29

S231

Directorate of Distance Education

L
A
W

B.G.L., First Year

Paper-2
BUSINESS LAW - II

MADURAI KAMARAJ UNIVERSITY
MADURAI - 625 021

Re Printed at SUN PRINTER, MDU-16. Ph 2603465 Yr. 2012-2013 - Copies 500

Dear Student

It is really a matter of pleasure and pride to see you on the roll of the Directorate of Distance Education for the Bachelor's Degree in General Law (B.G.L) and with great pleasure, we extend to you a warm and cordial welcome to the First Year B.G.L course of Students. Before you go through the pages of this subject, we wish to acquaint you with some particulars.

At the outset, we wish to state that some knowledge of law is indispensable for all persons. An individual is confronted almost daily with situations that demand legal information for correct action. Just as a game of foot-ball or hockey could not be played satisfactorily with out rules to govern the players so life in general and business world in particular could not continue without laws to regulate the conduct of people and to protect their rights.

It is well to add a few comments on " Business Laws – II ", detailed analysis of which will be given in the succeeding units, from sunrise to sunset every one of us will be entering into a number of contracts without our least knowing it and hence it is a truism worth mentioning that contract is the foundation of the civilized world. The law of contract which is enshrined in the Indian Contract Act, 1872 owe much to the English Common Law. To its credit, the Act has completed more than a century of its magnificent existence on the statute book. General principle of Contracts including Specific Relief Act given under the Business Laws-I, Commercial contracts like Indemnity, Guarantee, Bailment, Agency, Sale of Goods. Partnership and Negotiable Instruments are discussed in the Business Laws – II (Special Contracts). Besides law relating to Formation of Companies is also added in this Subject, to give you a brief idea about the formation of a company.

Business Laws-II is one of the six subjects for the first year B.G.L course. We spare no pains in enabling you to equip yourself both for the examination and for the pursuit of knowledge. We earnestly hope that your sincere efforts combined with your sustained work and co-operation would bring rich dividends for all concerned.

For your convenience, the subject, the Business Laws-II is divided into 10 Units. The syllabus for the same is given separately. Besides reading these units you are expected to go through the prescribed books also. The D.D.E. has arranged contact seminar classes in different centres in Tamil Nadu, depending upon the students enrolled for the course in each centre. You are requested to attend the classes regularly.

Looking forward to your co-operation and with best wishes.

Department of Law

PAPER - 2
BUSINESS LAWS – II

SYLLABUS

Contract of Indemnity: Definition – English and Indian laws, Distinction between indemnity and guarantee- Rights of the indemnity holder- Rights of the indemnifier – Implied indemnity dealt in secs. 69, 145, 164 & 222 of the Contract Act.

Contract of Guarantee – Definition – English and Indian Laws – Essentials and nature of guarantee – Distinction between guarantee and indemnity – Guarantee and insurance – Element of consideration in a contract of guarantee – Nature and quantum of surety's liability – Kinds of guarantee and their incidents – Suretyship arises on contract and not on notice – Position in English law – Duty of disclosure in guarantee – Rights of surety against principal debtor – Creditor- co-sureties difference in English law – Circumstances in which a surety is discharged.

Bailment: Definition – Indian and English – Essential of bailment and classification of bailment – Distinction between and pledge, sale, agency – Rights and duties of the bailor and bailee – Difference in English law – Finder of lost goods – Rights and liabilities – Difference in English law – Pledge – Definition – Rights of the pawnor and pawnee – Pledge by non owners – Lien – Kinds of lien, their nature and incidents – Even how lost.

Agency: Definition of contract of agency- creation of agency – Kinds of agency – Distinction between agent and servant and independent contractor – Who may be agent – Kinds of agents – Authority of agent ostensible and emergrncy delegation of authority – Delegatus non potest delegare – Sub-agent – Substituted agent – Effect of notice to agent, necessary conditions to bind the principal – Essentials of ratification and its effects – Rights and duties of an agent – Rights and duties of the principal. Principal and third parties – The doctrine of undisclosed principal and concealed principal – Termination of agency and when it becomes irrevocable.

Sale of Goods Act: Definition of sale and agreement to sell – distinction between sale and agreement to sell contract of work and labour – hire purchase agreement – bailment – exchange – gift. – Definition – goods – specific goods – future goods – mercantile agent – document of title to goods. – How is sale made – rule for fixing price and effect of goods getting damaged or perished in a contract of sale. – Stipulation as to time and other stipulation – Conditions and warranties – effects of breach when condition is treated as warranty – Rule as to passing of property – Sale by non-owners exceptions to Nemo dat quod non habet- Rules as to delivery – Unpaid vendor – his rights, lien and stoppage in transit – Remedies available to seller and buyer – Auction sale.

Partnership: Definition of partnership- essential of partnership – tests of partnership - Distinction between partnership and co-ownership – Joint Hindu Family incorporated companies – contract of service – legal notion and mercantile notion – Kinds of partners and duration of partnership- Mutual rights and duties of partners – Minor as a partner differences in English Law – Right of legal representatives and surviving partners. Authority of the partner implied and emeregency – Liability of the partner for the acts of the firm and for wrongful acts of other partners – nature of liability – Principles of Agency in partnership – Partnership property- test – Settlement of accounts good will and its disposal – distribution of assets – Retirement of partners – Dissolution of firm and circumstances – Effects of non-registration of firm.

Negotiable Instruments: Definition: Promissory not-bill of exchange- cheque negotiable instrument – drawee in case of need – acceptor for honour – holder – holder in due course-inchoate instrument-indorsement- payment in due course- inland and Foreign instruments – Distinction between promissory note bill of exchange – cheque – negotiability and assignability instrument executed in a representative capacity – Liability of drawer-maker-acceptor and endorser- consideration in negotiable instrument and accommodation- Kinds of indorsement and their effect. Effect of fraud and forgery in negotiable instrument- Rules of presentment of acceptance and payment- presentment when unnecessary- Different modes of discharge including material alteration – Dishonour of bills and notice of dishonour – Noting protest for better security- Acceptance for honour and reference in case of need- Rules as to payment of compensation-special rules of evidence-presumption and estoppel-Crossing of cheques – kinds of crossing and their effect marking of cheques- Protection to paying and collection bankers- Bills in sets- nature and incident- Rules in International Law governing negotiable instruments.

Company Law – Procedure of Formation of a company – Promotor, Incorporation Memorandum of Association Articles of Association – Prospectus.

Books for Study:

1.	Sale of Goods Act	-	Avtar Singh
2.	Indian Contract Act	-	R.K.Bangia
3.	Partnership Act	-	Avtar Singh
4.	Negotiable Instruments Act	-	Khargarmwala
5.	Mercantile Law	-	N.D.Kappor
6.	Mercantile Law	-	Das Gupta

SCHEME OF LESSONS

UNIT – 1

CONTRACT OF INDEMNITY AND GUARANTEE

INTRODUCTION

Ses.124 to 147 of the Indian Contract Act deals with the contract of indemnity and contract of guarantee. Indemnity is protection against loss. It is a promise to compensate a loss. The definition covers indemnity for loss. caused by human agency only. i.e. by the conduct of the promisor or by any other person. In a contract of indemnity there are two parties namely, indemnifier and indemnified or indemnity holder. What are the rights of indemnity holder when used, is discussed in the lesson.

A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default.(Sec 126) The object of a contract of guarantee is to enable a person to get a loan or to get goods on credit. There are three parties in a contract of guarantee, namely, debtor, surety, principal debtor and creditor. The difference between contract of indemnity and guarantee have been explained in the lesson. The parties to the contract of guarantee have certain rights and liabilities. Regarding surety's liability it is always secondary in the sense that the surety is liable only on default of the principal debtor.

The liability of the surety is also co – extensive with that of the principal debtor. This is explained in sec.128 of the Indian Contract Act. A surety is discharged from liability where the suretyship is void or voidable on account of some defect in the contract. The other modes of discharge of surety have been explained in this lesson, with illustrations and case laws.

The creditor must strictly comply with the terms of the contract of guarantee and if he changes the terms of the contract without consent of the surety will be released from his liability. Hence he is called as 'favored debtor'.

The general principles of the law of contract, are applicable to contract of indemnity and guarantee, bailment, Agency, sale of goods, and partnership contract also. Over and above those general principles, there are certain special rules and principles relating to these special types of contract which we are now going to discuss, one by one in Business Law – II subject.

OBJECTIVES

After studying this unit you will be in a position to understand the following features :

- Contract of Indemnity – Definition
- Implied Indemnity
- Rights of Indemnity holder
- When liability commences
- Contract of guarantee – definition and essential features
- Difference between Indemnity and guarantee
- Consideration for contract of guarantee
- Surety's liability
- Revocation of continuing guarantee
- Rights of surety
- Discharge of surety.

UNIT STRUCTURE

1.1 CONTRACT OF INDEMNITY - DEFINITION

Section 124 and 125 of the Indian Contract Act deals with the law relating to indemnity.“ A contract by which one party promises to save the other from loss caused t him by the conduct of he promisor himself or by the conduct of any other person is called contract of indemnity”. Contract of indemnity is really a part of the general class of contingent contracts.

The person who promises or undertakes to indemnify or to make good the loss is called ‘indemnifier’ and the promisee or whose loss is made good, is called ‘indemnified’.

Illustration: A contracts to indemnify B against the consequence of any proceedings which C may take against B in respect of a certain sum of Rs.1000, This is contract of indemnity.

1.2 CONTRACT OF INDEMNITY UNDER ENGLISH LAW

In English law "indemnity" is defined as a promise to save another harmless from the loss caused as a result of a transaction entered into at the instance of the promisor". Thus it is a contract of indemnity as a direct engagement between two parties whereby one promises to save an another harmless from the result of the conduct of the promisor himself or of any third person. The definition of indemnity in English Law is much wider than the former includes promise to save a person harmless from loss resulting not only from the conduct of the promisor or third person, but also from loss caused by events or accidents like death, disability, destruction by fire, cyclone etc., which do not depend on the conduct of any human being. Section 124 does not in term cover promises relating to losses arising from such accidents. Further Sections 124 and 125 deal only with express promises of indemnity.

A contract of indemnity must satisfy all the essentials of an ordinary valid contract. The object of entering into contract of indemnity is to protect the promise against anticipated loss. The contingency on which the whole contract of indemnity depends is the happening of loss. Now according to section 124 of the Indian Contract Act the loss to be made good must be either by the conduct of the promisor himself or by the conduct of any other person, and so if loss is caused by accident or by the conduct of promisee, it would not apparently amount to a contract of indemnity. If this strict view were accepted the contracts of insurance might have to be excluded. It may be submitted that such a strict application of the definition was not intended by the legislature. The Indian courts have, therefore applied the English equitable principles to indemnity for as has been stated in Gajanan Moreshwar V. Moreshwar Madan (1942 Bombay 302) by Chagla,J ... Secs. 124 & 125 of the Contract Act, are not exhaustive of the law of indemnity and that the courts here would apply the same equitable principles that the courts in England do...". In this context we should note that the English definition is more happily worded and the English Law in respect of indemnity has been followed by the Indian courts.

1.3 IMPLIED INDEMNITY

A contract of indemnity may either be express or implied and the latter may be inferred from the circumstances of a particular case. For example: Money paid by A under compulsion of law in respect of liability imposed on B or may be based on the obligation caused by the relationship of the parties, e.g. (the obligation of a beneficiary to indemnify his trustee, the relation between auctioneer and client, principal and agent).

1.4 RIGHTS OF THE INDEMNITY HOLDER

(Sec 125) the person to whom the indemnity is given i.e. the promisee acting within the scope of his authority is entitled to recover from the promisor:

1. All damages which he may be compelled to pay in any suit in respect of any matter to which promise to indemnify applies:

2. All costs which he may be compelled to pay in any such suit if, in bringing or defending it, he would not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity or if the promisor authorized him to bring or defend the suit.

3. All sums bonafide paid in respect of any compromise, provided the promisee has acted as a prudent man and there has been no express direction by the promisor not to compromise.

1.5 COMMENCEMENT OF LIABILITY

Before proceeding to next topic an important question has to be discussed as to when the indemnity be enforced or when does the liability of the indemnifier commences. The definition provided in the section (sec.124) state that the promisee under a contract of indemnity must have suffered loss before he can hold the promisor liable on the contract of indemnity. The happening of the loss is contingency on which the liability of the indemnifier springs in existence.

Under the English common law the original rule was that indemnity was payable only after the indemnity holder has suffered actual loss. The law on this point can be expressed thus, you must be damnified before you claim to be indemnified. But the court of equity held that indemnity holders liability had become then he was entitled to get indemnifier to pay off the claim.

The principles was enunciated in the case Re Richardson Exparte, "The Governors of St.Thomas Hospital In this case it was observed Indemnity is not necessarily given by repayment after payment, indemnity requires the party to be indemnified shall never be called upon to pay".

The principle was followed in the well known case **Gajanan Moreshwar, V. Moreshwar Madan** (AIR 1942 Bom. 302) where Chagla, J. observed when a person contracts to indemnify another and indemnified has incurred absolute liability, he has even without suffering actual loss call upon the indemnifier to place him in a position to meet the liability that may be cast upon.

GUARANTEE

1.6 DEFINITION OF CONTRACT OF GUARANTEE

According to sec 126, "A Contract of 'Guarantee' is a contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee, called the 'surety'. The person in respect of whose default, the guarantee is given called the principal debtor". And the person to whom the guarantee is given called the 'creditor'. A guarantee may be either written or oral.

In English law it is defined as "One in which a person undertakes to be answerable to another for the payment of debt or the performance of some act one the part of a person". e.g. when A requests B to lend Rs.1000 to C and guarantees that C will repay the amount within a stated time, and on C's failing to be pay, he will himself pay B, there is a contract of guarantee. Like a contract of indemnity a guarantee must also satisfy all the essential elements of a general contract. But it has got certain peculiar features of its own.

1.7 DIFFERENCE BETWEEN CONTRACT OF INDEMNITY AND CONTRACT OF GUARANTEE

A contract of indemnity is a single contract between two parties only, i.e., the indemnifier and the indemnified. On the otherhand in a contract of guarantee, there are three parties the creditor, principal debtor and surety.

In indemnity, the person giving the indemnity is primarily liable to the promise. In a guarantee, the surety's liability is secondary, the primary liability being that of the principal debtor.

In English Law, a contract of guarantee should be in writing as required by sec.4 of the Statue of Frauds, while a contract of indemnity need not be in writing. But according to Indian Law, both the contracts of indemnity and guarantee are valid whether they are written or oral.

In indemnity the indemnifier promises to save the indemnity holder from a contingent risk. But a surety agrees to discharge the liability of the principal debtor which is not contingent but subsisting.

In a contract of guarantee where a surety discharges a debt, payable by the principal debtor to the creditor, he on such payment, becomes entitled in law to proceed against the principal debtor for reimbursement in his (surety's) own name.

But in the case of contract of indemnity, the indemnifier cannot even after paying the indemnified, sue those third parties in his own name unless there is an assignment of the right from the indemnified – **Periyamanda Marakkayar v.Banians & Co.**

A contract of guarantee is to provide necessary security to the creditor against his advance but a contract of indemnity is made for the reimbursement of loss". Surety gives guarantee only on the request of the debtor but the indemnifier need not necessarily on the request of the debtor.

Illustration: C and D go to a shop – keeper : (1) "Let him (D) have the goods. I will see you are paid". The contract is one of indemnity (2)"Let D have the goods, and if he does not pay you I will". This is a contract of guarantee.

Ranchod V. Shopurji (1940 – 42.L.R.550) sought to emphasize the distinction between contract of guarantee and contract of indemnity.

In this case, the plaintiff had agreed to act as the sub – broker of the defendant who was a broker dealing in shares and securities. The plaintiff agreed to be responsible to the defendant for all business secured by him and for the due payment of all moneys payable with regard to them. The plaintiff also agreed to make good to the defendant all damage that may cause to the defendant in case of an default. When losses occurred in respect of the plaintiff's constituent the defendant settled the same by accepting smaller amounts from them. The plaintiff claimed that he was discharged from his ability. But it was held that the contract was one of indemnity and not of guarantee. The reasoning is that the constituents introduced by the plaintiff not only did not know of the existence of the guarantee but we themselves not in existence, when the said contract was entered into.

A contract of guarantee being a species of contract is subject to all the rules of contract of guarantee procured by fraud will not be enforced. The illustration cited earlier for both the contract of guarantee and indemnity may be looked into. We notice that in a contract of guarantee there are three separate contracts given rise to a triangular relationship. These are: (1) between the creditor and debtor, creating the debt, (ii) between the surety and the creditor creating a liability of surety in case of in case of debtor's default, and (iii) an implied contract between the surety and the debtor will indemnify the surety after the latter has paid the creditor on the debtor's default. Contracts of guarantee is usually entered into (a) to secure the performance of something which may be immediately related a mercantile transaction or (b) to secure the good conduct of another person who is to be appointed to some office (c) secure some one from injury arising out of some wrong committed by another. English law explaining this point clearly, says " A guarantee is a promise made by one person to another to be collaterally answerable for the debt, default or miscarriage of a third person". In *Jagjivandas v King Kamtion & Co* (1931 – 35, Bom. 661). It was held that to constitute a guarantee however it is not necessary that surety must undertake to be personally liable for the default of the principal debtor, it would be sufficient if a person deposits documents of his property by way of security with the creditor.

1.8 GUARANTEE NOT A UBERRIMAE FIDEI CONTRACT

The contract of suretyship is not a contract "uberrimae fidei" i.e. one requiring complete disclosure of all materials facts by the principal debtor, or the creditor, or the surety before the contract is entered into by them. Still the surety is entitled to know as much as the contract will tell him what the transaction is for which he is making himself answerable. But any guarantee which a creditor obtains by means of misrepresentation, express or implied or by keeping silent about matters relating to any material part of the transaction shall . be valid and the surety in this case cannot be held responsible for the defaults of the principal debtor (Secs 142 and 143). A situation of the above given kind exists where an employer continues to employ the principal debtor, but fails to tell the surety is a defaulter, thus representing him to be honest. The surety will be discharged from the contract of guarantee. A creditor is in possession of unusual and important facts must impart those facts to the surety at the time the contract is made. The courts deem it unfair to permit a creditor to take advantage of a suretyship contract when he knows that the surety is unwillingly assuming an unusual risk.

It is however, not every disclosure that a surety can require. Thus when a guarantee is given to a bank. It is under no obligation to inform the surety of matters affecting the credit of the debtor, or if any circumstances connected with the transaction which render the position of the surety more onerous. The rule is that the creditor need not offer information if the surety has equal opportunity to discover such facts. But if the guarantee is in the nature e.g. fieldity guarantee, all materials facts must be disclosed otherwise the surety can avoid the contract (*London General Omnibus Co V.Holloway).*

1.9 CONSIDERATION FOR A CONTRACT OF GUARANTEE

Like a contract of indemnity, a guarantee must also satisfy all the essential elements of a general contract. We have noted earlier that there is special feature to be referred to with reference to consideration received by the principal debtor, is sufficient for the surety. In other words, it is not necessary, to support a contract of suretyship, that the creditor should furnish any consideration furnished to the principal debtor. The Sec.127 enacts: "Anything done, or any promise made for the benefit of the principal debtor may be a sufficient consideration to the sure by for giving the guarantee".

Illustrations: (a) B requests A to sell and deliver to him goods of 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 promise to deliver the goods. This is sufficient consideration for C's Promise. In other words the determinant suffered by A, selling goods to B at C's request is sufficient consideration for C's promise.

(b) A sells and delivers goods to B.C afterwards requests A forbear to sue for the debt for a year and promises that if he does C will pay for them in default of payment B, A agree to for bear requested. This is a sufficient consideration for C's promise.

