within 7 days after his request.

- If any default is made by the company the above matter, the NCLT has the power to order so.

19.12 REGISTRATION OF RESOLUTIONS AND AGREEMENTS [Sec-192] :

The following resolutions and agreements are required to be registered with the Registrar of Companies :

a) Special resolution.

b) Resolutions which have been agreed to by all the members of the company but which, in the absence of such an agreement would have to be passed as special resolutions.

c) Any resolution of Board of Directors or agreement executed by a company relating to appointment, reappointment, renewal of appointment or variation of the terms of appointment of the Managing Director.

d) Resolutions or agreements which have been approved by all the members of a class of shareholders, but which have otherwise required to be passed by some particular majority or otherwise in some particular manner. And all the resolutions or agreement which effectively bind all the members of any class of shareholders though not agreed by all of them.

e) Resolutions passed by a company giving powers to Board of Directors :
- to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking.
- to borrow money beyond a certain limit or
- to contribute to charities beyond Rs. 50,000 or 5% of company's average net profits for the last 3 years whichever is greater.

f) Resolutions approving the appointment of a sole-selling agent.
g) Resolutions requiring a company to be wound - up voluntarily.
h) Copies of the terms and conditions of a sole selling agent (SSA) appointed under Section 294 or Section 294 AA.

19.13 SUMMARY :

Every company have to conduct certain meetings according to the provisions of Company's Act. They are different types depending upon the purpose and nature i.e. statutory meeting, which is conducted once in the life time of the company. Annual General Meeting, conducted every year, extra ordinary meeting conducted in special situations.

Resolutions are of two types.

1. Ordinary Resolution 2. Special Resolutions, resolutions may be passed by postal ballot.

Some resolutions should be registered with Registrar.

19.14 SELF - ASSESSMENT QUESTIONS :

1. What are the different kinds of meetings under Companies Act - 1956? Explain in detail.
2. What are the different types of resolutions which may be passed in the meetings of shareholders?
3. Discuss the following :
   - a) Postal Ballot.
   - b) Minutes.

19.15 REFERENCE BOOKS :

1. Sen Mitra - Commercial and Industrial Law
2. Gulshan, S.S. & Kapoor, G.K. - A Handbook of Business Law
3. M.P. Vijay Kumar - Business & Corporate Laws

- Dr. M. Vijaya Lakshmi.

LESSON - 20

DOCTRINE OF ULTRAVIRES - WINDING UP

20.0 OBJECTIVES :

This lesson is intended to discuss about Doctrine of Ultravires and Winding Up.

STRUCTURE :

20.1 INTRODUCTION :

Ultra means 'beyond', vires means 'powers'

Ultravires of a company means an act done beyond the legal power and authority of the company. An act ultravires the companies Act is illegal and void. An act ultravires the company (memorandum) is void.

20.2 DOCTRINE OF ULTRAVIRES

As act ultravires the Directors, but intravire the company can be ratified by the shareholders by a resolution in a general meeting. An act ultravires the articles can be ratified by a special resolution at a general meeting.

Ashburg Railway Carriage & Iron Co. Ltd Vs Riche.

A Railway company was formed with the object of making and selling railway wagons and carriages. The company entered into a contract with Riche to finance the construction of a railway line in Belguim. The company later repudiated the contract as one being ultra vires. Riche brought an action for dangers for breach of contract. The House of Lords held that the contract was ultravires and therefore null and void.

Lakshmana swamy Mudaliar Vs Life Insurance Corporation of India :

Directors of a company were authorised to make payments towards any charitable purpose or for any object useful for general public. The Directors paid a Rs. 2,00,000 to the trust formed for the purpose of promoting technical and business knowledge. The supreme court held the payment as ultravires.

The purpose of Doctrine of ultravires is to protect the shareholders and to safeguard the interest of the creditors.

20.3 EFFECT OF ULTRAVIRES TRANSACTIONS :

The impact of doctrine of ultravires is that a company can neither be sued on an ultravires transaction, nor can it sue. Since the memorandum is a 'public document' it is pen to public inspection. When one deals with a company, he is deemed to know about the powers of the company. If inspite of this, a person enters into a transaction which ultravires the company, then he cannot enforce it against the company.

20.3.1 Injuction :

Whenever an ultr-vires Act been or is about to be undertaken, any member of the company can get an injuction to restrain the company from proceeding with it.