(c) A sells and delivers goods to B.C, afterwards without consideration, agrees to pay for them in default of B. The agreement is void. The reason is that the promise of C is subsequent to the contract between the creditor A and the principal debtor B. Here there must be some extra consideration to support it, e.g. forbearance to sue, reduction of interest, etc., and the original consideration between A and B will not suffice.

The words "anything done" in sec 127 suggest that the past consideration is a sufficient consideration for a contract of guarantee. Consideration for a contract of guarantee has thus got certain peculiar features of its own. This is nothing but an application of the wider principle that in all cases of contract the really necessary element of consideration is the legal detriment incurred by the promisee at the promisor's request, and it is immaterial whether there is or is not any apparent benefit to the promisor.

Like any other contract, a contract of suretyship may be invalidated by total failure of the consideration as where the consideration for intended guarantee was postponing the sale of the debtor's goods, but the creditor was unable to stop the sale for want of the consent of other necessary parties, or where the consideration was withdrawal of a criminal prosecution against the debtor, but the court would not sanction the withdrawals as the offence was not compoundable.

Where A advanced money to B on a bond hypothecating B's property and mentioning C as surety for any balance that might remain due after realization of B's property and C was no party to the bond, but signed a separate surety bond two days subsequent to the advance of the money, it was held that the subsequent bond was void for want of consideration.

Special mention with regard to contractual capacity may be made here. The surety and the principal debtor are distinct persons and they must be persons competent to contract and also the principal debtor must be person capable of binding himself by the contract otherwise he will not be liable. It so happens that the surety is competent to contract, but the principal debtor is not: (e.g. if he is a minor or a lunatic) then the surety will be bound by his contract and liable to pay the creditor on default of the principal debtor. Further, the contract between a creditor and surety, being a collateral, secondary, accessory or contingent, undertaking to discharge the debtors liability, the surety will not be discharged from liability, even though the promise of the principal debtor is void on the ground of his incapacity to contract or as being ultra vires his powers. The promise of surety in such cases will be the principal contract, and is perfectly valid and enforceable. So where A sells and delivers goods to B, a minor and C a surety guarantees the payment of the price of the goods, on default of B the contract between A and B is not enforceable. So A is entitled to sue C, even though he may not be able to sue B. Also a discharge of the principal debtor by operation of law does not discharge the surety.

1.10 GUARANTEE AND CONTRACT OF INSURANCE

The contract of insurance although is an aleatory contract, depending upon an unforeseen event it is not a wagering or a speculative contact. The underlying principle of the law of insurance is to indemnify the insured what he lose by the happening of the event upon which the insurer's liability is to arise , and in no case is the insured entitled to make a profit of his loss. By applying the principle of indemnity many problems arising on insurance contract can be solved. But we find an existing debt of duty in the case of guarantee the performance of which is guaranteed by the surety, while in an insurance it is a promise to make good any loss or risk of any loss that may happen.

It is essential that in a contract of insurance the element of "insurable" interest should exist. But in a guarantee it is enough that there is valid consideration and consideration to the principal debtor will be sufficient to support the promise of the surety.

A contract of insurance is strictly one of "uberrima fidei" i.e. a contract based on utmost good faith whereas a guarantee is not so.

The principle of subrogation is applied in the contract of guarantee in the sense that the surety after discharging the debt payable by the principle debtor the surety on such payment can sue that principal debtors for reimbursement. The insurer cannot in his name sue third of his default.

The loss caused in contracts of insurance is mainly due to some accident or uncertain event and not as a result of the act of the promisor or any other party. In a contract of guarantee it is an agreement to perform the promise or discharge the liability of a third person in case of his default.

Having noted and considered this aspect in detail, we now proceed to deal with the nature and quantum of surety's liability.

A contract of guarantee presupposes the existence of three parties. We have considered that the liability of the surety is 'secondary, accessory, collateral and contingent". But he is called a "favoured debtor" and can demand strict compliance with the terms of the suretyship".

1.11 SURETY'S LIABILITY

According to Sec 128, " the liability of the surety is co – extensive with that of the principal debtor, unless it is otherwise provided by the contract".

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

Maharaja of Benares v. Har Narani Singh:- (1905) (28) All – 25) A guarantee to C the payment of rent becoming due from B to C. B fails to pay the rent. A is liable for the rent but not for interest on the rent, unless the bond contained such words as with interest there on".

The scope of surety's liability: This section limits the liability of a surety unless the contract provides otherwise. The word " Co – extensive" indicates that the liability of the surety will be the same as that of a principal debtor. In other words the quantum of obligation of the surety will be the same as that of a principal debtor, he is jointly and severally liable with the principal debtor. Where the principal debt is illegal or is unenforceable, the principal debtor and guarantor are not liable. When the principal debtor is not liable on the principal debt, surety is also not liable. In case the principal debtor is discharged by the creditor's breach, surety will not be liable.

We may cite the Madras High Court decision on this point *Subramanyan V. Narayanasmy :* 1951 Madras 48 F.B. A fullbench of the Madras High Court accordingly held overruling the decision in **Subramaniam v. Batcha Rowther** 1941, 2. M.L.J.751, that when a debt is scaled down under the Madras Agriculturists Debt Relief Act, 1938 the surety is liable to pay the creditor only the reduced amount. One inevitable point we may arrive at from the above is that when the principal debt is wiped out or reduced by legislation, the liability of the surety would also be extinguished or correspondingly reduced to the same amount.

The surety guarantees the due discharge of the principal debtor's liability on the default of the principal debtor. The better view is neither the creditor is bound to give any notice of the default of the principal debtor to the surety nor to exhaust all the remedies available to him as against the surety through the principal debtor has been sued. It follows that the surety's liability depends upon the terms of the contract. Above referred provision of the law, is clear and settled. The present section is just re – enactment of the Common Law.

As already noted the liabilities of the two parties are distinct and separate, arising from different contracts, it does not follow conversely, that a surety can never be liable when the principal debtor cannot be held liable. Therefore, when the contract between the creditor and the principal debtor is void, as in the case of a minor's contract in India or the contract between the two parties was avoidable at the option of the former, and was avoided by the former, surety will not be discharged from liability. He shall be held liable as a principal debtor. A surety who is a "favoured debtor", continues to be held liable even when the claim against the principal debtor within the period of limitation does not discharge the surety.

But a document which releases the principal debtor without expressly reserving the creditor's right against the guarantor, the guarantor would be also released from his liability. This rule is subject to one qualification i.e. it does not apply to a release by operation of law. But as we have seen before, the creditor varies the terms of the contract without the consent of the surety, he will be released from liability.

The surety being a favoured debtor, can very well insist on a rigorous adherence to the terms of suretyship contract. "A surety is undoubtedly and not unjustly, an object of some favour both at law and at equity". (Lord Elborne) He is a person who is guaranteeing the due discharge or performance of an obligation standing against a third person.

1.12 LIABILITY FOR WHOLE OR PART OF DEBT

There is an important distinction to be observed as to guarantee limited in amount. It is a question of intention of the parties, whether a guarantee is on the whole debt subject to a limit, or part of the debt only. The leading case of **Ellis v. Emanuel** lays down that in the case of floating balance debtor to the creditor the guarantee is as between the surety and the creditor to be construed both law and in equity, as applicable to a part of the debt only. But if the liability, in respect of a portion of which the guarantee is given, is a fixed and ascertained sum, then prima facie the contract of guarantee should be construed as one for the whole debt subject to the limit.

Illustration: A owes B Rs.5000/- and C has stood surety for Rs.3000/-. A question may arise whether C guarantees, only Rs.3000/- out of Rs.5000/- or the full amount of Rs.5000/- subject to the limit of 3000/-. If C has guaranteed only a part of the debt and only a divined of 25paise in the rupee; B can recover Rs.3000/- from C and Rs.500/- from A's estate, while C can claim Rs.750/- from As's estate. The point to be noted is that surety can prove, in the insolvency of the principal debtor as the amount guaranteed by him has been paid. If on the other hand C has guaranteed the whole debt subject to a limit of Rs.3,000/- then B can recover from CRs.3000/- and from A's estate a divined on the entire sum of Rs.5000/- viz. Rs.1,250 and he cannot claim any divined unless and until B has been fully paid.

The rule given above are subject to variation by a contract between the parties. Thus by means of an express contract a surety can even in the case of floating 0balance, hold himself liable for the whole debt subject to a limit.

1.13 KINDS OF GUARANTEE AND THEIR INCIDENTS

A suretyship may be intended to cover a single transaction alone as is given for a single debt. It comes to an end and when the debt guaranteed has been paid. In such case it may be called a "specific Guarantee". It may again, be a

"Continuing Guarantee". When it extends to a series of distinct and separable transactions. A continuing Guarantee is defined as "one which extends to a series of transaction, and is not exhausted by or confined to a single credit transaction". Whether in a particular case a guarantee is continuing or not depend on the language they have employed, the subject matter and the surrounding circumstances. Sec.126 of the Indian Contract Act defines a continuing guarantee as " a guarantee which extends to a series of transactions".

Illustrations: (a) A, in consideration that B will employ C in collecting the rents of B's estate, promises B to be responsible, to the amount of Rs.5000 for the due collection and payment by C of those rents. This is a continuing guarantee.

(b) A guarantees payment to B a tea dealer, the amount of Rs.1,000 for any tea he may from time to time supply to C. B. supplies C with tea to the value of Rs.2000 C fails to pay. The guarantee given by A was a continuous guarantee, and he is accordingly liable to B to the extent of Rs.1, 000 only.

(c) A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month b delivers fiver sacks to C. C pays for them. Afterwards B delivers four sacks to C which C does not pay for. The guarantee given by was not a continuing guarantee and accordingly he is not liable for the price of the four sacks.

The guarantee of the faithful discharge of his duties of one appointed as a clerk in a bank does not amount to a continuing guarantee. This is because it relates only to a single transaction and not to a series of transaction.

1.14 REVOCATION OF CONTINUING GUARANTEE

A continuing guarantee may be terminated or revoked as to future transactions in the following manner; (i) by notice to creditor (Sec 130) (ii) by death of surety (Sec 131) (iii) by variance in the terms of the contract between debtor and creditor (Sec 133).

1.14.1 Notice to the creditor

Sec.130: A continuing guarantee may at any time be revoked by the surety, as to future transaction, by notice to the creditor. This principles implies and is applicable only to cases where a series and separate transaction is postulated. The words "future transaction" – must be taken to imply the above view.

The following illustration will make the position clear : A in consideration of B's discounting, at A's request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 5,000 Rupees. B discounts bill for C to the extent of Rs.2,000/-. Afterwards, at the end of three months. A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 2000 Rupees on default of C.

1.14.2 By death of surety

Sec. 131: The death of the surety operates in the absence of any contract to the contrary, as a revocation of continuing guarantee, so far as regards future transactions. The above rule is applicable only in the absence of any contract to the contrary. An express provision that a guarantor or his representative may determine the guarantee by notice is an example of a contract to the contrary to such case more notice of the death is not enough.

1.14.3 By variance in the terms of contract

Sec. 133: Any variance made without, surety's consent, in the terms of the contract between the principal debtor and creditor, discharges the surety as to transactions subsequent to the variance. This would be explained further when dealing with the question of discharge of surety.

Illustrations: C agrees to appoint B as his clerk to sell goods at a yearly salary: upon A's becoming surety to C for B's duly accounting for money received by him as such clerk. Afterwards without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. A is not liable for subsequent misconduct of B. In the case Lloyds v Harper, A's son was employed by Lloyds and A guaranteed the faithful discharge of his son's duties. A died and the question arose whether thereby the guarantee had come to an end. It was held that it did not come to an end. The reasoning is stated as: The contract, in the given case is not really a continuing guarantee, for the consideration is entirely supplied at one time secondly, even assuming that it is a continuing guarantee, a contract to the contrary within the meaning of Sec. 131 may be implied.

Khatun Bibi v. Abdullah: A guaranteed the payment of rent by B under a lease granted by C. Subsequently C enhanced the rent. It was held that A was discharged from his suretyship in respect of the arrears as to rent accruing after the date when the altered terms as to rent came into force.

We now turn to discuss the rights and duties of parties under a contract of guarantee. As already noted the parties coming under this type of contract are; (i) the creditor (ii) the principal debtor and (iii) the surety (called as "favoured debtor")

1.15 RIGHTS OF SURETY

(i) Surety's rights against the creditor: English law upon this point is clear and protects the rights of surety effectively. The Contract Act on this aspect lays down a general principle of which the most important application is intended to keep alive for surety's benefit any rights of the creditor.

According to English law, where there are two joint promisors, (debtors) and inter se one of them is the principal debtor and other the surety, and the promisee (creditor) has knowledge of that fact, the person who is not the principal debtor is clothed with all the rights of a surety against the creditor. This is the principle laid down in **Rouse v. Bradford** Banking Co (1894) A.C. 586. But sec. 132 of the Indian Contract Act is different. If A and B make a joint promissory note to C and even if C knows that at the time when the note is made, A is the principal debtor and that B is (A's) surety, still C may proceed against B, as if B is the principal debtor. B is entitled to claim any of the rights of surety because mere notice of the fact is not sufficient. In Indian law, the question now is then how can he claim his privileges as a surety. The answer is that there should be an agreement between the surety and the creditor, whereby the latter agrees to make the former liable only in the event of a default by the principal debtor. When there is such an agreement the surety will be entitled to claim the following rights against the creditor.

1) After the guaranteed debt has become due, and before the surety is called upon to pay, the surety may 'require' the creditor to sue the debtor and recover the

amount – **Rouse v. Bradford** Banking Co, (supra). This right may be called 'quia timet'. However the surety must undertake to indemnify, the creditor for any risk, delay or expense which he may incur by so doing. The surety cannot 'compel', the creditor to sue the principal debtor before suing him.

2) In case of fidelity guarantee like guarantee of conduct, honesty etc., of the principal debtor insist upon the creditor terminating the services and this avoid future losses.

3) On being sued by the creditor, the surety can claim any set off or counterclaim which the debtor c2ould have claimed against the creditor.

4) 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 or without the consent of the surety, parts with such security the surety is discharged to the extent of the value of the security (Sec. 141). The surety is not entitled to claim any rights over securities subsequent given. The law in England in different.

In Forbes v. Jackson 1882 19. C.D. 615, it has been stated as follows. As a surety on payment of the debt, is entitled to all the securities of the creditor, whether he is aware of their existence or not, even though they were given after the contract of suretyship.

In the above given case the fact of the case are as follows, A mortgaged leasehold property and policy of insurance B to secure £200 and interest. C acted as surety. Later A borrowed further sums upto £ 500 from B and charged them on the same property. C was not aware of this. On default of A, C, paid £200 with interest and insisted to have the policy and the property assigned to him. B declined claiming the payment of the sum £500 also. It was held that on payment of £200, C was entitled to have both securites.

Govardhandas V. Bank of Bengal (1890) 15 Bom.48, it was held that a surety who has guarantedd a debt was not entitled to the benefit of a position of the creditors securities until the whole of the debt due was paid. According to the English decision in *Goodwin v. Gray* 1874 22 W.R. 312 the position is different.

The above rule is treated as untenable under English law. Where a surety has guaranteed by him, according to English law, entitled to all the rights of the creditor in respect of the amount, and to share in the security held by the creditor for the whole debt. The Madras High Court in Bhusayya v Suryanarayan (1944) Mad. 340 applied this principle.

1.15.2 Rights of surety against the principal debtor

(1) When the surety performs what he has agreed or undertaken under the contract of suretyship he is invested with all the right of the creditor which he can himself exercise against the principal debtor. This is called the right of "Subrogation". Sec. 140 embodies this principal. When a guaranteed debt has become due or default of the principle 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."

We may note in this section that either there must be a payment or performance and not a mere promise to pay and such payment or performance should be of the entire debtor liability, and not a part of it before the right of subrogation is acquired. No assignment of the securities is required to sue in his own name.

(2) We have equated the surety for all purposes to a "favoured debtor". The obvious reason for giving him favoured treatment would be clear from the following secsion.

Sec. 141 lays down : "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 or without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security".

(3) Implied promise to Indemnify the surety : 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 Isec. 145).

A surety can, before the payment has been made, compel the debtor to relieve him from liability by paying of the debt. The liability referred to is an ascertained and subsisting one.

1.15.3 Rights of surety against Co-Sureties

When there are other cosureties it is inequaitable to compel one co-surety to pay the entire debt of the principal debtor. As between co-sureties there is to be equality of the burden and the benefits." As already said, the surely can claim contribution for the excess amount paid by him. There should be equality of the burden and the benefits as between co-sureties. A surety who has paid more than his share of the debt to the principal creditor is entitled to the contribution from his co-sureties. But one qualification to the above right is that he must bring into account all securities he has received from the creditor in respect of the debt.

Where two or more persons are co-sureties for the same debt or duty either jointly or severally, and whether with or without the knowledge of each other, the co-securties 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 that part of it which remains unpaid (Sec. 146).

2) Co-sureties who are bound in different sums are liable to pay equally so far as the limits of their respective obligations permit (Sec. 147).

The English law on this point in different. According to English law where the co-sureties have agreed to become liable in different sums, they are bound to contribute proportionately. Indian Law Provides equality of payment so far as the limits of their respective obligations permit.

Illustration: A and B are two sureties for the liability of C, and A agrees to be liable to the extent of Rs.1000-and B to the extent of Rs.2,000/-C makes default of payment to the extent of Rs.1,500/-. According to Indian Law, A will have to pay Rs.750/- and B will have to pay Rs.750. But according to English Law. A will have to pay Rs.500 and B will have to payRs.1, 000/-.

1.16 DISCHARGE OF A SURETY

Surety will be discharged from his liability in the following cases: Broadly speaking they may be classified under three headings 1) Suretyship itself being void or voidable, on account of some detect in the contract, 2) Where suretyship is revoked 3) Where the creditor is guilty of improper conduct.

1.16.1 Suretyship itself being Void or Voidable

As we have already seen, a contract of suretyship is not a contract of uberrima fidei. Still the law requires that the surety shall be entitled to know as much as of the nature of transaction. Any guarantee that 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 (Sec. 142).

Where the guarantee is obtained by keeping silence as to material circumstances, it is also invalid. (Sec.143). The expression "keeping silence" limits the operation of this section to cases of willful or international concealment as distinguished from mere non-disclosure.

1. Where a person gives a guarantee upon a contract that a creditor shall not act upon it until another person has joined in as co-surety the guarantee is not valid if that one person does not join (Sec. 144). This section provides that any condition precedent to the liability should be satisfied before the surety is made liable. If he is one among the several co-sureties, he will not be made liable unless the others also join the suretyship.

2. Where the Suretyship is revoked: The distinction between "Specific" and "Continuing" guarantee have been noted and where the contract of suretyship relates to a single transaction (i.e. specific guarantee) then if the liability is incurred, it is not possible to revoke the guarantee given. But, if the liability has not been incurred. It can be revoked by notice. But in the case of continuing guarantee, which extends to a series of transactions the contract may be revoked either by notice or by death of the surety as to future transactions.

3. Where the creditor is guilty of improper conduct: The surety will be discharged of his liabilities the following circumstances recognized by law.

4. Variance in the terms contract: Where the terms of the contract between the principal debtor and the creditor are varied by the creditor. with consent of the surety. (Sec. 133)

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

A surety will be discharged if the creditor allows the amounts to be altered by one guarantor without the consent of others when several persons have agreed to become co-sureties for different amounts.

Ellesmere Brewery Cov Cooper (1896, 1 Q B 1657) illustrates this point clearly: A firm of brewers employed C and required him to execute a bond with sureties for faithful discharge of his duties. The bond was drawn up on with four sureties, N and E being liable to the extent of 50 each, and P and B to the extent of £ 25 each. P, B and E all signed, but N, who was the last to sign, added 25 only to his signature. The company accepted the bond so signed, Held: none of the sureties are liable on the bond.

Suppose the variation is not total or material or when it is beneficial to the surety, in such cases, whether he is discharged. This point was well discussed in *M.S.Anirudhan v. Thamco's Bank Ltd* (1963 I.S.C.R. 63).

i. The facts are the defendant guaranteed the repayment of a loan of Rs.20, 000 given by the plaintiff bank to the principal debtor. But the guarantee paper showed the loan amount to be Rs. 25,000 and the bank refused to accept it. Then the debtor reduced the amount to Rs.20,000 without the consent or intimating the same to the surety. He gave the deed to the bank which was accepted. The principal debtor failed to pay and the bank sued the surety. The important question was whether he was discharged, by such alteration. It was held by a majority that unsubstantial alterations, which are to the benefit of the surety do not discharge him from the liability.

ii. Release or discharge of principal debtor: A surety is discharged by any contract between the creditor and the principal debtor by which the principal debtor is released or by any set or omission of the creditor, the legal consequence of which is the discharge of the principal debtor (Sec. 134).

It is to be observed with regard to this section that if the creditor accepts the compromise suggested by the debtor surety will be discharged. But mere forbearance on the part of the creditor to sue the principal debtor, or to enforce any remedy against him does not, in the absence of contrary, to the contract discharge the surety (Sec.137). But a discharge of the principal debtor in bankruptcy does not operate as a discharge of the sureties. This act is not attributable to any act or omission of the creditor; as it relates to a release by operation of law.

iii. The surety is discharged where a contract is entered into between the creditor and his principal debtor, by which the creditor makes a composition with, or promises to given time to or not to sue, the principal debtor. If the surety by his bond enters into agreement with the creditor to the contrary he will not be discharged under Secs. 134 and 135. The general principle under Sec. 136 may be stated thus; a promise by the creditor to a third person, to give time to the principal debtor, would not discharge the surety. (iv) Where the creditor, without the consent of the surety, loses or parts with the securities belonging to the principal debtor, the surety is not held liable and he is discharged of his liability (Sec.141).

iv. Impairing surety's remedy: 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 surety requires him to do and the eventual; remedy of the surety himself against the principal debtor is thereby impaired; the surety is discharged. For example if A introduces B an apprentice to C and A guarantees B's fidelity, and C promises in his turn to verify the cash and check the accounts, but C omits to do so, and B embezzles. A will not be liable on his contract of suretyship.

1.17 DIFFERENCES BETWEEN ENGLISH LAW AND INDIAN LAW:

For the convenience of the students these differences are hereunder summarized :

1. In England the death of surety does not *ipso facto* operated to revoke the guarantee as to transactions entered into with the creditor without notice of the death. 2. In order to discharge the surety on grounds of variance in the contract, such variance must be a material one. 3. Release of one surety by the creditor shall discharge the others from liability. 4. An act or omission of creditor impairing the

Check Your Progress

1 Define Indemnity What are features of contract of indemnity of indemnity?
2 What are the different kinds of indemnity?
3 What are the rights of indemnity holder?
4. Define contract of guarantee and state the essential features of guarantee
5. When a continuing guarantee could be revoked?
6 What are the rights of surety against co-sureties?

surety's eventual remedy entitles him only to a proportionate revocation of the claim against him. 5. A creditor in England is under no obligation to disclose all facts in the absence of specific enquiry. 6. Contracts of guarantee in England must always be in writing. 7. The liability of co-sureties is *pro rata* to the liability undertaken.

1.18 SUMMARY

In this unit we have highlighted the scope of contract of indemnity and guarantee. Where two persons enter into an agreement in which one party promises to compensate the loss of the other, then it is a contract of indemnity. Such a loss must have been caused to him by the conduct of the promiser himself or by conduct of any other third person. Under English law the word indemnity carries a much wider meaning than the Indian Contract Act. It includes a contract to save the promises from the loss caused by whatever method. Under English law a contract of insurance is a contract of indemnity.

We have seen that contract of indemnity has two parties, namely, indemnifier and the indemnified. The rights of indemnified has been dealt with Sec.125 of the Contract Act.

In the case of contract guarantee there are three parties, namely principal debtor, the creditor and the surety. The liability of the surety is only secondary. His liability arises only when the principal debtor fails to pay his debt. The differences between contract of indemnity and contract of guarantee have been explained in detail. We hope you have understood the differences.

When a guarantee extends to a series of transactions it is called a continuing guarantee and the method of revocation of continuing guarantee have been analysed. After studying this lesson now you are in a better position to understand the various rights and liabilities of surety. The surety has certain rights against the creditor, the principal debtor and his co-sureties. Regarding surety, his liability is co-extensive with that of the principal debtor. Any change in the terms of contract of guarantee without the consent of the surety releases him from his liability. A surety is also discharged from liability by various modes which have been listed out in the lesson.

1.19 KEYWORDS

Retrospective	-	take effect from earlier date
Revocation	-	withdraw
Novation	-	substitution with new one
Aleatory	-	depending on chance

1.20 ANSWER TO CHECK YOUR PROGRESS

1. Refer 1.1
2. Refer 1.3
3. Refer 1.4
4. Refer 1.6
5. Refer 1.14
6. Refer 1.15.3

1.21 EXERCISE QUESTIONS

A. Short Answer Questions

1. What are the differences between contract of indemnity and contract of guarantee?
2. What are the rights of surety?
3. Explain why surety is considered to be favoured debtor?
4. When surety is discharged from liability?

B. Long Answer Questions

1. Define contract guarantee. Distinguish between contract of indemnity and contract of guarantee.
2. What are the rights and liabilities of the surety?
3. The liability of surety is co – extensive with that of the principal debtor.

UNIT - 2

BAILMENT

INTRODUCTION

When the ownership of goods is with one person and the possession is with another person it is known as bailment. Daily we came across with number of instances such as viz, leaving a cycle in a stand, delivering cloth to a tailor for stitching, depositing luggage in a cloak room etc. Sections 148 to 181 of the Indian Contract Act deals with the law of bailment. The parties to a contract of bailment are bailor and bailee. In the bailment, you must remember that ownership of goods is not transferred from bailor to the bailee. But possession alone is transferred. The rights, duties and liabilities of bailee and rights and duties of the bailor have been elaborately explained in this lesson giving lot of examples so that you can easily understand the legal principles. The laws relating to lien is also analysed. Lien means a right by which a person is entitled to retain the possession of goods another until the sum due to him is paid. L is of two kinds, particular lien and general lien. Who are entitled to these lien have been discussed in this unit. In the topic law of bailment we have also explained and analysed the position of finder of lost goods and what are his rights as provided in section 168 of the Contract Act. Lastly, in the unit, the law relating to pledge or pawn has been explained. It is special kind of bailment, where a thing is delivered as security for the repayment of debt.

OBJECTIVES

To discuss and analyse the following aspects:

- Bailment - definition and characteristics.
- Classification of bailment.
- Rights and duties of bailor and bailee.
- Finder of lost goods - his rights and liabilities
- Law relating to pledge
- Rights of pawnor and pawnee.
- Pledge by non - owners - when valid.
- Law relating to lien.
- General lien and particular lien.

UNIT STRUCTURE

2.1 BAILMENT - SCOPE AND DEFINITION

Chapter XI of the Indian Contract Act (Sees. 148 to 181) relates to the law of "Bailment"

Definition: A bailment, according to Halsbury's Laws of England is "a delivery of personal chattels in trust on a contract, express or implied, that the trust shall be duly executed, and the chattels redelivered, in either original or altered form as soon as the time of use for, or condition on which they were bailed shall have elapsed or performed".

Bailment is defined by Sec. 148 of the Contract Act and it reads; "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 delivering the goods is called the bailor. The person to whom they are delivered is called the bailee". Thus we find the definition given in the Indian Contract Act is also on similar lines as in English law. The above given definitions import the following essential element in a contract bailment 1. There must be a delivery either actual or constructive. 2. of goods. 3. by one person called the bailor, 4. to another person called the bailee, 5. for a specific purpose, and 6. upon a contract that the goods shall be returned in specie either in their original or in altered form or shall be disposed of according to the direction of the bailor.

Explanation to Sec. 148 clarifies the first element i.e., the delivery may be either direct or constructive.

Explanation: If a person is already in possession of the goods of another contracts to hold them as a bailee, he thereby become the bailee, and the owner becomes the bailor of such goods although they may not have been delivered by way bailment.

2.2 NATURE OF THE TRANSACTION

The contract of bailment necessarily involves a change possession - possession in the juridical sense. One who has custody without possession, like a servant or a guest, using his host's goods, is not a bailee. But as noted earlier constructive delivery will create the relation of bailor and bailee. Every one of us will be entering into a number of contracts of bailment, without our least knowing it. Where a watch is given for repair or diamonds are given for being set in a gold ring, the identical watch or identical diamonds, should be returned after the purpose for which they are given has been fulfilled. Whether it be a pledge of a jewel on the security of which money is borrowed or a delivery of goods to a railway company for being carried and delivered to the consigne, only to name a few, one will be entering into a contract of bailment. Obviously no transaction can be a bailment within the Act when a chattel is delivered by mistake, the intention being a different thing.

Bailment is necessarily considered as a kind of contract in most instances where goods are lent or hired or deposited for safe custody or as security for a debt, the delivering will be the result of a contract. However it is not to be assumed that without an enforceable contract there cannot in any case be a bailment. In England the conviction of an infant for the statutory offence of larceny by a bailee has been upheld (R.V.Modonald. 1884, 150. B.D. 324). Similarly under Indian Law it was held that the Government was not a bailee of stolen goods recovered by the police, there being no contract. **(Ram Gulam V. U.P.State A.I.R. 1950 All. 206).** In the same manner where property is deposited in court pursuant to an order passed by it, there is no bailment as the delivery is not pursuant to a contract. **(Mohammed Murad V. Govt.of U.P., A.I.R. 1956 All. 75).** The general principles involving these aspects have been stated by Cheshire and Fifoot in the following lines, "Confusion will be avoided only if it is remembered that bailment is a relationship sui gerneris and that, unless it is sought to increase or diminish the bailee by the very fact of the bailment it is not necessary to incorporate into the law of contract".

R.S. Wright also has given a concise statement of the principles relating to the law of contract of bailment. "In general any person is to be considered as a bailee who otherwise than as a servant either receives possession of a thing from another or consent to receive or hold possession of a thing for another upon an undertaking with the other person either to keep or return or deliver to him the specific thing or to convey and apply the specific thing according to the directions, antecedent or future, of the other person". However, the Supreme Court in **State of Gujarat V. Memon Mohammed** (A.I.R. 1967 S.C. 1885) held that a bailment may arise independent of contract. The Court observed, "Bailment is dealt with by the Contract Act only in cases where it arises from a contract, but it is not correct to say that there cannot be a bailment without an enforceable contract".

A sale differs from bailment in that there is a stipulation in the latter for delivering back the same goods after the purpose for which they are delivered has been accomplished. In a sale there is an absolute transfer of ownership by the seller to the buyer and no question of returning the same goods could possibly arise.

Ashby V. Tolhurst (1937) 2A. E.R.837, sought to emphasis the distinction between Bailment and License where there is no delivery contemplated. The facts in brief were as follows:

A was allowed to park his car at parking place on payment of the prescribed parking fee. It was stolen from there. In an action against the authorities on the basis of bailment, it was held that since there was no delivery of the vehicle in question the relationship created was only that of a licensor and a licensee. Hence authorities were not liable as bailees.

2.3 DEPOSIT OF MONEY

Again, where money is deposited by a customer with a bank, we may note that there is no obligation to return the identical coins which are deposited. Nor can the customer question the use to which it is put. It should be further noted that the relationship is not one of bailor and bailee, but of a debtor and a creditor - **Shanti Prasad v. Director of Enforcement,** (A.I.R. 1962 S.C. 1764).

2.4 EFFECT OF DELIVERY

We have noted above that the delivery may either be actual or constructive. (Refer to Expl. to Sec. 148). Where the whole property is transferred on a contract for an equivalent in money or in other commodities the transaction cannot be in the nature of bailment but one of sale or exchange. The delivery under Sec. 149 of the Contract Act may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee.

Kaliyaperumal V. Visalakshi (A.I.R. 1939 Mad 32): A lady employed a goldsmith for the purpose of melting gold jewellery and making new jewels. Every evening she used to receive the half made jewels from the goldsmith's house of which she retained the key. One night the box was stolen. Held, in s suit by the lady against the goldsmith that he was not liable for the loss of the box. Here there was a re-delivery of the jewels to the lady and they were not in the possession of the goldsmith when during the right they were stolen.

A person who has sold the property in goods to another but is still in possession of the goods can continue possession of the goods as a bailee of the purchaser. This is a case of constructive delivery.

2.5 THE ELEMENT OF CONSIDERATION

Indian Contract Act requires lawful consideration as an element for giving enforceability to an agreement. Usually, in a contract of bailment there will be consideration, by way of money payment by the bailor, as in the case of a watch given for repairs, or by the bailee, as in the case of contract of hire of furniture etc, but such consideration is unnecessary to support the promise of the bailee, to return the goods the so called detriment allegedly suffered by the bailor, cannot be so treated as "consideration in a juridical sense." But the ruling in **Bainbridge V. Firmstone** (1839) has held such detriment suffered by the bailor, in parting with the possession of goods, is sufficient consideration to support the bailee's promise to return them.

In the above case the question related with regard to the parting of two boilers allowing the bailees to weigh them and return them in good condition. In the course of the judgement, Lord Patterson made the following observation "The consideration is that the plaintiff, at the defendant's request had consented to allow the defendant to weigh the boilers. I suppose the defendant thought he had some benefit; at any rate there is a detriment to the plaintiff from his parting with the possession for even so short time."

The scope of this principle was considered by Cheshire and Fifoot in the following rules "Bailment is a relationship sui generis and that it is not necessary to incorporate into the law of contract and to prove a consideration".

The same view was taken in **COGGS V. BERNAD**. The plaintiff declared that defendant had undertaken to remove several containers of brandy from one seller to another but the work was so carelessly done that a quantity of brandy was lost. The defendant contended there was no consideration for the undertaking. Holt. C.J., expressed that "the owners trusting him with the goods is a sufficient consideration to oblige him to a careful management." The rules above suggest that even in a gratuitous bailment the bailee cannot disclaim his obligation to return the goods hailed.

Classification of Bailments

Lord Holt mentioned six kinds of bailments as under:

i) Depositum: A simple bailment of goods by one man to another to keep for the bailors use.

ii) Commodatum: The goods lent to a friend gratis to be used by him and to be eventually returned.

iii) Locatio Rei: When goods are delivered to the bailed for hire.

iv) Vadium: When goods are delivered to the bailee for hire i.e., pawn or pledge.

v) Locatio operis faciendi: Delivery of goods for being transported or something to be done about them by the bailee for reward.

vi) Mandatum: Same as Locatio operis faciendi, but without any reward.

Bailment according to Story may be classified into three main classes.

1. Those for the exclusive benefit of the bailor. 2. Those for the exclusive benefit of the bailee. 3. Those for the mutual benefit of both parties.

In Halsbury's Laws of England, bailments are divided into —

1. Gratuitous i.e., something done for no reward.

2. Non-Gratuitous i.e., for reward.

The Indian Contract Act does not deal especially with these types of bailment. Nor does it follow any special divisions considered above. It makes special reference with the general principles bailment together with the duties, abilities and the rights of the bailor and bailee. It also makes provision for the rights of lien and deals with some of the special types of bailment e.g., pledge and finder of lost goods. The rest are dealt with by separate Acts, e.g., Carriers Act, Railways Act, etc.

We have to consider now, the rights and duties of parties under a contract of bailment

2.6 DUTIES OF BAILOR

2.6.1 Duty of Disclosure

The extent of disclosure depends upon whether the bailment is gratuitous or non-gratuitous. In the former, the bailor should disclose all known faults or defects to the bailee. In the case of a non-gratuitous bailment where it is for consideration, the bailor is liable for loss or damage caused to the bailee even if he was not aware of the existence of such defects. The rule is that in such a bailment there is an implied warranty that it is fit for such use. The point is clearly illustrated in Sec. 150 of the Contract Act.

The bailor is bound to disclose to the bailee the defects 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. If he fails to disclose, he is responsible for damage arising to the bailee directly from such faults. (Sec. 150)

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

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. (Sec. 150). He has to examine the goods and remove such defects as reasonable examination would have disclosed.

Illustration: 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.

In Read V. Dean (1949 I.K.B. 188) the plaintiffs hired a motor launch from the defendant for a holiday on the river Thames. The launch caught fire. The plaintiffs were unable to extinguish the fire since the fire-fighting equipment being out of order. As a result they were injured and suffered loss. The Court held that the defendants were liable.

2.6.2 To Bear Necessary Expenses

The bailee is no doubt in the absence of a contract to the contrary, in case of gratuitous bailment, required to pay the ordinary and responsible expenses of the bailment, while the extraordinary expenses should be borne by the bailor. In case of a non-gratuitous bailment, even the ordinary expenses incurred by the bailee for the purpose of bailment should be borne by the bailor.

2.6.3 To Indemnify Bailee

The bailor is bound to indemnify the bailee for any cost or loss which the bailee may incur because of the defective title of the bailor to the goods bailed (Sec. 164). Because of defective title the bailor is not entitled to make the bailment or to receive back the goods or to give directions respecting them. However if a person other than the bailor claims goods bailed, the bailee may apply to the court to stop delivery of the goods to the bailor, and to decide on the title to the goods.

2.7 DUTIES OF BAILEE

2.7.1 To take care of Goods Bailed

The first and foremost duty of the bailee is to take care of the goods bailed by the bailor, and to return them in their original condition or in a condition altered as per the terms of the contract. The degree of care that is expected of a bailee in different cases of bailment was at one time of great importance in English law, as it was supposed that the degree of care required varied according as the bailment was gratuitous or for reward. But modern English law has discounted with such distinction. Now the law on the point may be said to be the same both in England and India. Sec. 151 and 152 declare a uniform standard of care without even recognizing any distinction between gratuitous and non-gratuitous bailment. Law prescribed only uniform standard of diligence or care of that of an ordinary, reasonable and prudent man would take of his own goods of the same type and under similar circumstance. Sec. 151 reads, "In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would under similar circumstances, take his own goods of the same bulk quality and value as the goods bailed".

Sec. 152 reads as follows: "The bailee, in the absence of any special contract is not responsible for the loss, destruction, deterioration of the thing bailed, if he has taken the amount of care described in Sec. 151".

It may be noted here that the bailee may enlarge his liability by special contract under Sec. 152. From the wordings of sees. 151 & 152 it seems that an irreducible minimum is suggested. But Sees. 151 and 152 are interrelated to each other. The wording under Sec. 151 is unsatisfactory in the same that there is complete absence of words permitting any contract to the contrary and sec. 151 is applicable to all cases of bailment However, there are some cases holding that it is open to a bailee to reduce his liability below the standard fixed by Sec. 151 - **Sheik Muhamed Vs. B.I. Steam Navigation** Co, (1908, 32 Mad 95).

In cases governed by the provisions of Sees. 151 and 152 the loss or damage of goods entrusted to a bailee is prima facie evidence of negligence and the burden of proof, therefore, to disprove negligence lies on the bailee. A person hires a horse for riding in a sound condition and the horse dies the same day while it is in custody. It is for the hirer to satisfy that due care has been used both generally and in respect of the horse.

It is clear from the above sections the standard of diligence required is the same in the case of gratuitous as well as non-gratuitous bailments, e.g., care of an average prudent man. To taken an illustration if a cow is delivered for safe custody it is enough if it is kept in the backyard properly enclosed, and even if it is for reward, no one would expect in to be kept in the drawing room.