London Country Council Vs Atorney General :

The council had power to run trainways. It ran omni buses to feed trainways. Held, that the running of omni buses was ultra vires and the council was restrained from running omni buses.

20.3.2 Personal Liability of Directors / Agents :

Any member of a company can maintain an action against the Directors of the company to compel them to restore to the company the funds of the company that have been employed by them in an ultravires transaction.

20.3.3 Property Acquired Under Ultra-vires Acts :

If a company's money has been spent on ultravires in purchasing some property, the company's right over that property must be held secure since the amount though wrongly acquired, represents the company's capital.

20.3.4 Ultravires Contracts :

Contracts ultravire the company are avoid and cannot become intravires the company for reason of estoppel or lapse of time or ratification. The company may however alter the objects clause for the future, but such alteration will not validate, the past ultravires acts done.

20.3.5 Ultravires Torts (Civil Wrongs) :

The company is not liable for civil wrong done by Directors / Agent in the course of ultravires transaction. The company would be liable for torts only if :

(a) The action is within the scope of memorandum of association.

(b) The act was committed within the course of employment.

20.3.5.b. Exceptions :

(a) If an act is ultravires the Directors of the company but intravires the company the shareholders may ratify it.

(b) If an act is ultravires the Articles of the company, the Articles may be altered to include the act within the powers of the company.

(c) If an act is intravires the company but is irregularly done, the shareholders may ratify it.

(d) The company can sue a person who borrows money from the company under a contract which is ultravires, for the recovery of the money.

(e) If an act is ultravires the company the rights arising independently thereon are not affected. Further, the rights over the property acquired by ultravires expenditure are protected.

(f) If a company has purchased some property from a third party under ultravires contract or has taken an ultravires loan, the third party has the right to follow its property or money if it exists in specify. He may also obtain an injuction from the court restraining the company from parting with that property or money. But he must act before the identity of the property is lost or the money is spent.

(g) If a company takes an ultravires loan and uses it to pay off intravires debts, the lender who has lent money under ultravires contract is substituted in the place of the creditor who has been paid off and he can recover the money.

(h) If the company has taken an ultravires loan through misrepresentation of fact by the Directors, the lender has the right to make the Directors, personally liable on the ground of breach of impired warranty of authority.

(i) If a Director of a company makes an ultravires payment, the amount, the company can compel him to refund the amount. The Director however has the right to be identified by the person receiving the money provided he knew the transaction to be ultravires the company.

20.4 DOCTRINE OF CONSTRUCTIVE NOTICE :

The memorandum of Association and Articles of Association of every company are registered with registrar of companies. The office of the registrar is a public office and consequently they are public documents open and accessible to all. Any person dealing with the company is presumed to have read the

memorandum and Articles irrespective of whether he actually reads it or not. This kind of presumed notice is called as 'Doctrine of constructive notice'. The legal effect of its doctrine is that if a person deals with the company and the transaction is inconsistent with the provisions of memorandum and Articles, he cannot plead ignorance of the provision of these documents.

Kotla Venkataswamy Vs Ram Murthy

The Articles required that all deeds should be signed by the Managing Director, the Secretary and a working Director on behalf of the company. The plaintiff accepted the deed of mortgage signed by the secretary and a working Director. Held that the plaintiff could not claim under this deed.

This doctrine is not a positive one but a negative doctrine. It operates in the company's favour and against the person who failed the enquiry.

20.5 DOCTRINE OF INDOOR MANAGEMENT

This doctrine is an exception to the doctrine of constructive notice.

According to this doctrine, persons dealing with the company are presumed to have read the registered documents and to see that the proposed dealing is not inconsistent therewith, but they are not bound to do more; they need not enquire into the regularity of internal proceedings as required by memorandum and Articles. They can presume that all this is being done regularly.

The doctrine has its origin in the case of Royal British Bank Vs Turquand

The Directors were authorised by the Articles to borrow on bonds such sums of money, by obtaining approval of the shareholders by way of a resolution in a general meeting. The Directors gave a bond to 'T' without authority of such a resolution. Held, that 'T' could sue the company on the strength of the bond, as he was entitiled to assume that necessary resolution has been passed. Hence this doctrine is also referred to as the rule in Turquand's case.

20.6 EXEPTIONS TO THE DOCTRINE IN INDOOR MANAGEMENT :

20.6.1 Knowledge of Irregularity :

Where a person dealing with the company has notice of the irregularity as regards internal management, he cannot claim benefit under the rule of indoor management. Thus a director of a company cannot normally claim the benefit of this rule, because he is also acting for the company in the transaction.