Brief mention may be made with regard to Common Carriers and inn-keepers. The provision of Sees. 151 and 152 of the Contract Act embody in effect the Common law rules. How far this remains unaffected by the Contract Act must be considered now.

"Common Carriers" under English Common Law were liable as insurers of goods except in cases of act of God and the King's enemies. The position in India has been altered and amended by the Carriers Act of 1865 which now enables a bailee of this class to limit his liability by special contract. Regarding carriage of goods by sea, over and above the Contract Act there is the Indian Carriage of Goods by Sea Act of 1925. Carriage by Air is governed by the Carriage by Air Act of 1972. With regard to Carriage by Railway, it is governed / by Railway Act of 1989. The liability in this type of Carriage by Railway, is limited by special agreement between the parties in the usual form of "risk notes" under which goods may be consigned at owners risk" or railway "risk" or at "specially reduced rates'.

While English Law imposes liability comparable to insurers in case of inn-keepers, Indian Law is different in the sense that a hotel manager in India is in the position of a bailee and bound by the Contract Act.

2.7.2 Goods Bailed should not be mixed with other goods

The bailee has a duty not to mix the goods bailed with his own goods. The bailee should maintain the separate identity of the bailor's goods. The rules in brief are analysed in sees. 155 to 157 as follows:

1. If the bailee mixes the goods of the bailor with his own with the bailor's consent each has, in the mixture an interest proportionate to their respective shares.

2. However, 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, the property in the goods remain in the parties respectively, but the bailee is bound to bear the expenses of separation or division and any damage arising from the mixing.

For example: A bails 100 bales of cotton marked with a particular mark to 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 other incidental damage.

3. The bailee might have mixed goods bailed without the bailor's consent and a separation cannot be effected. In such a situation the bailor is entitled to be compensated by the bailee for the loss of goods.

To Illustrate: A bails a barrel of cape flour worth of Rs.45 to B, B without A 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.

2.7.3 No unauthorized use

Sec. 153 reads as follows: '*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.

It will be observed that the bailee should not make greater use of the goods bailed. If the goods are used for unauthorized purpose, he will be liable for the loss even if he had exercised reasonable care as stated in Sec. 151. Even act of God or inevitable accident would be of no defence.

Lilley V. Double Day (1881) 7 Q.B. D 510 ; The defendant in this case contracted to warehouse some goods for the plaintiff at Kingsland Road, but warehouse some portion else where. A fire occurred there, with out any negligence on the defendant's part and goods wee destroyed. The defendant was held liable for the loss.

2.7.4 Bailee should return the goods bailed

It is the duty of the bailee to return or deliver the goods without demand on the expiry of the time or after the accomplishment of the purpose. Otherwise the bailee will be held liable for the loss occasioned by the delay. If several joint owners of goods bailed them, the bailee may deliver them back to according to the direction of one joint owner and without the consent of all, in the absence of any agreement to the contrary.

Rampal V. Gowrishankar (A.I.R. 1952 Nag.8). In this case, where a Pawnee refused to return the goods even after the debt was cleared by the pawner, and the goods were subsequently stolen. The Pawnee was held liable.

Income-tax Commissioner V. P.M.Rathod & Co, (AIR1959 S.C. 1394): Where goods are delivered to the office for transmission by V.P.P. to a buyer, they must be delivered to the buyer on payment of the price. Delivery without receiving the price will render it liable as a bailee for delivering goods against directions.

In case of non-gratuitous bailment, the bailor cannot claim its return earlier than the stipulated time. But a gratuitous bailment may be terminated at any time. If the bailor compels the return of the article and such return causes a loss exceeding the benefit derived by the bailee the bailor is bound to compensate the bailee. The bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of bailment.

2.7.5 Duty to return increase or profit

According to Sec. 163, in the absence of any contract to the contrary, the bailee is bound to deliver to the bailor any increase or profit which may have accrued from the goods during the period of bailment. The illustration appended to this section explains the point clearly.

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.

2.8 RIGHTS OF BAILOR

a) The foremost right of the bailor is to get or claim back the goods bailed or to give the necessary directions for otherwise disposing of the property.

b) The bailor is entitled to claim any increase or profit which may have accrued from the goods bailed (Sec. 163).

2.9 RIGHTS OF BAILEE

a) Lien: Lien signifies the right of a person who has possession of the goods of other, to retain such possession until some claim attaching to it is satisfied. This is, of course, the most important right of a bailee.

b) Immunity: The bailee is not held liable to the true owner if he, in good faith, delivers them back to the bailor or according to his directions and it turns out that he had no title to the goods (Sec. 166).

A bailee is estopped a from denying the title of the bailor to bail the goods and to receive them back (Sec. 177 of the Evidence Act, 1872).

c) The bailee is entitled to lawful charges or remuneration for providing his services.

Suits against wrong doers: In a contract of bailment, the bailee is in a favourable position and bailment is an instance of duplicate possession. If a third person wrongfully deprives the bailee of the use or possession of the goods bailed or does them any injury, the bailee is entitled to sue the wrong doer just as much as the bailor himself can. But whatever is obtained by way of relief or compensations in any such suit shall, as between the bailor and the bailee, be dealt with according to their respective interests.

2.10 FINDER OF LOST GOODS

The subject of Finder of Lost goods is very interesting and we shall discuss it at great length here. The position of finder of lost goods is discussed in Sec. 71 of the Contract Act which reads thus, "A person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee'.

The obligation specified in this section is based on the basis of a quasi-contract. Ordinarily speaking a person is not under any duty to take care of the goods belonging to another left on a road or other public places by accident or inadvertence, but if he takes them into his custody he has to take care of them like a bailee. It therefore, follows that the position of a finder of goods is exactly that of a bailee in the case of a deposit. Sections 168 and 169 contain the following rules relating to his rights -

1) A finder of lost goods cannot recover remuneration for trouble and expense voluntarily incurred by him for preserving the goods and finding out the owner.

2) He may, however, exercise particular lien against the goods for such remuneration

3) Where, however, a reward has been offered for the return of the goods, he can use for such reward.

4) Where the goods found are the subject of a sale and the owner cannot be found after reasonable search or refuses to pay the lawful charges of the finder, he may sell them when: a) they are about to perish or lose the greater part of their value or b) the lawful charges of the finder amount to two thirds of their value.

From the above points, the irresistible conclusion is that the liability of a finder is implied by law even though there is no contract of bailment, Sec. 403, Expln: 2 of the Indian Penal Code deals with the criminal liability of a finder of lost goods that he would be guilty of misappropriation of property if he appropriates it to his own use, when he knows or has the means of discovering the owner. The application of these principles would be clear from the decision **Newman V. Bourne**. The facts in brief were as follows:

P, a customer in D's shop put down her coat with a broach pinned to it and forgot to take up the coat. One of D's assistants found it and it was placed in a drawer over the weekend. On Monday next it was found missing. D was held liable to P for not taking reasonable care which in the circumstances a prudent man would have taken.

As against everyone save the true owner, the property in the goods found in public or quasi public place vests in the finder on his taking possession of it. We have seen under certain circumstances. But English Law is different on this point and according to common law the finder cannot sell it even if the true owner has not turned up. Under English law, unless the true owner has intentionally abandoned the chattle, his title is not lost and be can recover it from the hands of anyone other than a purchaser in "market over" (**Clayton v. Le Ray** 1911 2 K.B. 1031)

We note from the above points, that the position of the finder of lost goods is precisely that of a bailee and hence it is obligatory on his part to show the same degree of care expected from a bailee under Sec. 151. Again he should not use the goods for his own purpose, as laid down in Sec. 154. Above all, he should not mix the goods with his own goods and if he does so inevitable consequence as laid down in sees. 155 to 157 will follow.

2.11 PLEDGE

2.11.1 Pledge or Pawn

Pawn is a bailment of goods as security for the payment of a debt or performance of a promise. In this case, the bailor is called the Pownor, and the bailee is called the Pawnee. (Sec. 172).

Willis, J. in **Hallday V. Holgate** (1868 3 Ex 290) observes: "There are three kinds of security, the first a simple lien, the second a mortgage passing the property out and out, the third a security intermediate between a lien and mortgage, namely, pledge where by contract a deposit of goods is made as security for a debt and the right to property rests in the pledge so far as is necessary to secure the debt".

Sec 172 of the Contract Act defined pledge as "a bailment of the goods as security for payment of a debt or performance of a promise." Pledge involves a delivery of goods by the pawnor to the Pawnee either actually or constructively.

To constitute a valid pledge the bailor must be in possession in the legal sense, that is possession of goods under a legal right or title. In other words, it means that transfer of possession in the judicial sense, is essential in a valid pledge. The rider to the above rule is that only movable goods can be pledged.

2.12 PLEDGE AND BAILMENT DISTINGUISHED

The main difference between these types of contracts lies in the purpose of contract : 1) in a pledge the possession of good is transferred under an agreement from pawnor to pawnee as security for the payment of a debt, or the performance of a promise. In a general bailment there is no such idea. 2) A bailee can exercise a lien on goods bailed, but has no right of sale. Pledgee can sell the goods under certain circumstances. 3) A bailee obtains a right of possession of the goods bailed : a pledge gets a 'special property' in the goods.

Differences between a bailment and mortgage may be noted briefly. In the case of a mortgage of goods the property in the goods passes to the mortgagee though their possession remains with the mortgagor. But the goods which are pawned continue to be the property of the pawnor, though their possession will be with the Pawnee. That distinguishes a pawn from a mortgage. This is a very broad distinction between a pledge and a mortgage. We have not touched upon the finder and the more subtle distinctions between the two.

2.13 RIGHTS OF PLEDGEE

The pledgee has the following rights in respect of the goods bailed. 1) The Pawnee can retain the goods not only for the payment of the debt, but also for interest and expense incidental to possession or preservation of goods (Sec. 173), 2) in the absence of a contract to the contrary, the Pawnee cannot retain the goods for debts other than those for which the pawn was made, but such a contract shall be presumed in the case of advance made subsequent to the pawn. 3) A pawnee can also recover extraordinary expenses incurred by him for the preservation of goods pledged. It may be observed here that he cannot retain the goods. His only remedy is to sue for recovery of extraordinary expenses. 4) Where the pawnor makes default in payment of debt the pawnee may: i) bring a suit upon debt, retaining the goods pledged as collateral security or ii) himself self the thing pledged after giving the pawnor a reasonable notice.

If the proceeds of such private sale are less than the debt the Pawnor is liable for the balance. If they are in excess, the pawnee shall pay the surplus to the pawnor, it is by virtue of this right that we say that the pawnee gets a "special property" in the goods pledged. Provision as to notice is mandatory and cannot be waived at the time of making the contract of a pledge. If goods are sold by the pawnee without notice of sale, he can be sued for conversion. These are the various rights of the pawnee in respect of the goods pledged with him.

2.14 PAWNOR'S RIGHT OF REDEMPTION

(Sec. 177) If a time is stipulated for the payment of the debt, or performance of the promise for which the pledge is made and the pawnor makes default in repayment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them, but he must take care, pay in addition, any expenses, which have arisen from his default.

The section is self explanatory and does not require any comment. This section specially protects the pawnor's ownership in the goods bailed subject to certain qualifications.

2.15 PLEDGE BY NON-OWNERS

Ordinarily it is only the owners of goods that can make a valid pledge, but in certain exceptional cases pledge made by non-owners will also be valid. This general rule is expressed by the maxim. "Nemo dat quod non habet" (no one can convey a better title than what he has). This rule is equally applicable to contracts of sale as well as to pledge. If the rules were otherwise, it will lead to anomalous results and there will be any amount of temptation for pawnbrokers to join hands with thieves and swindlers. But as we noted earlier there are some exceptions even to this rule. As the meaning of the word "possession" in the old Sec. 178 gave rise to conflict of judicial opinion, the conflict was resolved by recasting Sec. 178 into sections namely, 178 into sections namely, 178 and 178A. By the present section, a pledge of goods made by a person who is not the real owner is valid and binding on the owner in the following cases.

2.15.1 Pledge by mercantile agent (Sec. 178)

By sec. 2(9) of the Sale of Goods Act, "mercantile agent", means mercantile agent having in the customary course of business, as such agent, authority either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of goods. This definition has been taken from Sec. I of the English Factors Act, 1889.

Where mercantile agent is with the consent of the owner in possession of goods or the documents of tide to goods, any pledge made by him, when acting in the ordinary course of business of mercantile agent shall be as valid as if he were expressly authorized by the owner of the goods to make the same provided that the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor had no authority to pledge. To validate a pledge by a mercantile agent the pledgee must have acted in good faith and must not have at the time of the pledge notice that the pawnor had no authority to pledge the N goods. The possession of the goods in the hands of mercantile agent must have been with the consent of the owner and the mercantile agent acts in the ordinary course of business. The Privy

Council in **Official Assignees of Madras V. Mercantile Bank of India Ltd.** 58 Mad. 181 (P.C.) held that under Indian law, a Railway Receipt was document of title and was equated with the goods it covered and that a pledge of the same had the same effect as pledging the goods represented by it. This was the decision of the Privy Council under Sec. 178, before amendment. It may be noted there that the old section did not expressly include a railway receipt in the list of document of title to the goods. But Sec. 2 (4) of the Sale of Goods Act now expressly includes a railway receipt in the definition of documents of title.

2.15.2 Pledge by person in possession under voidable contract

As seen above, the law permits under certain circumstances a pledge by a person is to facilitate mercantile transaction. Sec 178-A engrafts the following exception to the maxim, "Nemo dat quod non habet" in favor or bonafide pledges by a person in possession of the goods pledged by him under a contract voidable under Sec. 18 or 19 A of the Contract Act, (i.e., voidable on the ground of coercion, fraud, undue influence or misrepresentation) but the contract has not been rescinded at the time of the pledge. The pawnee acquires a good title to the goods, provided he acts in good faith and without notice of the pownor's, defeat of title.

2.15.3 Pledge where pawnor has only a limited interest

Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of the interest.

Example: A finds a watch on the road and spends Rs.25/- on its repairs. He pledges it with B for Rs.50/- The real owner can get the watch by paying Rs.25/- to the pledgee.

2.15.4 Pledge by Co-Owners

Where there are several joint owners of goods are in the sole possession of one of the co-owners, with the consent of other co-owners such a co-owner can make a valid pledge of goods. /-

2.15.5 Pledge by seller or buyer in possession after sale;-

Beside the cases mentioned above, a seller left in possession of goods even after sale, can make a valid pledge, provided the pawnee acts in good faith.

Illustration: A buy goods from B, pays for them, but leaves them in the possession of B and B then pledges the goods the goods with C who does not know of the sale to A, the pledge is valid.

Similarly, if the buyer has got possession of goods with the consent of seller before payment of price and pledges them, the pawnee will get a good title provided he does not have notice of sellers right of lien or any other right. Even an agreement for sale is enough. But it may be noted that an option to buy will not suffice. The hirer under a hire-purchase agreement is not a person who has agreed to buy goods for this purpose unless a binding agreement to buy exists. The above point is hardly likely to present any difficulty in actual practice. The right of pledge given to that buyer or seller as the case may be is by virtue of his possession of goods so that his possessor right should be an efficacious one.

2.16 LIEN

Right to retain possession of goods is known s "Lien." Lien in other words signifies the right of person who has in his custody the goods of another to retain such possession until debt due to him has been discharged or satisfied. A lien being a species of suretyship, differs from a mortgage. In the case of mortgage the origin of the debt is immaterial and the mortgagee has an absolute interest in the property conveyed subject to a right of redemption by the mortgagor. But in the case of the lien until he is paid. Whereas in the case of a mortgage the origin of the debt may be a loss or a debt for goods sold, etc., a lien can only be security on property which is or has been the subject of transaction between the parties.

The following example is worth mentioning: A sells goods to A and B has paid only part of the amount due on goods sold. Here, A, an unpaid seller of goods has a lien on the goods sold for the unpaid purchase money.

It may be noted with caution a lien is essentially a right of retention and does not extend to bringing the property to sale unless the same is conferred by the statute. From the above rule it follows that a lien may rise either by operation of law or agreement between parties. It may again be divided into 1) Possessory Lien 2) Maritime Lien and 3) Equitable Lien.

2.16.1 Possessory Lien

It is one which appertains to a person who has possession of goods which belong to another, entitling him to retain them until the debt due to him has been paid. It is again divided into; i) Particular and ii) General.

2.16.2 Particular Lien

It is otherwise called "special lien." It is a right to retain possession over those particular goods belonging to another for the discharge of a debt or liability which had arisen in respect of those goods.

2.16.3 Bailee's Lien

A bailee has a particular lien which he can exercise on the goods bailed till he is paid for services. The section on the point (Sec. 170) provides as follows:

Where the bailee has in accordance with the purpose of the bailment rendered any service involving the exercise of labourer skill in respect of the goods bailed, he has in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them."

From the above section we note that the bailee's lien is a possessory lien and it is lost when possession is lost. It is also called particular lien for such a lien is confined only to the particular goods in respect of which labour or skill has been expended by the bailee.

Besides the bailee, other persons who are entitled to exercise particular lien are: (a) unpaid seller of goods, (b) finder of lost goods (sec. 168), (c) agents; (d) pledges; (Sec. 173 & 174) (e) carriers; (f) inn-keepers; (g) railways etc.

Under all circumstances, if the bailee, does not complete the work within the agreed time or reasonable time he is not entitled to lien on the goods. However, the right of lien arise only where "labour and skill" have been used so as to confer an additional values on the article. So, a person who takes an animal for feeding has no lien, but a veterinary surgeon has. We have so far dealt with particular lien and it would suffice to consider two illustrations.

Illustration: (a) A delivers a rough diamond to B. a jeweller to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered, b) A gives cloth to B tailor, to such a coat. B promise A to deliver the coat as soon as it is finished and to give a three month's credit for the price. B is not entitled to retain the coat until he is paid.

2.17 GENERAL LIEN

A general lien is the right to retain the property of another for a general balance of accounts. The retention of goods will be available in this type of lien not only for the discharge or a debt of liability incurred in connection with them, but also for the general balance of account arising out of similar transaction between the parties. General lien is a kind of a special privilege which the law has granted only to few persons: 1) bankers; 2) factors; 3) wharfingers; 4) attorneys of a High Court; 5) policy brokers, and 6) others by express agreement.

The general balance of accounts here refers only to lawful claims that must have arisen to them while acting in the above given capacities. Sec. 171 of the Indian Contract Act lays down:-

"Bankers, factors, wharfingers, attorneys of a High Court and policy brokers may, in the absence of a contract to the contrary, retain as security for general balance of account any goods bailed to them, but no other persons have a right to retain as a security for such a balance goods bailed to them, unless there is an express agreement or contract to that effect.

It is therefore, clear that these parties can exercise general lien against any goods under their possession and for any sum legally due on a general balance of account. Thus, banker's lien extends to all bills, cheques and money paid by the customer as a banker. This enables banker to recover all his dues by way of loan or overdraft. The banker thus by virtue of this lien may transfer funds of the debtor to whatever account the banker chooses, to set off or liquidate the debt.

Check Your Progress

1. Define bailment
2. What are the different types of bailment?
3. Who is a finder of lost goods?
4. Define pledge
5. Distinguish between bailment and pledge
6. What are the rights of pledgee?
7. Explain pawners right of redemption

2.17.2 Equitable lien

It is a right created by statute and is no way dependent on the possession of the property to which it is attached. For example an unpaid seller of movable property has an equitable lien on the property for the amounts due to him. It is to be noted that the lien is enforceable by bringing the charged property to sale.

2.17.3 Maritime lien

It is usually not possessory in nature. It is enforceable by an action in rem against the ship itself. Generally it is right binding a ship, her furniture, tackle, cargo and freight for payment of a claim founded upon maritime law.