Howard Vs Patent Ivory Co.

The Directors of the company, under the Articles, had no power to borrow more than 1000 pounds without the resolution of the company in the general meeting. Without such a resolution, the Directors borrowed 2500 pounds from themselves and took debentures. It was held that the Directors had the

notice of internal regularity and hence the company was liable to them only to the extent of 1000 pounds.

Devi Ditta Mal Vs Standard Bank of India :

A transfer of shares in a company was approved by two Directors. One of these Directors was not validly appointed. The other was disqualified by reason of being the transference himself. These facts were not known to the transferor. Held the transfer was ineffective.

20.6.2 Negligence :

Where a person dealing with the company could discover the irregularity i.e. transactions which are unusual or not in ordinary course of business, if he had made proper enquiries then he cannot claim protection under this rule. Likewise, a person who deals with the company may be put upon enquiry by reason of unusual magnitude of the transactions having regard to the position of the agent who is acting for the company.

Underwood Vs Bank of Liverpool :

The Articles of a company provided that the business of the company was to be managed by the Directors. The Director and the principal shareholder of the company advised the Bank to credit the cheques in favour of the company into his own account. The bank accordingly credited the cheque in favour of the company into his own account. An action was brought against the bank by the company on behalf of the debenture holders. The Bank defend that it has acted on the Directors instructions and that as a Bank it was not necessary to see whether the internal proceedings for the Director's communication was appropriate or not. The court held that considering the peculiar nature of instruction, the bank should have in the ordinary course suspected irregularity. The court held the bank liable to compensate the company for cheques credited to directors personal account.

Ruben Vs Great Fingall Consolidated Co.

The plaintiff was the transferre of a share certificate issued under the seal of the defendent company. The certificate was issued by the company's secretary who had affixed the seal of the company and forged the signatures of two Directors. The certificate was held to be void.

20.6.4 Void Acts :

Where the acts done in the name of the company are void abinitio, the doctrine of indoor management does not apply.

20.6.5 Lack of Authority :

If an officer of a company makes a contract with a third party and if the act of the officer fails outside his ordinary authority, the company is not bound.

Credit Bank Cassel Vs Schenkers Ltd :

A Branch manager of the company drew a bill of exchange and also endorsed bills on behalf of the company although he had no authority for these acts from the company. Held, the company was not bound.

Anand Biharilal Vs Binshaw & Co.

The Plaintiff accepted a transfer of the company's property from its accountant since such transaction is apparently beyond the scope of an Accountants authority, it was held void.

20.6.6 No Knowledge of Articles :

The Protection under the rule of Indoor Management, would be available only if the person had knowledge of the Articles. So, if a person had knowledge of the Articles. He cannot claim protection under the rule of indoor management.

20.7 WINDING UP

INTRODUCTION :

A company is brought into existence, by a legal process and when for any reason, it is desired to end its existence, it must again be by the process of law.

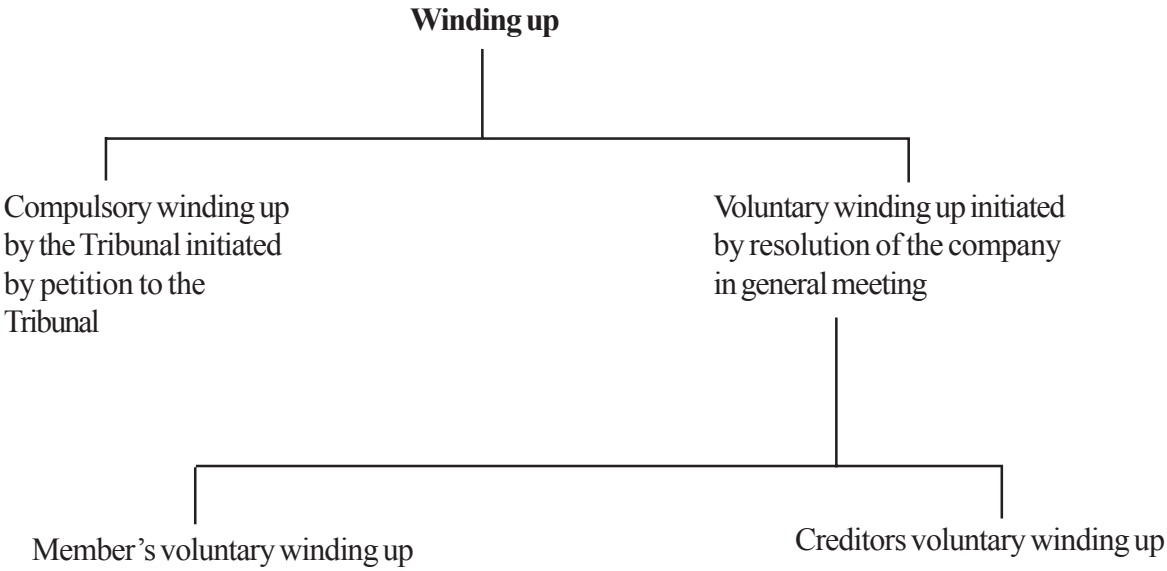
There is no power given in the Companies Act or in any other Act, by which a company duly incorporated can be got rid of unless it can be got rid of by being extinguished by the section of the Act which provide for the winding up of companies. In the words of Sir Palmer, " A company incorporated under the Companies Act, cannot be put to an end except by winding up or by removal from the register as a defunct company."

MEANING :

Winding up of a company is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such a dissolution its assets are collected, its debts are paid off out of the assets of the company or from contributions by its members, if necessary. If any surplus is left, it is distributed among the members in accordance with their rights. During the process of winding up the company still exists and has corporate powers until dissolution. Till dissolution the property of the company remains vested in the company.

20.8 MODES OF WINDING UP

The following chart explains the various modes in which a company may be wound up.



20.8.1 VOLUNTARY WINDING UP

A voluntary winding up of a company is entirely different from a compulsory winding up. Voluntary winding up is winding up by the members or creditors of a company without interference by the Tribunal.

The object of a voluntary winding up is that the company and its creditors are left to settle their affairs without going to the Tribunal, but they may apply to the Tribunal for any directions or orders if and when necessary. From the point of view of the company itself a voluntary winding up has more advantages over a compulsory winding up, the chief being that there are not so many formalities to be compiled with. This form of winding up is by far the most common and the most popular.

A company may be wound up voluntarily when --

(a) the period fixed by the articles for the duration of the company has expired or an event upon which the company is to be wound up has happened and the company in general meeting has passed ordinary resolution.

(b) the company has for any cause whatever passed a special resolution to wind up voluntarily [Section 484]. The company may be wound up by special resolution even if it is prosper ous. No articles of the company can prevent the exercise of this statutory right.

A resolution for voluntary winding up must be advertised in the official gazette and also in some newspaper, circulating in the district where the registered office of the company is situated, within 14 days of the passing of the resolution. If default is made in complying with this provision, the company and every defaulting officer shall be punishable with fine which may extend to Rs. 500 per day for every day during which default continues. [Section 485]. Officer herein includes the liquidator also.

A voluntary winding up commences from the date of the passing of the resolution. [Section 486].

The date of commencement of winding up is important for various matters, such as liability of past members who will not be affected if, on the date of commencement of winding up, a year had elapsed after they ceased to be members.

Consequences of Voluntary Winding Up :

(1) Effect on status of a company : In the case of a voluntary winding up, the company ceases to carry on the business from the commencement of the winding up except so far as may be required for the beneficial winding up of the business. However, the corporate status and the corporate powers of the company will continue until it is dissolved. (Section 487).

A voluntary winding up does not necessarily operate as notice of dismissal to the company's employees, but there is no change in the personality of the employer. But where the circumstances of the winding up are such that the company can no longer carry on business, its contracts and its servants will necessarily cease, leaving the employees free to claim damages if they are so entitled.

Example : By a written agreement F was appointed as managing director of a company for five years. Before the expiration of the five years, the company passed a resolution for voluntary winding up, as it could not by a reason of its liabilities continue its business. F voted in favour of this resolution. It was held that --

(a) the voluntary winding up operated as a wrongful dismissal of F, and
(b) the fact that F voted in favour of the resolution did not prevent him from claim ing damages. [Fowler v. Commercial Timber Co. Ltd. (1930) 2 K.B. 1 (C.A.)].

(2) Board's power to cease on appointment of a liquidator : On the appointment of a liquidator the powers of the board of directors, managing or whole time directors and the manager shall cease, except for the purpose of giving notice to the registrar of the appointment of the liquidator. (Sec. 491).