Thus the above summation would bring the law on this subject nearer home.

2.18 SUMMARY

A bailment is the delivery of goods by one person to another for some purpose upon a contract. When the purpose is over, the goods shall be returned or otherwise disposed of according to the directions of the person delivering them. In bailment though there is delivery goods, ownership is not transferred. The parties to the contract of bailment are, bailor and bailee. The law confers certain rights to the bailor and bailee, similarly casts certain duties to them, which we have discussed in this unit at length.

Another interesting topic is law relating to lien. Lien means right to retain possession of goods to another until the sum due to him is paid. This right is called possessory lien. Such lien is of two types, namely, particular lien and general lien. The persons who are entitled to exercise lien and under which circumstances have been well explained in this unit. The position of a finder of lost goods which is similar to a bailee is dealt under sec. 168 of the Contract Act. Pledge is similar to bailment in nature. Where a thing is delivered as security for the repayment of a debt has been analysed in this unit. The differences between bailment and pledge have been listed out, along with the rights of the pawner and pawnee. The circumstances under which a non- owner can pledge the goods though the general rule is a pledge made by any person other than the owner is invalid, has been explained in this unit with illustrations.

2.19 KEYWORDS

Indemnify	-	saving a person against loss or harm.
Redemption	-	get back the goods or property by payment.
Voidable	-	avoidable by the affected party.

Wharfingers	-	Agents in-charge of loading and unloading goods at Harbour.
Factors	-	business Agents.

2.20 ANSWER TO CHECK YOUR PROGRESS

1. Ref. 2.1.
2. Ref. 2.6.
3. Ref. 2.10.
4. Ref. 2.11.
5. Ref. 2.12
6. Ref. 2.13.
7. Ref. 2.14.

2.21 EXERCISE QUESTIONS

1. Define bailment. State how far consideration is essential to a contract of bailment.
2. Briefly explain the rights and duties of a bailee.
3. Explain the scope of bailee's lien.
4. Write a note on pledge. What are the rights of pawner and pawnee?

UNIT – 3

AGENCY

INTRODUCTION

"Agency" is a comprehensive word which is used to describe the relationship that arises where one man is appointed to act as the representative of another and the person so appointed is called as "agent" and the contract which he is appointed is called agency. The law of agency is dealt under chapter X (Secs.182 to 238) of the India Contract Act. Contracts of agency are based upon two principles of law (a) **Qui facit per alium facit per se** i.e., when a person does by another he does himself. Regarded from this aspect, the acts of the agent shall for all legal purposes, be considered to be the acts of the principal. (b) Whatever a person is legally competent to do by himself shall also be allowed to be done through an agent except contracts involving personal services such as painting, marriage, etc.

In the business world, it is not possible to run a business by oneself without the help of others. Such other person is called agent. The person who appoints the agent is called the principal. The function of an agent is to bring his principal into contractual relationship between principal and third parties. As between the principal and third person any person may become an agent. A special feature of law of agency is that no consideration is necessary to create an agency.

An agency may be created in different ways. All these have been explained in the unit with illustrations and leading cases. There are different kinds of agents. Under the head mercantile agents, we have got Auctioneers, Brokers, Factors and del creder Agents.

Agency is based on mutural trust and confidence, so the agent cannot delegate his authority to any other person without the consent of the principal. This is expressed by the Latin maxim, 'delegatus non potest delegare'. Of course it has got exceptions, which have been discussed in detail in this unit.

OBJECTIVES

- To analyse the definition of Agency.
- To understand the difference between Agent and servant, independent contractor.
- Various modes of creating Agency
- Different categories of Agents
- Authority of an agent
- Appointment of sub-agent
- Sub-agent and substituted agent-Differences.
- Agency by ratification and when ratification is valid.
- Termination of Agency

UNIT STRUCTURE

3.1 DEFINITION OF AGENT

An agent, according to sec. 182 of the India Contract Act is a person employed to do any act for another or to represent another in his dealings with third parties. The person for whom such act is done, or who, is so represented, is called the principal.

Under English law agency is defined as the employment of the person by another, in order to bring the latter into legal relations with a third person.

Thus it will be noticed that the idea underlying agency is the idea of representation of one person by making an agent merely a connecting link between the principal and the third party. It must be further remembered that it is not mere employment that creates an agency, but employment for the purpose of putting the principal into legal relations with others. An agency agreement is one by which the agent is authorized to establish, privity of contract between his employer called the principal and a third party. Thus the agent acts only as "conduit pipe". The essential point about an agent's position is its power of making the principal answerable to the third parties. A person does not become agent on behalf of another merely because he gives him advice in matters of business.

3.2 AGENT DIFFERENT FROM SERVANT AND INDEPENDENT CONTRACTOR

Though an agent resembles a servant in certain respects there are points of difference between the two. On a contract with a third party which is within the scope of his employment neither a servant nor an agent incurs any personal liability.

A domestic servant renders personal service to his master. But he cannot be called as an agent. An agent differs from a servant in the following respects:

	Agent		Servant
1	An agent is employed for the purpose of creating contractual relationship between the principal and third parties.	1.	A servant is employed to work under the supervision of his master. He has no authority to make contract on behalf of his master
2	The principal directs what work the agent has to do, but not how it is to be done.	2.	The master has as a right to direct not only what work is to be done but also how it is to be done.

3	An agent receives instructions from the principal, but he is free to carry out them according to his own discreation.	3.	The master not merely instructs but also controls the manner in which instruction are carried out. He is under complete control of his master than the agent.
4	An agent receives commission on the basis of the work done by him.	4.	A servant is usually paid by way of wages or salary.
5.	An agent may work for several principals at the same time.	5.	A servant usually serves under only one master.

The question arises whether a man has acted as an agent or an an independent contractor in his own interest. The later is a person who is his own master in the sense that he is employed to bring about a given result in his own manner and not according to the orders given to him from time to time by his employer. Thus it is obvious that a retailer A, who in response to an order from a customer B, buys goods from a wholesaler C, and then resells them to B is acting as an independent contractor. He is a middleman, not the agent of B. Though an agent resembles an independent contractor, an agent to a limited extent is subject to the direction and control of the principal.

The independent contractor doffers from an agent in the following respects:

	Independent Contractor		**Agent**
1.	An independent contractor who undertakes to do some work for another is not subject to the control or directions of the employer.	1.	An agent's principal has to act according to the instructions.
2.	Independent contractor cannot bind the employer to third parties.	2.	An agent parties by themselves can bind the principal to third his acts or omissions.

However where an agent having authority to delegate his authority appoints another person to act in the contract of agency such a person is called substituted agent when the original agent having authority to appoint another person to act for the principal such person is called substituted agent.

An agent may have, often has in fact a large discretion, but he is bound by law to follow the principal's instructions provided they do not involve anything unlawful. An agent as such is not a servant, but a servant is generally his master's implied agent, the extent of agency depending on the duties and position of the servant. To this extent an agent may be considered as a superior kind of servant, i.e., "Superior Servant

3.3 CREATION OF CONTRACT OF AGENCY

A contract of agency like any other contract has all the essential requirements of a contract, with some peculiar features of its own. As has been noted, the main object of entering into a contract of agency is to bring the principal into legal relation with third persons. Hence as follows that any person, if he is competent to act for himself, may set through an agent. It is of importance to remember in the connection that a person under a legal or natural disability of incapacity cannot appoint an agent. For example, the appointment by a minor is held void, and if an agent acts for a minor, he will be personally liable to the third party Sec.183 clearly states that "Any person who is of the age of majority according to the law to which he is subject and who is of sound mind, may employ an agent" and Sec.184 provides that: "As between the principal and third persons, any person may become an agent but no person who is not of the age of majority and of sound mind can become an agent so as to be responsible to his principal according to the provisions in that behalf herein contained". These provisions contained in sections 183 and 184 of the Contract Act indicate that while that principal must have the capacity to contract, there is nothing in them which prohibits a minor from being an agent though he cannot be subjected to my liability towards his principal.

3.4 CONSIDERATION IS NOT NECESSARY TO CREATE AGENCY

Consideration is one of the essential requirements for the validity of every contract. As for the presence of consideration, Section 185 states that consideration is not necessary to create an agency. In Allahabd Banking v. Simla Banking industrial Co., (A.I.R. 1929 Lohore 182) it was observed. "Agency is not a contract for which an express consideration on either side is necessary because on the one hand the fact of employment and the credit thereby gained and on the other the promise to act, are of themselves sufficient of constitute a good contract".

Thus it may be noted that a Contract of Agency requires no consideration. It comes under the category of those contracts which law declared to be valid without consideration.

The authority of an agent may be either express or implied. An authority is said jto be express then it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case, and things spoken or written or the ordinary course of dealing, may be accounted by circumstances of the case. If a person gives another an authority to act on his behalf by a power of attorney, or by a letter, or by stating that order in so many words, the authority is said to be express. The following illustration will clearly show the authority of the agent which may be implied in nature.

Illustration: A owns a shop in Madras, living himself in Madurai, and visiting the ship occasionally. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop and of paying for them out of A's knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

3.5 DIFFERENT MODES OF CREATING AGENCY

We will now consider the different modes of creating Agency. It will be convenient to discuss the different types of transactions in the following order: 1) Agency by precedent authority: 2) Agency by subsequent authority: or ratification: 3) Agency by estopped; 4) Agency by holding out; and 5) Agency of necessity.

3.5.1 Agency by precedent authority

In this case the authority given by a principal to his agent is express authority enabling the latter to bind the principal by acts done within the scope of that authority. As seen above, no particular form is necessary for appointing an agent. This type of agency is created by appointing an agent either by words spoken or written.

3.5.2 Agency by subsequent authority

If A, without any precedent authority whatever, purports to contract with C for and on behalf of B, and later B ratifies and adopts the contract the relationship of principal and agent arises between A and B.

In that case the principal is bound by the act whether it be for his detriment or advantage and whether it is founded on a tort or a contract, and with all the consequences which follow from the same act done by his authority. Hence this law of agency is known as agency by '*ratification' or 'ex-postlater facto 'agency.*

3.5.3 Agency by Estgoppel

When an agent has, without authority done acts or incurred obligations to third persons on behalf of this principal, the principal is bound by such acts or obligations of that has by his words or conduct induced suich third persons to believe that such acts and obligations were within the scope of the agent's authority. Where a person by his words or conduct has willfully led another to believe that certain set of circumstances or facts exist and that other person has acted on that belief. He is estoppe or precluded from denying the truth of such statements. In the words of Lord Halsbutry 'Estoppel arises when you are precluded from denying the truth of anything which you have represented as a fact, although it is not a fact".

Illustration: If A proclaims himself as the agent of B and B knowing the same does not contradict it, and a third person, enters into a contract with a bonafide belief that A is B's agent, it will be estopped from contending subsequently that A is not his agent.

3.5.4 Agency by Holding out

The rule of agency by holding out may be briefly stated thus. Agency by holding out arises under such circumstances where there is a positive conduct making a holding out of a previous occasion to infer an agency on a subsequent occasion. Thus if A sends out his servant B with money to buy some articles from a merchant and B buys the article on credit. A is not held liable as principal. However if A is in the habit of taking things on credit from the merchant through the servant B, B buys articles not required by A also on credit from the merchant along with those required by A, then will be liable to pay for those goods also with the goods he ordered on the basis that B was his agent by holding out.

3.5.5 Agency of Necessity

There is a limited class of cases in which on the ground of urgent necessity, one person may be bound by a contract made by another on his behalf but without his authority.

Great Northern Railway v Swafield, exemplifies this principle the facts were, a Station Master of a particular station had to incur expenses in feeding a horse which had arrived at his station by rail on account of the failure of the consignee to take delivery of the same without delay. Held that, the Station Master could recover the amounts so spent on the basis of an agent of necessity.

Before an agency of necessity can be inferred, the following pre-requisites have to be satisfied. (a) There should be an actual and definite necessity for the creation of agency. A person who seeks to bind a principal bears the bonus of proving that the course adopted by him was reasonably necessary in the circumstances; b) it should be practically impossible to communicate with the principal; c) The person acting as an agent must have acted bonafide with the interests of all parties concerned.

3.5.6 Wife as an implied agent to her husband

Here again it is reasonably dear that marriage does not give the wife an innate power to bind her husband by contracts with third persons, but where she is living with him there is a presumption, though no more, that she is entitled to pledge his credit for necessaries which are suitable to his style of living and which fall within the domestic department usually confined to the care of the wife. This principle was laid down in Debenham V. Mellon (1880 A.C,. 24). In this case, the defendant was the manager of a hotel, where his wife acted as the manageress. They lived together in the same hotel, but had no domestic establishment of their own. The wife incurred with a tradesman a debt for cloth's payment for which was demanded from the husband. The Court held that the husband was not liable because the mere fact of cohabitation did not give rise to presumption of agency, unless it was a domestic establishment. The following principles can be analysed in this connection.

A wife living with her husband has the implied authority of the husband to buy articles of household necessity. In the striking words of Hornby; "As long as people continue to live in houses the wife will normally do the household shopping, and the husband will pay the bills. The law of principal and agent will always cut deeply with the law of husband and wife".

The implied authority can be challenged by the husband only when he is able to prove that: 1) he had expressly forbidden the wife from borrowing money or buying goods on credit, or 2) the articles purchased did not constitute necessities, or 3) he had given sufficient funds to the wife for purchasing the articles she needed to the knowledge of the seller or 4) the creditor had been expressly told not to give credit to he wife, or 5) the tradesman has been expressly warned not to supply goods on credit. If it is proved that the wife lives apart from the husband for no fault of her own but under justifiable circumstances compelled to live apart, the husband would in law, be liable to maintain her, and be bound to pay her bills or maintenance during that period.

Thus from the above discussion, it seems to us that the wife may be an agent of necessity, to pledge her husband's credit for necessaries of life supplied to her in case her husband, has neglected to provide for her.

Further, the English Matrimonial Proceedings and Property Act, 1970 which abolish the implied agency of wife, provides in Sec.41 (1) that any rule of law and equity confeering on a wife authority as an agent of, necessity to her husband, to pledge his credit or to borrow money on his credit is hereby abolished".

3.6 CLASSIFICATION OF AGENTS

Agents my be classified in various ways. They may be divided into (a) mercantile or commercial agent, and (b) non-mercantile or non-commercial agents.

Another broad classification of agent is (i) general and (ii) special. An agent is said to be general where he is authorised to do each and every lawful act which may be necessary to enable him to carry out his agency : e.g. the manager of a branch office would be a general agent to do all that is necessary to carry on the branch of business. A special agent is who is authorised to do a particular act on behalf of his principal i.e., to go and buy any particular article or to sign particular document for his principal.

3.6.1 Mercantile or commercial agents

The law of contracts concern more with mercantile agents. Some of the common mercantile agents known to this branch of law are auctioneers, brokers, factory and commission agents. They will be considered below:

1. Auctioneer

Simply stated, auctioneer is an agent appointed by the seller to sell goods by public auction for a remuneration, in the shape of commission commissba. An auctioneer is usually entrusted with possession of goods. Again he is given the authority to sell or deliver goods only on payment of the price. He is moreover a particular agent having the dual function of acting on behalf of the seller till the knocking of the bid after which he becomes the agent of the buyer. In English law an auctioneer is also the agent of the buyer for the purpose of signing the memorandum under the English Sale of Goods Act. As he is in possession of the goods he is given the right to sue for the price of the goods in his own name and he enjoys a lien goods upon for his dues.

2. Banker

A banker is one who in the ordinary course of business, receives money, which he repays by honouring the cheque of the person from whom, and on whose account, he receives. The relationship between a banker and his customer-is that of a debtor and creditor with the super added obligation on the part of the banker to honour the cheques of the customer drawn upon him, to this extent, a banker is an agent of his customer.

3. Broker

Another very familiar type of mercantile agent is broker. A broker too is an agent employed to buy or sell goods or property on behalf of the person employing him. He does not take possession of the goods or property. He only acts as middleman to bring the contracting parties to a meeting point and is paid commission for his services. As he differs from a factor by not having possession fo goods, he has no lien. Then most important difference between a broker and commission agent may be noted here. A commission agent is employed not to establish privity of contract between his principal and third parties, but to sell or buy goods for the principal at the most favorable price available, business, persons dealing with him are entitled to presume that he has authority to do all such-acts as are necessary incidental to such a business. This 48 what is known as *doctrine of apparent authority*. When it is said that an agent's-acts was within the scope of his apparent authority all that is meant is that the act appeared to be authorised. A leading authority is *Watteau V. Fenwick (*1893 IQB 346_). The defendants had forbidden the manager of their hotel from buying cigars on credit. The plaintiff gave cigars to the manager on credit, which were used in business. The manager's name appeared over the board and the plaintiff trusted him and had never heard of the defendants being unable to recover price from the manager, the plaintiff such as would naturally be supplied to and dealt in such an establishment" Wills J therefore held that "once it is established that the defendants as the real principal, the ordinary doctrine as to principal and agent applied, that the principal is liable for all the acts of the agent which are within the authority usually confided to an agent of that character, notwithstanding limitation, as between the principal and agent put upon that authority".

From the above cited decision, the following can be inferred. The ostensible authority once created may be curtailed by his principal. The right of a third party against the principal on the contract of his agent though made in excess of agent's actual authority was nevertheless to be enforced when the evidence showed that the contracting party had been led into an honest belief in the existence of the authority to the extent apparent to him where, however, a person contracting with the agent has actual or constructive notice of any restriction on the agents ostensible authority. He is bound by the restriction.

The doctrine of ostensible authority, is given statutory shape in sections 188 and 237 of the Contract Act Sec 188 reads as follows. "An agent having an authority to do every lawful thng which is necessary in order to do such act. An agent having an authority to carry a business has authority to do every lawful thing. necessary for the purpose of usually done in the course of conducting such business".

Sec.237 lays down "When an agent has without authority done acts or obligations if he has by his words or conduct induced such third persons to believe that such acts and obligation were within the scope of the agents authority."

The following illustration appended to this section clarifies this point. A consigns goods to B for sale, and gives him instructions not to sell below fixed price. C, being ignorant of B's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price a is bound by the contract.

Sec.188 has been used normal circumstance whereas Sec.189 is made applicable in cases of emergency and infact under Sec.189 an agent can exercise larger powers, Sec.189 is as follows. An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances". In such cases the principle of agency by necessity is deemed to be conferred on the person so acting as an agent.

3.8 DUTY NOT TO DELEGATE (SEC.190)

As a general rule, an agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally.(Sec.199).The reason for this rule is that confidence in a particular person is at the root of contract of agency. Delegatus non psotesrt delegare (a delegate cannot further delegate) is a well known maximum of the law of agency. Ordinarily, therefore the agent cannot further delegate the work which has been delegate to him by his principal. This is particularly true when the agent is appointed for the performance of any task requiring discretion or judgement. But to this general rule, there are certain expectations. In the following case the agent may delegate the work to another. The following are the well recognized exceptions: (1) Where the duties of the agent do not require any skill or confidence, and be satisfactorily performed by anyone: (ii) where the custom prevailing, in the trade, or trade usage, as it is called, permits delegation (iii) Where the principal knows the agent intends to delegation (iv) Where the nature of the business requires delegation, (v) in unforeseen emergencies (Sec. 190).

3.9 DIFFERENCE BETWEEN A SUB-AGENT AND SUBSTITUTED AGENT

A sub agent has to be distinguished from a substituted agent Sec. 191 makes special reference to "According to Sec. 191 a "Sub agent" is a person employed by and acting under the control of the original agent in the business of the agency".

A substituted agent is defined by Sec.194 thus, "Where an agent, holding an express or implied authority to name another person to for the business of the agency, has named another person accordingly, such person is not a sub-agent but an agent of the principal for such part of the business of the agency as is entrusted to him".