On the appointment of a liquidator the powers of the board of directors cease except so far as the company is general meeting or the liquidator (in a members voluntary winding up) or the committee of inspection or if there is no such committee, the creditors (in a creditor's voluntary winding up), sanction the continuance. (Sec. 505).

A difference between section 505 and section 491 may be noted while under section 491 the powers of the entire managerial personnel cease, under section 505 the powers of the board of directors alone cease.

(3) Avoidance of Transfer etc. after commencement of winding up : In the case of a voluntary winding up, any transfer of shares in the company, not being a transfer made to or with the sanction of the liquidator , and any alteration in the status of the members of the company, made after the commencement of the winding up, shall be void. (Sec. 536).

Types of voluntary winding up : A voluntary winding up may be :

(A) A members Voluntary winding up. (B) A creditors voluntary winding up.

20.8.2 CREDITOR'S VOLUNTARY WINDING UP :

Where a company proposes to wind up voluntarily and the directors are not in a position to make the statutory declaration of solvency, the winding up is a creditor's voluntary winding up. The provisions for creditors voluntary winding up are similar to those applicable to the member's voluntary winding up except that in the former, it is the creditors who appoint the liquidator, fix his remuneration and generally conduct the winding up. Section 500 to 509 deal with creditor's voluntary winding up. They are discussed as under :

1. Meeting of Creditors : (Section 500). When the declaration of solvency is not made by the directors, the company shall cause a meeting of the creditors of the company to be called on the day or next following day on which the resolution for voluntary winding up is to be proposed. Notice of the meeting of creditors shall be posted to creditors simultaneously with notice of the meeting of the company. The notice calling the meeting of the creditors shall be advertised in the official gazette and once at least in two newspapers circulating in the district where the registered office of the company is situated.

The board of directors shall lay before the meeting of the creditors a full statement of the position of the company's affairs together with the list of its creditors and the estimated amount of their claims. One of the directors must preside at the meeting.

If the meeting of the company at which the resolution for voluntary winding up is to be proposed is adjourned, and the resolution is passed at an adjourned meeting, any resolution passed at the meeting of the creditors shall have effect as if it had been passed immediately after the passing of the resolution for winding up of the company.

2. Notice to Registrar : [Section 501]. The company shall give notice of resolution passed at the creditors meeting to the registrar within 10 days of its passing.

If the company fails to send the notice, within the prescribed period, the registrar of companies, the company, every officer of the company and the liquidator shall be punishable with fine which may extend to Rs. 500 for every day during which the default continues.

3. Appointment of liquidator :[Section 502]. The creditors and the company shall appoint a person to be the liquidator. If different persons were nominated, the person nominated by the creditors shall be the liquidator. Any director, member or creditor of the company may, within 7 days of the nomination made by the creditors, apply to the Tribunal for an order that the person appointed by the company shall be the liquidator. Where no person is nominated by the creditors, the person nominated by the company shall be the liquidator. On the other hand, if no person is nominated by the company, the person nominated by the creditors shall be the liquidator.

4. Committee of Inspection : [Section 503]. The creditors at their meeting may appoint a committee of inspection consisting of not more than five persons. Where such a committee is appointed, the company may also appoint at a meeting such number of persons not exceeding five to act as the members of the committee. The creditors may resolve that any of the person appointed by the company ought not to be the members of the committee of inspection. In such cases, unless the Tribunal otherwise directs, they cannot act on the committee. The Tribunal may appoint other persons in place of persons objected to.

5. Liquidator's Remuneration : [Section 504]. Remuneration of the liquidator may be fixed by the committee of inspection or the creditors if there is no committee of inspection. Otherwise the Tribunal may fix his remuneration. Remuneration fixed as above cannot be increased in any circumstances.

6. Power of board to cease : [Section 505]. The board usually ceases to function on appointment of the liquidator. The board may act in so far as the committee of inspection (if any) or the creditors in general meeting may sanction the continuance thereof.

7. Vacancy in office of liquidator : [Section 506]. The creditors in general meeting may fill up any vacancy caused in the office of the liquidator other than a liquidator appointed by or by the direction of the Tribunal.

8. Meeting at the end of each year : [Section 508]. Where the winding up continues for more than a year, the liquidator shall call a general meeting of the company and a meeting of the creditors at the end of the first year from the commencement of the winding up and at the end of each succeeding year within three months from the end of the year or such longer period as the central government may allow. The liquidator shall lay before the meeting an account of his acts and dealings and of the conduct of the windings up during the preceding year. The object of these provisions is to give regular information to the creditors and shareholders.

If the liquidator fails to comply with these provisions he is liable to be fined upto Rs. 1,000 in respect of each failure.

9. Final meeting and dissolution : [Section 509]. As soon as the affairs of the company are wound up, the liquidator shall make up the account of the winding up showing how the winding up has been conducted and property of the company has been disposed of.

20.8.3 LIQUIDATORS IN VOLUNTARY WINDING UP :

Appointment of liquidator : In a member's voluntary winding up, the company in general meeting shall appoint one or more liquidators for the purpose of collecting the company's assets and distributing the proceeds among creditors and contributories. If a vacancy occurs by death or resignation or otherwise in the office of the liquidator the company in general meeting may fill the vacancy. (Section 490 and 492).

In the case of a creditors voluntary winding up, the creditors and the members at their respective meetings, may nominate a person to be the liquidator of the company. However, the creditors are given a preferential right in the matter of the appointment of the liquidator with a power to the Tribunal to vary the

appointment on application made within seven days by a director, member or creditor. (Section 502).

Power of the Tribunal to appoint liquidator : In a member's or creditor's voluntary winding up, if for any cause whatever there is no liquidator acting, the Tribunal may appoint the official liquidator or any other person as a liquidator of the company. The Tribunal may also appoint a liquidator on the application of the registrar. (Section 515).

Body corporate not to be appointed as liquidator : A body corporate shall not be qualified for appointment as a liquidator of a company in a voluntary winding up. Any appointment of a body corporate as liquidator shall be void. (Section 513). A partnership firm of accounts is not a body corporate and as such may be appointed liquidator of a company.

Corrupt inducement affecting appointment as liquidator : Any person who gives or agrees or offers to give, to any members or creditor of the company any gratification with a view to securing his own appointment or nomination or to securing or preventing the appointment of someone else, as the liquidator is liable to a fine which may extend upto Rs.10,000. (Section 514).

Notice by liquidator of his appointment : When a person is appointed the liquidator and accepts the appointment, he shall publish in the official gazettee notice of his appointment, in the prescribed form. He shall also deliver a copy of such notice to the registrar. The liquidator shall do this within 30 days of his appointment. Where the liquidator fails to comply with the above provision, he is liable to a fine which may extend to Rs. 500 for each day of default. (Section 516).

Effect of the appointment of liquidator : On the appointment of a liquidator, in a member's voluntary winding up all the powers of the directors, including managing director, whole time directors as also the manager shall cease except so far as the company in general meeting or the liquidator may sanction their continuance. (Section 491).

On the appointment of a liquidator in creditor's voluntary winding up, all the powers of the board of directors shall cease. The committee of inspection or if there is no such committee, the creditor's meeting by resolution may sanction continuance of the powers of the board. (Section 505).

Remuneration of liquidator : In a member's voluntary winding up, the general meeting shall fix the remuneration to be paid to the liquidators. Unless the question of remuneration is resolved the liquidators shall not take charge of his office. Once remuneration is fixed it cannot be increased. (Section 490).

In a creditors voluntary winding up, the remuneration of the liquidator is fixed by the committee of inspection and if there is no committee of inspection then by the creditors. In the absence of any such fixation, the Tribunal shall determine his remuneration. Any remuneration so fixed shall not be increased (Section 504).

All costs, charges and expenses properly incurred in the winding up, including the remuneration of the liquidator, shall subject to the rights of secured creditors, be payable out of the assets of the company in priority to all other claims. (Section 520).

Removal of liquidator : In either kind of voluntary winding up, the Tribunal may, on cause shown, remove a liquidator and appoint the official liquidator or any other person as a liquidator in place of removed liquidator. The Tribunal may also remove a liquidator on the application of the registrar.

The term 'on cause shown' does not necessarily mean personal misconduct or unfitness. It means any conduct which would make the liquidator no longer fit to act as such. Where the liquidator disregards the wishes of creditors in an insolvent company and the wishes of contributories in a solvent company, it may be sufficient cause on which Tribunal may remove a liquidator.

Example : The secretary of a company was appointed as liquidator. He was intimated with the directors and to some extent jointly interested with them. There was sufficient evidence that he took their side strongly. A contributory moved against the liquidator and two directors for an order compelling them to pay money for which they were liable in a fiduciary relation. It was held that there was sufficient cause for the removal of the liquidator. [Re Sir John Moore Gold Mining Co. (1879) 12 Ch. 325].