Illustrations

1. A directs B his solicitor, to sell his estate by auction, and to employ an auctioneer for the purpose. B names C an auctioneer, to conduct the sale; C is not an agent, but is A's agent for the conduct of the sale.

2. A authorizes B, a merchant in Calcutta, to recover the moneys due to A from C & Co. FI instructs D, a solicitor, to take legal proceedings against C & Cp for the recovery of the money. D is not a sub-agent, but is solicitor for A.

Thus the Indian Contract Act makes a distinction between a sub-agent' and a person who is put in relation with the principal and called the "Substituted agent". The important difference between the two is that an agent not only appoints a sub-agent but also keeps him under control. As the sub agent acts under the control of the agent there is no privity of contract between the principal and the sub agent and therefore, the sub-agent cannot sue the principal for the remuneration due to him, nor can the principal sue the sub-agent for any moneys due, although principal, as regards third parties. In the case of the sub-agent. But one of the effects of appointing a substitute with reasonable care. Once this is over, the original agent walks out of the transactions and the newly appointed person carries on the business of agency. Sec 195 says that selecting such agent for his principal, an agent bound to exercise the same amount of discretion as of a man ordinary prudence would exercise in his own case; and if he does this he is not responsible to principal for the acts or negligence of the agent so selected.

Illustrations

1. A instructs B, a merchant to buy a ship for him. B employs a ship surveyor of good reputation to choose a ship for A. The surveyor makes the choice negligently and the ship turns out to be unseaworthy and is lost. B is not but the surveyor is responsible to A.

2. A consigns goods to B, a merchant for sale. B, in due course employs an auctioneer in good credit to sell the goods of A, and allows the auctioneer to receive the proceeds of sale. The auctioneer afterwards becomes insolvent without having accounted for the proceeds. B is not responsible to A for the proceeds.

3.10 SUB-AGENT PROPERLY APPOINTED AND SUB-AGENT IMPROPERLY APPOINTED

From the above, it is evidently clear that an agent has authority to appoint a sub-agent either with express permission of the principal or in some cases without such permission. The relations of the sub-agent to the principal depend on the question whether the agent "had an authority to appoint the sub-agent and whether the sub-agent is properly appointed. Where an agent having authority to do so, has appointed a person to act as a sub-agent he is called a sub-agent properly appointed. Delegation is improper when it is not authorised; that is when it is not within any of the recognized exceptions Sec.193 speaks about agent's responsibility for sub-agent appointed without authority. Thus where an agent, without authority, appoints a sub-agent, he is called a sub-agent improperly appointed. By the principal. But a sub-agent improperly appointed cannot represent the principal as regards third persons but can openly bind the agent by contract entered into with them. The agent is held responsible for the acts of the up agent improperly appointed both to the principal and to the third person. (Secs. 192 & 193).

To sum up, there is a vital difference between a sub-agent and substituted agent. Between the principal and sub-agent no privity is created but privity exists between the principal and a substituted agent. Further the legal relation between sub-agent and the principal depends upon whether the appointment is proper of improper.

3.11 EXPOST FACTO AGENCY OR AGENCY BY RATIFICATION

If we pause here for a moment, it seems reasonably clear that the doctrine of ratification comes into play when a person has done an act on behalf of another without his knowledge or authority. Briefly stated, this doctrine gives the person on whose behalf the act is done an option either to adopt the act by ratification or to disown such act. Such ratification as seen earlier may be expressed or implied from conduct. The legal result of ratification is expressed by saying that ratification relates back to the original making of the contract so that the agency is taken to have come into existence from the moment the agent first acted, and not from the date of the principal's ratification. Ratification tantamounts to prior authority, or ratification is equivalent to an antecendent or prior authority. The law on this subject is expressed by the maxim "*Omnis retihabitio retrotrahiutr etmandato priori acqui* paratur "(Ratification relates back and is equivalent to prior authority). Ratification is thus a kind of affirmation of unauthorized acts and again it brings a contract of agency into effect from a retrospective date. The following illustration requires attention in this context.

If A, without any precedent authority whatsoever, purports to contract with B for and on behalf of C, and later C ratifies and adopts the contract the relationship of principal and agent arises between C and A.

Here the ratification relates back to the contract made by A, and both B and C are in exactly the same position as if C had been the original contracting party.

Suppose, on January 1st B offers to buy land from A who in fact is manager and agent of the property of C. On Jan. 2nd. A accepts the offer on C's behalf though he has no actual or apparent authority to do so. On Jan. 4th B purports to revoke the offer. On Jan, 10th h C, ratifies the acceptance of A.

Here again the ratification relates back to acceptance i.e. to the moment when there was a finally concluded contract between B and A. It follows, therefore, that B's attempted revocation is inoperative as being too late, and C is entitled to claim specific performance. Here the contract is deemed to have been concluded between B and A on the 2nd January.

There can, however, be no ratification unless the offer has been unconditionally accepted for unless and until this is proved, no contract exists to be ratified.. If for example, A's acceptance on Jan, 2nd was not absolute, but was expressly made subject to ratification by C, there would be no completed contract until cratified, and a revocation by B before that date would be effective. This was the principle followed in Watson V.Davis Sec. 196 lays down the rule on the above point.

"Where acts are done by one person on behalf of another but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow 'as if they had been performed by his authority".

3.12 ESSENTIALS OF A VALID RATIFICATION

A valid ratification must satisfy the following essential conditions:

1) First, the principal must have been in existence and competent to contract at the time when the agent acted on his behalf as well as on the date ratification. Acts done on behalf of a minor, without his authority, cannot be ratified by him on attaining majority. Similarly, contracts entered into by promoters of a company on its behalf before its incorporation, cannot be ratified by the company after it comes into existence (Kelner vs. Baxter (1866) C.P. 174)

2) The second condition of ratification is that the person (who) makes the contract must profess at the time of making it to be acting on behalf of, and intending to bid, the person who subsequently ratifies the contract. In other words the acts must be done for or on account of the principal and not on account of the agent himself. It must be in the name of the principal. The agent must avowedly or expressly contract as an agent for a principal in contemplation Keighley v. Durent.

3) The third essential is that there should be an act capable of ratification. A contract that is void in its inception cannot be ratified. Thus transactions void ab ignition cannot be ratified.

4) The act must be legal and capable of being ratified by the principal. The shareholders of a company cannot ratify an ultra vires contract made by the director. Thus ratification can be of the acts which the principal had the power to do. The act which the principal is incapable of doing cannot be ratified.

5) Ratification must be made with full knowledge of all the material facts. Ratification by a person whose knowledge of the facts of the case is materlially defective shall be bad in the eyes of the law and will not bind the parties to contract (Sec. 196).

6) Ratification must relate to the whole act and not to a part of it. Act must be ratified in its entirely. Ratification of apart of the act will not be valid. Either the whole contract should be ratified or avoided (Sec. 199).

7) Ratification cannot be made so as to subject a third party to damages, or terminate any right or interest of a third person (Sec. 200).

Following illustrations are given in the section:

a) A not being authorised there to by B demands, on behalf of B the delivery of a chattle, the property of B from C, who is in possession of it. This demand cannot be ratified by B, so as to make C liable for damages for his refusal to deliver.

b) A holds a lease from B, terminable on three months notice C, as authorised person, gives notice of termination to A. The notice cannot be ratified by B so as to be binding on A.

c) Ratification of an act must be made within reasonable time after the contract was entered into by the agent. It cannot take place after the purposted principal has by words or conduct intimated to the other party that he does not intend to ratify.

3.13 EFFECT OF RATIFICATION

Ratification establishes the relationship of principal and agent as well as principal and third party.

Another important effect of ratifications is that ratification relates back and take effect to the date on which the agent first contracted (Sec. 196). Hence there is a contract between the principal and the third party from the date when the agent first contracted not from the date of ratification.

3.14 TERMINATION OF AGENCY

Sec 201 of the Indian Contract Act-provides the general rules regarding the termination of agency. This section has been held is not exhaustive of the circumstances which an agency comes to an end. The relationship of agency is determinable either by act of the parties or by operation of law. We will consider these methods in seriatum. An Agency may be terminated in any one of the following ways (Sec. 201)

1) By revocation of agency by the principal
2) By renouncing the business of agency by the agent
3) By the business of agency being completed
4) By death or insanity of principal or agent
5) By the insolvency of the principal

As the present section cannot be deemed to be exhaustive the relationship of principal and agent may end in the following circumstances also, where an agent has been appointed for a fixed term, the expiration of the term puts an end to the agency, whether the purpose of the agency has been accomplished or not (*Lalijee v. Dadubhar)* (1915) 23 Cal. L. J. p. 190

A contract of Agency is automatically terminated when its business is completed. In other words, when the agency is for a particular purpose the agency will be terminated when the object is achieved.

Thus, for example, the authority of an agent appointed to sell goods ceases to be exercisable when the sale is completed. He cannot afterwards alter the terms of the sale. Venkatachapathy v. Narayanan (1 914 h, 39 Mad 376). The application of this rule would seem to be in conflict with the decision in Babu Ram v. Ram Dayan (1890) 12 *All 541*. It was held here that agency is not, terminated in the completion of the sale but continues until payment of the sale proceeds to the principal.

If the subject matter of the business of agency has impossible of being carried out, either on account of destruction of subject matter or by its being rendered unlawfully, the agency will be terminated.

When an agency is terminated by the principal dying or becoming insane the agent is bound to take on behalf of the representatives of his late principal, all responsible steps for the protection and preservation of the interests entrusted to him (Sec.201), Revocation and renunciation may be implied in the conduct of the principal or agent respectively. Sec.201 provides an illustration on this point.

A empowers, B to let A's house. Afterwards A lets its himself. This is an implied revocation of B's authority.

Thus the principal may revoke the authority given to his agent at any time before the authority has been exercised so as to bind principal. Where, an agency has been created for a fixed period. Reasonable notice would be necessary to terminate it. Where an agency has been created for a fixed period, compensation would have to be paid for its period, compensation would be have to be paid for premature termination, if the termination is without sufficient cause.

Irrevocable Agency

In certain circumstances, however the authority of the agent is irrevocable. They are as follows . 1) When the agent has interest in the subject matter of Agency 2) When the agent has already exercised his authority so as to bind the principal 3) Where the agent has incurred personal liability.

3.15 AGENCY COUPLED WITH INTEREST

One clear case in which an authority cannot be unilaterally revoked by the principal is where it is coupled with an interest held by the agent. For instance, a borrower, in consideration of a loan authorizes the lender to receive, the rents of Blackacre by way of security, he authority, remains irrevocable until payment of the loan in fun has been effected. This doctrine applies, however, only where the authority is created to order protect the in the authority is created order protect the interest of the agent, it does not extend to a case where the authority has given for some other reason and the interest of the agent arises later. This was the issue in Swart V. Sanders (1848) C.B. 895. In this case goods were consigned to a factor for sale and he subsequently made advance to his principal on the credit of the goods. It was held that the subsequent advance could not convert the agency into one coupled with interest. Wilde C.J. stated the rule thus, "the making of such and advance may be a good consideration for and agreement: sec. 202, Provides, "When an agent has himself and interest in the property which forms the subject matter so the agency, the agency cannot in the absence of an express contract, be terminated to the prejudice of such interest". The following example appended to this section illustrate this principle.

a) A gives authority to B to sell A's land, and to pay himself out of the proceed, the debts due to him from A. A cannot revoke the authority, nor can it be terminated by his insanity or death.

b) A consigns 1000 bales of cotton to B who has made advances to him on such cotton and desires B to sell the cotton, and to repay himself out of the price amount of his own advances. A cannot revoke his authority not is it terminated by his insanity or deity.

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

More represents of remuneration cannot be an "interest" within the meaning of this section. It can be seen that in the case of an agency coupled with interest, the agency cannot in the absence of any express contract, be terminated to the prejudice of such agent.

3.16 EFFECTS OF TERMINATION : RULE REGARDING EFFECTS OF TERMINATION ARE FURNISHED UNDER SEC. 208 AND 210

1. The authority of an agent so for as he is concerned comes to end of the moment he knows that the authority has terminated (Sec.208).

So far as third parties are concerned, they can proceed to deal with the agent, as such, till they come to know of the termination of the authority (Sec 210).

The following illustration is relevant to our discussion – A directs B to sell goods for him and agrees to give B five percent commission on the price fetched by the goods. A afterwards, by letter revokes B's authority. B after the letter is sent, but before he receives it, sells the goods for 100 rupees as is commission.

Since in this particular instance he sells the goods before receiving the letter of revocation isgood.

As already noted, even death or insanity of the principal terminates the agency. According to law, mere facts on death is sufficient and need not even he brought to the notice of the agent. Indian law is different on point. In India, it is determined only when the fact of death or insanity comes to their knowledge. After the determination of the agency by death or insanity comes to their knowledge. After the determination of the agency by death or insanity of the principal the agent is bound to take reasonable care of the principal's properties in his hand.

Sec.210 provides that on the termination of the authority of an agent, authority of all sub-agent is also terminated. As a general rule this is obvious. There may be cases where a substitute rather than a sub-aget has been appointed, and there appears by express agreement or by nature of the case an intention that his authority shall not be determined when that of original agent is revoked.

3.17 AGENT'S DUTIES TO PRINCIPAL

When the fact of agency is established, the need to consider the rights and duties of an agent is inevitable. The duties of an agent to his principal may be briefly set forth under the following heads. They are as follows:

3.17.1 Conduct of business according to directions

An agent is bound to conduct the business of his principal according to the direction given by the principal. In the absence of such directions, he has to act according to the custom where prevails n doing business of the same kind at the place where the agent conducts such business. If the agent act otherwise and any loss is sustained, the agent must indemnify the principal. If any profit accrues, the agent must account for it. (Sec. 3211)

Illustration

a) A an agent engaged in carrying on for B a business, in which it is the custom to invent from time to time, at interests, the money which ma be in hand;

omits to make such investments. A must make good to B the interest usually obtained by such investments.

b) B, a broker, in whose business it is not the custom to sell on credit, sells goods on credit to C whose credit at the time was very high C, before payment becomes involvement, B must make good the loss to A.

Thus for example, in Lilley Vs. Double day (1881) 7Q, B.D. 510, an agent was instructed to warehouse the goods of his principal at a specified place. But he placed a part of the goods at a different warehouse which was equally safe. But the goods were destroyed without negligence. It was held that the agents must bear the loss. So if the agent departs or disobeys the instructions of his principal, he is absolutely liable for the loss.

ii) Use of ordinary skill and negligence

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, unless the principal has notice of his want of skill he must always act with reasonable diligence and use such skill as he possesses. He must make compensation to his principal in respect of the direct consequences of his own neglect, want of skill or misconduct. But if the loss or damage is indirectly caused by such neglect, want of skill or misconduct the agent will not be liable. (Sec. 212).

For e.g. A an agent for the sale of goods, having authority to sell on credit, sell to B on credit, without making proper and usual enquires as to the solvency of B. B, at the time of such sale is insolvent. A must make compensation to his principal in respect of any loss thereby sustained.

3.17.3 Accounts

An agent is bound to render proper accounts of his principal on demands (Sec.213). It is one of the important duties imposed on the agent that he must keep proper accounts and produce them with vouchers and receipts whenever the principal desires their production.

3.17.4 To communication with principal

It is a further duty of the agent, in case of difficulty, to use all reasonable diligence in communicating withi his principal and in seeking to obtain his instructions. Thus where the goods were consigned by the principal to a particular place and the agent tool them to a different place for sale in order to minimize the loss without communicating and getting the pincipal's instructions and loss resulted, the agent was held responsible (Sec.214).

3.17.5 To pay all sums to the principal

An agent is bound to pay his principal all sums received on his account subject to deductions such as money due to himself in respect of advances made or expenses, properly incurred, and also the remuneration due to him (Sec. 218).

3.17.6 Not to set up adverse title

When the reagent has obtained goods or property from the principal as an agent, he is precluded from setting up his own title or setting up the title of third parties to the property.

3.17.7 Not to use information obtained in the course of Agency

When an agent has obtained any information in the course of agency, the agent must on no account use it against the interest of the principal. If an agent does not make use of such information the principal can stop him from doing so of an injunctions. Again an agent should not disclose any confidential information, supplied to him by the principal.

3.17.8 Not to delegate authority

Subject to the six exceptions an agent must not delegate his authority to another person, but from the work himself.

3.17.9 Duty to avoid conflict of interest

The principle incorporated in Sec.215 provides that if an agent deals on his own account in the business of agency, without first obtaining the consent of his principal and acquiring him with full facts, the principal may repudiate the transaction if he can shoe that (1) material fact has been dishonesty concealed from him (b) the dealing of the agent has been disadvantageous to him.

Where, for example the agent discovers a mine on the principals estate and without disclosing this fact buys the estate for himself, the principal may repudiate the transaction.

If the agent without the knowledge of the principal, deals in the business of the agency on his own account, and on behalf of the principal, the principal can nevertheless claim the profits resulting from such transactions (Sec.216)

Illustrations

1) A direct B, his agent to buy a certain house for him. B tells 'A" it cannot be bought, and buys the house for himself. A may on discovering that B has bought the house compel him to sell it to A at the price he bought it.

2) A directs B to sell A's estate B on looking over the estate before selling finds a mine on the estate which is known to A. B informs A that he wishes to buy the estate for himself, but conceals the discover of the mine. A allows B to buy in ignorance of the existence of mine. A on discovering that he know of the mine at the time he bought the estate may either repudiate or adopt the sale at this option.

3.18 RIGHTS OF AN AGENT AGAINST HIS PRINCIPAL

3.18.1 Right to receive remuneration

Where the services rendered the agent were not voluntary or gratuitous the agent is entitled to claim the remuneration or commission and expenses property incurred by him. Every agent is clearly entitled to his agreed remuneration or if there is no agreement to a reasonable remuneration. In the absence of any contract to the contrary - his right to claim remuneration will arise only when he has carried out the object of the agency in full without being guilty of misconduct. Where that agent is prevented from earning his remuneration by some wrongful act or default of the principal, the agent can recover by way of damages the actual loss sustained by him which, in cases where he has done everything will be the full amount of remuneration. But where the agent has misconducted him self in the business of the agency, he will not be entitled to his remuneration (Sec.220). It may be observed in this connection that if an agent indirectly or directly concludes with the other side he never claim any commission.

A man who is the agent of A in a transaction between A and B, and who also acts secretly for B in the same transactions presumed to act corruptly".

3.18.2 Right of retainer

The agent has the right to retain, out of the money received on behalf of the principal, money advanced or expense, properly incurred in conducting the agency business. The agency may paid the money at the request of the principal, or on account of the understanding implied by the terms of the agency of through mercantile usage. But an agent cannot retain sums received by him in one business for his commission in another business though it may be on behalf of the same principal. (Sec. 217).

3.18.3 Right of Lien

In the absence of any contract to the contrary a agent is entitled to retain goods, papers and other property both movable and immovable of the principal received by him until the amount due to himself for commission, disbursement and service in respect of the same has been paid or accounted for to him. This lien is generally a particular confined to claims arising in respect of the particular goods and property. The property on which the agent claim his lien must not have been received by him by a wrongful act. No sooner, the agent parts with the possession of the gods his right of lien is lost. The right of lien can equally be claimed by a properly appointed sub-agent (Sec.221).

3.18.4 Agent to be indemnified against consequences of lawful acts. The employer of an agent is bound to indemnify against the consequence of all lawful acts done by such agent in exercise of the authority to conferred upon him".

An agent entitled to be indemnified against the consequences of an act causing injury to the rights of third person but which was done by the agent in good faith, while exercising the authority (Sec. 223). But this right to indemnify does not apply to criminal acts of an agent even though they are authorized by the principal.

3.18.5 Right to compensation

Sec.225 provides for the right reads thus,

"The principal must take compensation to his agent in resopect of injury caused to such agent by the principal's neglect or want of skill. "The following illustration makes the point clear : A employs B as a brickplayer in building a house and puts up the scaffolding himself. The scaffolding is unskillfully put up; and B is in consequence hurt. A must make compensation to B.

3.19 RELATION OF PRINCIPAL WITH THIRD PARTIES

Having explained the true nature of contract of agency, it now remains to consider the liability of principal of third parties. Only those acts which have been done within the scope of agent's authority alone bind the principal. Sec. 226 is based on this principle it reads thus.

"Contracts entered into thorough an agent and obligations arising from an done by an agent may be enforced in the same manner, and will have the same legal consequences as if the contract has been entered into and the acts done by the principal in person".

From the above section it is clear that the principal is vicariously bound by all contracts and liable for obligations arising from the acts of the agent as if he has incurred them personally.

Once it is established that the agent is acting within the scope of his ostensible authority, the principal will be made liable as regards third parties for all the acts and obligations of an agent. What is ostensible authority of an agent has been discussed in an earlier lesson. The reasoning is that an apparent authority is deemed to be the real authority. Ostensible authority is the authority of an agent as it appears to others. It may happen sometimes that an agent while acting within the scope of his ostensible authority he exceeds the actual authority granted to him. In such a case an option is given to the principal either to ratify those acts or disown such acts. But where the principal follows the latter course of action and where part of the act done by the agent, which is within the authority, so much of the act as is within the authority will be binding upon the principal (Sec 227). Where the authorized work is not separable from the rest, the principal may repudiate the whole of the transaction where an agent was authorized to draw bills up to Rs.200/- each, the principal was not held liable even to the, extent of Rs.200 when the agent drew up to Rs.1000 each.

Further to fix the principal with vicarious liability for the misrepresentations made or frauds committed by his agent, it is necessary that the wrong must have been committed in the course of the principal's business. But if they are made in respect of matters not falling within the authority of the agent, the principal will not be liable. The principal is bound by any other notice given to or information obtained by the agent in the course of business transacted by him.

Where an agent neither discloses the existence of his principal nor his representative character, the third parties can on discovering the representative character, proceed against him for the contract entered into by the agent. It may further be emphasized that the agent will not be personally liable under such a contract. Even in case where the agent is personally liable, a person dealing with him may hold either him or his principal both of them liable. The position is somewhat different in English law where the third party has to select between the liability of the principal or agent and the election once made is final and binding on him – *Kendall v. Hamilton (1879) 4 App. Cases 504).* It is again interesting to note that the third part; cannot sue the principal or agents as the case may be where third party induces either of them to believe that he would not be made liable, and the other alone would be made liable (Sec. 234)

3.20 RIGHTS AND LIABILITIES OF UNDISCLOSED PRINCIPAL

The doctrine of undisclosed principal undoubtedly occupies unique place in the contract of agency. Though the doctrine owes its origin to English law happily the application of this doctrine in Indian law is incorporated in Sec.231 and 232. The doctrine of undisclosed principal comes into play when an agent, though having authority to contract on behalf of another, makes the contract apparently in his own name without disclosing the fact of agency or without disclosing the identity of the principal though the fact of agency is disclosed. By the resultant effects of this principle, either the agent or the principal when discovered may be sued and either the agent or the principal may sue the other party to the contract

Sec.231 reads as follows:- If an agent makes a contract with a person who neither knows nor, has reason to suspect, that he is an agent, his principal may require the performance of the contract, but the other contracting party has as against the principal, the same right as he would have had against the agent, if the agent had been the principal. If the principal discloses himself before the contract is completed, the other contracting party will have the option to refuse to fulfill the contract. For this he should show that, if he had known who the principal in the contract was, or if he had known that the agent was not a principal he would not have entered into the contract". But if the third party did not believe the agent to be a principal, he cannot set off against the principal any claim which he may have against the agent.

As a corollary to this principle the following point of law incorporated in Sec.232 can be noted:- "Where a person enters into a contract with another, without knowing or having reason to believe that he is an agent, if his principal requires performance of the contract he can only obtain it, subject to the rights and liabilities between the agent and the party to the contract".

This section creates difficult and complicated problems regarding the right to set off. If the party honestly and reasonably believed the agent to be the principal party he can claim set off against the amount due to the principal when the latter is discovered. But a man who has not been misled cannot claim this right.

The right of action possessed by the undisclosed principal is however subject to two limitations. Firstly, the authority of the agent to act for the principal must have existed at the time of the contract, for where the rule is otherwise any person would be free to intervene in the contract.

Secondly, if the contract expressly or by implications, shows that is to be confined in its operation to the parties themselves the possibility of *agency* is negatived and no one else can intervene as principal.

Thirdly where the personality of the contracting party is of such importance that it is to be taken as a term of the contract no other party an interfere, e.g., contract to write a book by a particular author, to draw a picture etc.

3.21 LIABILITY OF AGENT TO THIRD PARTIES

To conclude this part of the unit, we my briefly discuss the relevant rules and principles regarding the liability of agent to third parties.

If a person falsely represents himself to be the authorized agent of another, and thereby induces a third person to deal with him as such agent, he is liable, if this acts are not ratified by the alleged principal, to make compensation to the other party for any less or damage arising from such dealings (Sec 235). A person who thus falsely represents himself is known as "pretended agent". The liability imposed on him is called liability for breach warranty of authority. This principle was applied in the well known *decision to colleen v. Wright. By Sec.225* a person falsely contracting as agent is not entitled to require performance of the contract. There is a clear distinction between Indian law and English law on the point. Under English law, if the agent purports to act for an undisclosed principal though really for his (agent's) benefit he can claim performance of that contract; but he cannot claim it if he purported to act on behalf of a named principal. In India such performance cannot be claimed by the agent in any case.

It will be observed that generally as agent is not made personally liable in respect of a contracts entered into by him as an agent. There are exceptional cases in which an agent will be personally liable and the position of an agent is determined by special rules. Usually under the following cases he is personality liable (a) Where the contract expressly provides for the personal liability of the agent; (b) where an agent does not sign on negotiable instrument as an agent (Sec.28) of the Negotiable instruments Act. If an agent appears as party then his liability depends upon whether he signs as acceptor or in some other capacity such as drawer on endorser, c) Where the agent acts for a foreign principal. (One of the trade usages established by the Law Merchant was that a person who contracted as agent for a foreign principal was to be regarded as having contracted as principal to the exclusion of foreigner), (d) where an agent acts for an undisclosed principals (d) where the agent acts for a principal who cannot be sued on account of his being a minor, or a foreign sovereign, etc., (f) where the agency is coupled with interest; (g) where, according to trade usage, an agent in certain kinds of questions is personally liable.

Check Your Progress

1. Define Agency What are the essentials of agency?
2. What is agency by estoppel?
3. When can wife pledge her husband's credit?
4. What is meant by regency by ratification
5. When is an agent entitled to receive emuneration?

Sec.230 of the Contract Act embodies the above principle and provides as follows "In the absence of any contract to elect, the agent cannot personally enforce contracts entered into by him behalf of his principal, nor is he personally bound by them".

This section in particular speaks about the agent's immunity from personal liability. Wider application of this principle is given even to those acts where agent has contributed beyond his authority Sec.230 while incorporating the principal of agent's immunity from personal liability, provides that the agent may contract to undertake personal liability under certain circumstances discussed earlier.

3.22 SUMMARY

A agent is a person who concepts link between principal and third party. The principal should be competent to contract. Accordig to Sec.185 no consideration is necessary to create an agency. Agency may be created in different ways such as express, implied or by holding out or by necessity. Agency may also be created by subsequent ratification. The effects of the ratification is that all the acts done by the agent will find the principal as if they had been performed by his authority.

An agent's authority may be put an end to when principal revoke it. However when the agency is coupled with interest, it is irrevocable according to Sec.202. Whether an agent can delegate his authority to another? Agency it a matter of trust and confidence. An agent is appointed only because the principal has got full confidence in his integrity or ability. An agent cannot further delegate. However there are exceptions to this rule. Where an agent having authority to delegate his authority appoints another person to act in the matter of the agency such other person is called s sub-agent is properly appointed his act will find the principal.

Further, in this lesson you would have studied at length about various rights and duties of an agent. Likewise, liabilities of principal to third parties and liability of agent to third parties. Lastly, a contract of agency may be determined either by act of parties or by operation of law. The instances are well explained in the lesson with examples. Having studied the lesson now, you may be in a better position in understanding the law relating to agency.

2.23 KEYWORDS

Termination – put an end

Incompetent – not eleigible

Estoppel	–	prevented from denying]
Revocation	–	taking back (or) withdrawing
Privity	–	contractual relationship.
Gratuitous	–	act done without any consideration

3.24 ANSWERS TO CHECK YOUR PROGRESS

1. Refer 3.1
2. Refer 3.5.3
3. Refer3.5.6
4. Refer 3.11
5. Refer 3.18.1

3.25 MODEL QUESTIONS

1. Define Agency. How is an agency created?
2. What are the differences between an agent and servant?
3. Who is a sub-agent? What are his rights and liabilities?
4. What is expost fact agency? What are the essentials of a valid ratification?
5. Under what circumstances is an agency terminated?
6. Explain the rights and duties of the principal and agent.

UNIT - 4

SALE OF GOODS

INTRODUCTION

The law relating to sale of goods is now governed by the provisions of the Indian Sale of Goods Act, 1930. The Act repealed and codified Chapter VII (sections 76 to 123) of the Indian Contract Act, 1872, which contained the law relating to sale of goods. The present Act is mainly based on the English Sale of Goods Act, 1893, except for a few principles, specially incorporated to meet the requirements of commerce in our country. The important changes brought about by the present Act may be considered below:- (i) The Act provides a clear distinction between a sale and an agreement to sell; (ii) differences between warranty and a condition has been rightly emphasized; (iii) the rules regarding stoppage in transit, and auction sale have been analyzed; (iv) The Act also provides the cases in which a non owner can convey a valid title, and (v) further it has a number of rules for deciding question of passing ownership in goods.

A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. Here the term property denotes the right of ownership. What is transferred? The right of ownership in the goods is transferred from the seller to the buyer. This is called 'a sale' in the case of agreement to sell, the transfer of ownership is to take place at a future time or subject to the fulfillment of certain conditions. You will be studying the subject Sale of Goods Act, in two units.

In this unit the differences between sale and agreement to sell, sale and bailment have been listed out. Similarly there is differences between sale and hire purchase agreement though hire purchase reasonable a sale, it is an agreement for hire with an option to purchase. In the hire purchase agreement the hirer has to pay a particular amount every month and on payment of last installment he becomes the owner of goods. In the case of contract of sale of goods, the subject matter may be either existing goods or future goods. Future goods means goods to be manufactured or produced or acquired.

The next important topic explained in the unit relates to conditions and warranties in a contract of sale. A condition is a term which is o essential to the contract and the breach of which will entitle the other party to treat the contract as repudiated.

On the other hand a warranty is a term which is collateral to the main object of the contract and it is not so important hence it is known as warranty. It entitles the other party to claim for damages and has no right to reject the good and treat the contract as repudiated.

Various implied conditions and warranties have been analysed with the help of illustrations and leading case laws. You may please read the unit carefully and try to understand the law relating to sale goods. The rest of the topics in contract of sale of goods will be discussed in the next unit.

OBJECTIVES

- To understand the following aspects.
- Definition of Sale of Goods.
- Difference between Sale and agreement to Sell.
- Difference between sale and Hire purchase
- Definition of Goods
- Different types of Goods
- Conditions and Warranties.
- Distinction between condition and warranty.
- Implied conditions in a condition of sale.
- Condition as to quality of fitness.
- Doctrine of cavear emptor

UNIT STRUCTURE

4.1 DEFINITION OF GOODS

According to sec. 2 (7) of the Sale of Goods Act 'Goods' means every kind of moveable property, otherthan actionable claims and money, and includes stocks and shares, growing crops, grants and things attached or forming part of the land which are agreed to be severed before sale or under the contract of sale".

Sec. I(1) of the English Sale of Goods Act defines goods thus. "Goods includes all chattels personal (tangible movable property other than things in action and money".

It is to be noted here that the definition of goods in English Law is somewhat narrower than the corresponding one in Indian Law. Stocks and shares according to the definition in the English Act are not goods but according to Indian Law they are goods. It is however interesting to note that both in England and in India money is excluded from the definition of goods.

Sec. 76 of the Indian contract Act (repeated) defined goods thus.

"Goods means and includes every kind of movable property". Movable property by Sec.3 Clause 34 of the General Clauses Act, means property of every description except immovable property", and immovable property has been defined in Sec. 3 Clauses 25 of that Act as including "land benefits to arise out of land and things attached to the earth or permanently fastened to anything attached to the earth.

It may be observed that actionable claims and money are excluded in the definition of goods. An actionable claim is defined by Sec.3 of the Transfer of Property Act, as claim to any debt, other than a debt secured by mortgage of immovable property, or by hypothecation or pledge of immovable property to any beneficial interest in movable property not in the possession either actual or constructive of the claimant which the civil courts recognize as affording grounds for relief whether such debt or beneficial interest be existent, accruing conditional or contingent. As has been noted on an earlier page provisions of the sale of Goods Act are applicable only those things strictly called goods and sale of immovable property is governed by the Transfer of Property Act.

4.2 CONTRACT OF SALE OF GOODS

Contract of sale is defined under Sec. 4 of the Act :- (1) "A contract of goods is a contract whereby the seller transfers the property in goods to the buye for a price. There may be a contract of sale between one part owner and anothe (2) A Contract of sale may be absolute or conditional".

A close reading of this definition reveals that barter or exchange of one kind of goods for another, is not included in the definition. To constitute a valid sale, according to the law, in England as well as India, there would be an agreement between the parties for the purpose of transferring the title of goods, which presuppose, their capacity to contract. Transfer of property in question must take place for some money consideration called "price". It is expedient to note here that as a result of the transaction, property in the goods should actually pass. Because of the essential circumstances discussed earlier, even if title to the goods passes, but not as a result of the contract between the parties, express or implied, there is no sale. In the same way if the consideration, for the transfer is not money, but other valuable consideration, it may be either an exchange or barter but not sale. So also if under the contract, the property in goods sold has not passed, there is only an agreement to sell and not an actual and completed sale. To constitute a valid sale there must be a concurrence of the following elements viz., (i) Parties must be competent to contract. (ii) mutual assent, (iii) the property in the thing must be transferred from the seller to the buyer, and (iv) a price in the form of money paid or promised - New India Sugar Mills, Vs. Commissioner of Sales Tax (A.I.R. 1963, S.C. 1207).

The definition of contract of sale includes an agreement to sell, as well as sale, and in Sec. 4(3) and (4) the points of difference between the two are noted thus: "where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but, where the transfer of property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell. (4) An agreement ot sell become a sale, when the time elapses of the conditions are fulfilled subject to which the property in the goods is to be transferred.

4.3 DIFFERENT BETWEEN SALE AND AGREEMENT TO SELL

One of the characteristic features of this new Act is that it provides a vital distinction between sale and an agreement to sell. The essence of this distinction is that it determines the rights and liabilities of the seller and buyer. Several important legal consequence obviously follow from this distinctions. The other points of difference may be noted briefly below.

(1) As stated above where the property in the goods is transferred from the seller to buyer the transaction is one of the sale. But when the transfer of property is to take place at a future date or it is to take place subject to some conditions thereafter to be fulfilled the transaction is an agreement to sell.

(2) An agreement to sell is an executory contract whereas a sale is executed contract.

(3) An agreement to sell create only rights in personam i.e., a right available against an ascertained person (the buyer or the seller as the case may be). But a sale creates rights in rem, i.e. a right available against the world at large.

(4) In an agreement to sell, buyer can be sued only for the loss caused by the seller by his default. But in sale, the buyer can be sued for the price of goods in case he fails to pay for the goods, even though goods are in the possession of the seller.

(5) In an agreement to sell, the seller being still the owner, he can effectively convey title in the goods to another person, and the buyer's remedy is to sue for the damage for seller's breach. In a sale, ownership having already passed to the buyer, the seller will be guilty of conversion, if the goods are sold to another. The original buyer in such cases can recover the identical goods from third parties.

(6) If there is an agreement to sell and the good are destroyed by accident, the loss will be the seller's even though the goods are in possession of the buyer. In such circumstances in a sale the loss falls on the buyer, even if the goods are with the seller, because the ownership has vested in the buyer.

(7) If in an agreement to sell the buyer has paid the price and the seller thereafter has become insolvent the buyer could not claim the goods, but could claim only a reliable dividend for the money paid. In similar circumstances, the ownership having already passed in a sale the buyer, as a owner would be entitled to recover the identical goods from the Official Receiver or Assignee in insolvency.

(8) If the buyer becomes an insolvent without paying the price, the seller in the case of an agreement to sell is not bound to part with the goods to the Official Assignee until he is paid in full. If the transaction is a sale the seller has to deliver

the goods to the official Assignee, except when the seller has a lien over the goods. The seller's only remedy is to claim a dividend in the insolvency of the buyer.

The term "contract of sale" referred to above is a generic term and it includes an agreement to sell as well as a sale. Sales Tax Officer, Pilibhit v.Budh Prakash (1954) S.C.J.57. In the instant case it was held that liability to Sales Tax can raise only when there is a completed sale, under which price is paid or payable, and not when there is only an agreement to sell which can only result in a claim for a damages.

4.4 SALE AND CONTRACT FOR WORK

A distinction has to be made between a sale and a contract to work and labour. The distinction between the two is of vital importance as the two have different legal effects. A sale presupposes the delivery of goods by the owner to another for a money consideration. But if the substance of the delivery is only subsidiary there is no sale of goods. In a contract for a work or labour, ownership is not transferred but what is involved is only the exercise of skill of labour and the delivery of goods is only subsidiary. The Sale of Goods Act, both English and Indian, do not apply to contracts for work and labour. Sometimes it is difficult to determine the nature of the cotract. In **Lee Vs. Griffin**; (1841) 30 L.J.QB 258, a dentist agreed to make artificial teeth for a person and fit them into his mouth. The contract was held to be contract for sale of goods, and not one for work and labour. In **Robinson Vs. Graves**; (1935 1KB, 579), contract with an artist who agreed to paint a picture for an agreed sum, on the canvas and with the materials to be supplied by the other party, was held to be a contract for work and materials and not sale of goods.

The simple test to determine the nature of the contract is that when the goods are ultimately to be delivered, it is a contract of sale eventhough some labour on the part of the seller of goods may be necessary. Of course this test may be true in all cases. "One has to look at the substance of the contract" said Green, L.J. in the cases of Robinson v.Graves (1935 1KB,579). Even such an application of this principle to the concrete fact of particular cases may cause difficulty, and hence each particular contract must be judged on its own particular merits. It was held in **Nenuram Vs. State of Rajasthan** (AIR 1967 Raj 50) that a contract for supplying and fixing wooden windiows and doors together with frames and for painting them is a contract of work and labour and not for sale.