A liquidator should not be removed arbitrarily. In Hardit Singh Giani vs Registrar of Companies, Delhi High Tribunal ordered the removal of a liquidator on the grounds that :

(i) he had not deposited certain amounts as required by section 553 of the Companies Act;

(ii) he had been unco-operative and defiant regarding the recovery of the company's claim;

(iii) the process of liquidation was a collusive affair between the ex-managing director and the liquidator.

20.9 OFFICIAL LIQUIDATORS :

Appointment of Official Liquidator (Section 448) :

As per new provisions of the Companies (Second Amendment) Act, 2002 the appointment of Liquidator shall be made in the following manner :

(1) For the purposes of this Act, so far as it relates to the winding up of a company by the Tribunal, there shall be an Official Liquidator who :

(a) may be appointed from a panel of professional firms of chartered accountants, advocates, company secretaries, costs and works accountants or firms having a combination of these professions, which the Central Government shall constitute for the Tribunal ; or

(b) may be a body corporate consisting of such professionals as may be approved by the Central Government from time to time ; or

(c) may be a whole-time or a part-time officer appointed by the Central Government. provided that, before appointing the Official Liquidator, the Tribunal may give due

regard to the views or opinion of the secured creditors and workmen.

(2) The terms and conditions for the appointment of the Official Liquidator and the remuneration payable to him shall be :

(a) approved by the Tribunal for those appointed under clauses (a) and (b) of sub-section (1), subject to a maximum remuneration of five per cent. of the value of debt recovered and realisation of sale of assets ;

(b) approved by the Central Government for those appointed under clause (c) of sub-section (1) in accordance with the rules made by it in this behalf.

(3) Where the Official Liquidator is an officer appointed by the Central Government under clause (c) of sub-section (1), the Central Government may also appoint, if considered necessary, one or more Deputy Offical Liquidators or Assistant Offical Liquidators to assist the Official Liquidator in the discharge of his functions, and the terms and conditions for the appointment of such Official Liquidators and the remuneration payable to them shall also be in accordance with the rules made by the Central Government.

On a winding up order being made the offical liquidator, by virtue of his office, become the liquidator of the company (Sec. 449).

Where the official liquidator becomes or acts as liquidator, there shall be paid to the central government out of the assets of the company such fees as may be prescribed.

A liquidator shall be described by the style of "The Official Liquidator" of the particular company in respect of which he acts and not by individual name [Sec. 452].

20.10 CONTRIBUTORY :

In a going company, that is, before liquidation a member is liable and bound to pay full amount on the shares held by him. This liability continues even after the company passes into liquidation. The shareholder then becomes a contributory and certain changes occur in his status, rights and liabilities.

Section 428 defines the term 'contributory'. It means every person who is liable to contribute to the assets of the company in the event of its being wound up and includes the holder of fully paid up shares. The word 'liable to contribute' to the assets of a company are very wide and might have been held to include persons other than members, such as debtors, and holders of share warrants, but it is now settled that it refers only to members, past and present and their representatives.

20.11 SUMMARY :

Companies have been given very wide powers to alter their Articles. But it must not be inconsistent with the Act, it must not conflict with the memorandum. An act beyond the legal power and authority of company is known as doctrine of ultravires.

20.12 SELF - ASSESSMENT QUESTIONS :

Short Answer Question:

1. Define the term 'winding up' in relation to a company.

2. Mention the different modes of winding of a public company.

3. When can contributory file petition for the winding up of the company by the Tribunal ?

4. When does compulsory winding up of a company commence ?

5. Who is an Official Liquidator ?

6. Who is a contributory ?

Essay Type Question :

1. Doctrine of Indoor Management
2. Doctrine of Ultravires. Discuss.
3. What do you understand by the winding up of a company ? What are the various modes of winding up ?
4. State the procedure for the members voluntary winding up of a company.
5. Who is a contributory ? What is the nature and extent of his liability ?
6. Describe the duties and powers of liquidator appointed by the Tribunal ?

20.13 Reference Books :

1. Sen Mitra - Commercial and Industrial Law
2. Gulshan, S.S & Kapoor, G..K. - A Handbook of Business Law
3. M.P.Vijay Kumar - Business and Corporate Laws

- Dr. M.Vijaya Lakshmi