We are now in a better position to lay down the essential element of a sale. Because of the essential characteristics discussed above, a contract of sales of goods differs in more than one respect from other types of hire – purchase, a contract of bailment, exchange, gifts etc.,

4.5 SALE AND HIRE PURCHASE AGREEMENT

This hire purchase contract which is very popular now – a – days is a development of modern commercial transaction. In this kind of contract there is no agreement to buy but only an option is given to the hirer has a right to become the owner after paying regularly the stipulated price or to return the goods and put an end to hiring. A sale differs from a hire purchase agreement in that in the former case the ownership of the goods has already passed from the seller and buyer is given the 'option' of purchasing the goods on making the full payments. Thus a hire purchase agreement is an agreement for hire with an option to purchase. The hirer will become the owner of the goods on the payment of the last instalment, by which he is said to exercise the option of purchasing the goods. The two elements which distinguishes a sale from a hire purchase may be noted as (i) Hire – purchase agreement is a kind of bailment which differs from a contract sale in that even though the hirer pays the money on consideration of the use of goods, yet the ownership vests with the person who gives the goods on hire. (ii) As a matter fact, in the case of a hire – purchase contract an element of sale is postulated. The property in goods passes when the option is finally exercised, after complying with all the terms of the agreement by the intending buyer. The distinction is of far – reaching importance especially as regards third persons. As noted above, hire purchase is as incomplete agreement to purchase the goods. Unlike a seller, a hirer cannot exercise any ownership rights on the goods i.e., rights to retail or pledge the goods till he has paid all installments. If the would be buyer becomes insolvent or fails to buy the installments, the real owner can always get back the goods. Moreover, a hire – purchase is not a contract for sale since the hirer enjoys a right to terminate the agreement at his pleasure by non-payment of the further installments.

The "option" frequently referred to above however must be a real one and the hirer must not be compelled to exercise the "option". Further sales tax is not leviable on a hire purchase until it becomes a sale (KL Johar & Co v D.C.T.O. AIR 1965 S.C 1082).

4.6 SALES AND BAILMENT

The distinguishing mark of a bailment a distinguished from a sale will have to be viewed from the following important aspects.

In the case of a bailment, the ownership does not pass to the bailee. The goods are delivered for a specific purpose with the condition that when that purpose is over the goods will be returned in specie. Hence in the case of bailment only possession passes to the buyer, who can use the goods in any way he pleases. If we look into the definition of bailment it is clear that it implies that the right to claim a re-delivery of the property deposited in bailment, is reserved to the bailor. But in a sale on the other hand the buyer becomes the owner of the goods.

4.7 SALE AND GIFT - DIFFERENCES

In the case of sale, goods are transferred to an another for a consideration called "price". The obvious reason is that a contract of sale just like any other and therefore, must satisfy all essential of a valid contract as laid down in Sec.10 of the India Contract Act. But gift is a transfer of property made and effected voluntarily and without consideration. In a gift the ownership passes to the donee "gratis" and thus the price element is absent. It is not a sle.

4.8 GOODS

The subject matter of a contract of sale essentially the 'goods' and we have already noted that the definition of "Goods" Sec.2(7) in defining goods lays down that "Goods" means every kind of moveable property other than actionable claims and money and includes stocks and shares growing crops, grass and things attached to or forming part of the land which are agreed to be served before sale or under the contract of sale. It may be noted that money and actionable claims are excluded from the above definition. "Money here implies current money i.e. the recognized currency in circulation but not old and rare coins which may be treated as goods are brought and sold as such. Stocks and shares being things in action are not goods under English Law, but according to Indian law they have been expressly included in the definition of laws they have been expressly included in the definition of goods. "Moveable property" is defined in the General Clauses Act, 1867 vide Sec.

3(34) as property of every description except immovable property. Actionable claims dèfine in Sec.3 of the Transfer of Property Act, 1882 as: "a claim to any debt other than a debt secured by mortgage of immovable property or by hypothecation or pledge of immovable property or to any beneficial interest inmoveable property not in the possession either actual or constructive of the claimant, which the civil courts recognize as affording grounds for relief, whether such debt or beneficial interest be existent accruing conditional or contingent.

The expression used in English Law is "chose in action or thing in action". Here a person has not the enjoyment of the things but merely a right to recover it by a suit or action. E.g. A debt is a thing in action and actionable claim. As noted earlier thing in action is not included in the definition both according to English Law and Indian Law. If we pause here for a moment, it seems clear that water, gas electricity are, all included in the definition of goods. The Supreme Court in Commissioner of Sales Tax v. Electricity Board (A.I.R.1970 S.C.832) held electricity to be goods.

4.8.1 Existing Goods

Goods may be neither existing goods as where they exists at the time of the contract. It may be either owned or possessed by the seller at the time of contract. It is necessary that they must be in actual of possible existence. In case of sale by an agent or pawnee the goods are possessed but owned by the seller (agent or pawnee). Illustration A sells his horse to B, believing that the horse exists when in fact the horse is dead; no contract will arise.

Existing goods may be either specific goods or unascertained goods or they may be generic goods. Sec.2(4) defines specific goods mean goods identified and agreed upon at the time a contract of sale is made". (e.g. a car, a book).

The above definition is illustrated by the following example. If A who owns a number of cows, promises to sell one of them the contract is one for unspecified goods. If the cow that is to be sold has been pointed out or individualized without any doubt as to its indemnity the contract is for specific goods.

Although it is convenient for the purpose of exposition to discuss this definition of specific good" in isolation, practical problems often require the simultaneous application of the definition of "ascertained good". The form or term is really wider import. "Ascertained Goods" as compared with "specific goods" may be intended to cover the case of goods which have become ascertained subsequently to the formation of the contract although they could not be "specific goods" under Sec. 2(4) of the Act. The rules with regard to the contracts of specific goods are stated in section 7 and 8 which read as follows : "Whereas 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 becomes so damaged as no longer to answer their description in this contract" (Sec.7).

Where there is an agreement to sell specified goods, and subsequently 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 is "there by avoided". (Sec.8). It may observe that the above sections relate only to specific goods and not unascertained goods. This particular aspect is discussed later.

4.8.2 Generic or Unascertained goods

Goods may be unascertained when they exist in bulk but the exact quantity to be transferred cannot be specifically identified and they are defined only by description. The distinction between specific goods and unascertained goods is clearly illustrated by the example given below. A has ten horses. He promises to sell one of them to B, pointing it out to B at the time of the sales. The contract in this case is a sale of the specific horse. If on the other hand, A merely promises to sell anyone of the horses, the contact is for unascertained goods. The horses will becomes ascertained when a makes up his mind as if which one of the horses he will sell and B consents to buy that horse.

The main principles to be noted in case of unascertained goods in found in Sec.18 of the Sale of Goods Act, which read thus, "When the sale is of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are unascertained".

4.8.3 Future Goods

Sec .6(1) of Sale of Goods Act makes it possible for a person to sell or offer to sell future goods, i.e., goods which are to be manufactured produced or acquired after the making of the contract. A contract of the sale of future goods is always an agreement to sell. It is to be remembered that it is never actual sale for a man cannot assign what is not in existence. Future goods are not the same thing as unascertained goods. Where an oil merchant agrees to sell oil to be pressed from seeds. In his possession, the contract is for sale of future goods. For example, A contract to sell 20 bales of cotton to be delivered at a future date. This is a valid contract even though A has got the cotton bales with him nor say other means of getting them except to go into the market to buy them. Although the subject of sale has no present existence, yet if it be the natural product, or expected increase, something to which the seller has a present vested right the sale will be good. Thus a valid contract of sales may be made of the wine that a vineyard is expected to produce or the grain that a field is expected to yield during the year, or the wool that may grow on the sheep. To make it clearl only those goods which can be the subject matter of ownership i.g. famed animals, fish in a pond can alone be sold as future goods. But other goods (e.g., animals in the jungle) which are free and not owned by anyone cannot be the subject matter of sale as future goods.

4.8.4 Contingent Goods

The goods which form the subject matter of a contract of sale in certain cases may be contingent goods. Sec.6(2) makes a specific reference for this type of goods. There may be a contract for the sale of good the acquisition of which by the seller depends upon a contingency which may or may not happen. This type of goods may be called cotingent goods. The underlying principle is brought only by the following illustrations. A agrees to sell 100 bales of cotton provided the ship which is bringing them reaches the post safely. This is an agreement for the sale of contingent goods.

4.9 MERCANTILE AGENT

The essential validity of a contract of sale is that the transfer or property is always from the seller to the buyer. The corollary is that every contract of sale involves at least two parties, seller and buyer and no one can be a seller to himself. But to this rule we have already noted one exception pledge of goods by now – owners (Refer to previous lesson on "Bailment"). "Mercantile Agent" in Sec.2(9) of the Sale of the Goods Act which read thus.

"Mercantile agent" means a mercantile agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for purposes or sales, or to law goods, or to raise money to the security of goods. The definition excludes a warehouseman a carrier or a servant for these persons are not acting in the ordinary course of business such as agents. The chief kinds of mercantile agents are factors, brokers. auctioeneers etc. It is founder on this principle that a sale by a mercantile agent is valid when (i) he is in possession of goods or of the document of the title to goods with the consent of the owner (ii) the sale is made by him and he is acting the ordinary course of a mercantile agent. (iii) the buyer acts in goods faith and has not at the time of contract of sale notice that the seller has no authority to sell. This definition is taken from the English Factors Act and the term mercantile agent is technical expression used to denote a special type of agent. It now remains to consider the definition of Documents of title of goods.

4.10 DOCUMENTS OF TITLE TO GOODS

Document of title to good includes a bill of leading, dock warrant, warehouse keeper's certificate, wharfinger's certificate, railway receipt, warrant or order for the delivery of goods and any other documents used in the ordinary course of business as proof of the possession or control of goods, or authorizing or purporting to authorize, either by endorsement or by delivery, the possession of the document to transfer or receive goods thereby represented Sec.2(4).

The list of documents given to the definition may be considered as inclusive and not exclusive. Besides the above referred documents, any other document can fall under this category on condition (1) it represents the goods and (2) in the ordinary course of business (i) it serves as a proof of possession of control of goods or (ii) entitles the possession of such document to transfer or receive the goods represented thereby.

A bill of leading is a receipt for goods delivered over and shipped on board a slip, signed by the captain of the ship or his agent and the ship named therein. It may also be noted that possession of goods converted by a railway receipt may be transferred by endorsement of the railway recipt is therefore, follows that an unendorsed railway, receipt is not a document of title to goods, but if a consigned gives a railway receipt to any other person it may be inferred that he appoints the other person his agent to take delivery of the goods from the railway compay – **Candas v Amarchana.** However, it is not necessary that these documents of title should be negotiable instruments.

So far, we have consider in detail the various terms and its legal effect in a contract of sale and these terms are of far reaching importance particularly when we analyze the formalities of sale.

4.11 HOW IS SALE MADE?

It is to be noted again that though the law relating to the sale of goods is governed by a separate Act the unrepeated provisions of the Contract Act are to continue in apply to contracts for the sale of goods. The general rules and principle as laid down in the Contract Act relating to capacity of a party to enter into a contract, disability of persons, incompetent to contract, unlawful consideration or object of a contract void contract, damages, fraud, misrepresentation will equally hold good to a contract of sale.

A contract of sale of goods is a contract where by the seller transfers or agrees to transfer the property in goods to the buyer for a price. There may be contract of sale between one part owner and another. A contract of sales is governed be absolute or conditional. As a contract of sale is governed by general rules of contract there must be an offer to buy or sell goods and as acceptance of that offer, parties competent to contract and genuine mutual consent. Further the contract of sale must be for a price, which is defined in sec 2(10) of Sale of Goods Act, as "the money consideration for the sale of goods".

The contract of sale may either relate to an actual transfer of property or an agreement to transfer property at a future date subject to some conditions. Where ownership pass immediately from the seller to buyer it is a scale but where property is to passes on some future date is an agreement to sell. The essential element here is that there is transfer or agreement to transfer property. It implies "ownership" and delivery of possession". In this connection we may note in a contract of Bailment there is neither actual transfer nor agreement to transfer property in goods. What involved here is that goods are delivered for some purpose on the condition that they shall be redelivered soon after the purpose is over. Hence in a contract of bailment as distinguished from a contract of sale there is only delivery of possession and not "transfer ownership".

In most of the cases, the contract of sale pre supposes two parties i.e., buyer and seller. It is obvious that the transfer of property is from the seller to the buyer. However one owner can sell to another and as such there may be a transfer of his share by a partner to his firm and vice versa. Sec.4(1) of the sale of Goods Act makes a specific reference to this point.

4.12 PRICE

One of the essential element of a sale is price. In a contract of sale the consideration is always money. Price may be defined as the money consideration for a sale of goods. We shall consider in detail the scope of Sec.9 which governs the rules relating to "Price" in a contract of sale.

4.13 SEC.9 LAYS DOWN

The price (i) may be fixed by the contract of parties (ii) may be left to be fixed in a manner thereby agreed or (iii) may be determined by the course of dealing between the parties or (iv) if not capable of being fixed in any of the above ways. It may be a reasonable amount payable by the buyer. What is reasonable price is a question of fact depends on the circumstances of each particular case. Further rules are furnished by Sec.10 where the price is to be fixed by a third party. Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party and such third party cannot or does not make such valuation, the agreement is thereby avoided, provided that, if the goods or any other part there of have been delivered to. Where such third party is prevented from making the valuation by the fault of the buyer or seller, the party not in fault may maintain a suit for damages against the party is fault".

From the additional rules provided by the Act, it may be observed that subsequent fixation of price for the goods sold is valid under Indian Law. The position in English Law is different. An agreement that goods shall be for price to be subsequently agreed will not be a valid and concluded contract in English Law.

Again, where there is no consideration the transaction amounts to a gift and not a contract of sale. Similarly, if the consideration is delivery of some other goods, the transaction amounts to an exchange or barter and not a contract of sale.

As noted, a contract of sale is subjected to the ordinary rules of the Contract Act, and it must be made by an offer to buy or sell goods for a price and the acceptance of such on offer. The contract may provide for the immediate delivery of the goods or immediate payment by instalments, or that the delivery or payment or both shall be postponed.

A contract of sale may be made for writing or by word of mouth, or party. In writing and party by word of mouth or may be implied from the conduct of the parties. But this is subject to the provision of any law for the time being in force (Sec.4).

4.14 PERISHING GOODS

"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".

This section applied only to specific goods. Specific goods means good identified and agreed upon at the time of contract of sale is made. The general rule is based on the maximum res extinctal (a thing that has caused to exist as contained in sec.20 of the Contract Act). There can be no sale without a thing transferred to the purchaser in consideration of the price received which mean. If at the time of the contract the thing has ceased to exist, the sale is void it may be noted that where the parties to a contract and under a mistake as to a matter of fact essential to the contract, the contract is void. (Sec.10 of the Contract Act).

The ignorance of the seller is the most important consideration under this section. This word without the knowledge of the seller given in the above sections refer only to the ignorance of the seller and no that of the purchaser.

Two illustrations may be considered here: (a) A agrees to sell B 'specific' goods supposed to be on it way from England to Bombay. It turns out that, before the day of the bargain the ship conveying the cargo had been cast a way and the good lost. Neither party was aware of the facts. The contract is void. (b) A agrees to buy from B a certain horse. It turns out that the horse was dead at the time of the bargain though neither party was aware of the fact. The contract is void.

Another point to be noted with regard to perished goods is that if the goods without the knowledge of the seller have become so damaged as no longer to answer to their description in the contract, the contract is void

Goods perishing before sale but after agreement to sell. The general rule of law on this point is provided under Sec.8 which reads thus : Where there is an agreement to sell specific goods and subsequently the goods without any fault on the part of the seller or buyer perish or are damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided".

Whereas previous section 7 gives restricted application only with regard to the case where goods have perished, etc., at the time when the contract was made. Section 8 relates to the good perishing after the agreement to sell but before the sale is effected i.e., before the property goods passed to the buyer. To put it briefly under Sec.7 the contract is void ab initio while under Sec. 8 the agreement can be avoided. Again this section is founded on the role of impossibility of performance (vide Sec.56 of the Contract Act).

The general rule of law as regard risk is that the goods remain at the seller's risk until the property therein is transferred to the buyer but when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not (Sec.26). That is the risk prima fact passes with property in goods. So that if the goods perish before the risk passes to the buyer it is the seller who suffers the loss.

It will be seen that both sections 7 and 8 apply only to the sale of specific goods. *If the sale is of ascertained quality of* unascertained goods the perishing of the whole quantity of such goods in the possession of the seller will not relieve him of his obligation to deliver. The combined legal effects of both specific and unascertained goods have already been dealt with sufficiently earlier. We shall now *proceed to explain the legal effect of* unascertained goods perishing before making of contract of sale with the help of an illustration.

A agrees to sell to B 50 bales of Bengal Cotton out of 3000 bales in his godown. The godown had at the time of the contract, been destroyed by fire unknown to A. Here the sale is not specific goods but of a certain quantity of unascertained goods. The contract is not void, and A must procure 50 bales of Bengal Cotton elsewhere or pay damages for the breach.

4.15 CONDITIONS AND WARRANTIES

It will necessary hereafter to analyze the stipulations or terms in a contract of sale known as condition and warranties and to observe their legal effects in modern law. It will be observed that in this connection the law, as embodied in the old Contract Act, was materially altered and brought into line with English Law. As the contract of sale is essentially consensual, before a contract of sale is concluded certain statements or representations are made by the parties to each other. Representations made by the seller with reference to the goods may be by way of either a 'stipulation' forming part of the contract or merely an expression of opinion. A statement will amount to a stipulation or promise if the seller assumes to assert a fact of which, the buyer is ignorant; and will be a mere opinion not amounting to a stipulation where the seller merely states an opinion upon a matter on which he has no special knowledge and on which the buyer may be expected to have an opinion. A mere commendation by the seller of goods on his wares does not amount to a stipulation and does not give remedy against the seller. A striking illustration may be considered here. If A wants to sell a horse and he says to B an intending buyer the horse is a beautiful and is worth Rs.1000/- he is commending his representation is merely an expression of opinion.

Thus we find that the stipulations to terms in a contract may be either conditions or warranties. They are defined in sec.12 as follows (1) A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or warranty (2) A conditions a stipulation "essential" to the main purpose of the contract the breach of which gives rise to a right "Treat the contract as repudiated" (3) A warranty is a stipulation, collateral to the main purpose of the contract the breach of which give rise to a claim for damages but not a right to reject the goods and treat the contract as repudiated. (4) whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition though called a warranty in the contract.

Stipulation as to time: unless a different intention appears from the terms of the contract stipulation as to time of payment are nor deemed to be of the essence in the contract of sale. Whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract (Sec.11).

Illustration (a) A goes to B a horse dealer and says, I want a horse which can run at a speed of 40 m.p.h . The horse dealer points out at a particular horse and says. 'This will suit you, A buys the horse . Later on A finds that the horse can run only a speed of 30 m.p.h.

In the above illustration we find a breach of condition because the stipulation made by the seller forms the very basis of the contract (b) A goes to B a horse dealer and says I want a good horse. The horse dealer show him a horse and says , " It can run at a speed of 40 m.p.h". A buys the horse, later on A finds that the horse can run only at a speed of 30 m.p.h. We note in this illustration that there is a breach of warranty because the stipulation made by the seller was only a collateral one and was not of a fundamental nature.

4.16 WHEN A BREACH OF CONDITION IS TAKEN AS A BREACH OF WARRANTY

As noted above Sec.13 draws a clear distinction between a condition and warranty. If a stipulation forms the very basis of the contract or is essential to the main purpose of the contract it is known as condition. If on the other hand the stipulation though not essential to the main purpose of the contract or in the words of the section is collateral to the main purpose of the contract i.e. is a subsidiary promise. It is known as warranty. The aggrieved party in case of the breach of conditions may treat the contract as repudiated. But the effect of a breach of warranty is to give the aggrieved party a right to claim only damages and he cannot therefore repudiate the contract. Two contrasting cases may be cite here to point out the difference between a conditions and a warranty.

In **Behn v Buruness** (1863, 122 E.R.281) a charter party contained a recital by the ship owner that the ship was then in the port of Amsterdam. It was found that the ship was not in that port at the time where the contract was made. The characters refused to load the cargo and repudiated the contract on this ground. It was held that the term was the "condition" and the characters were justified in refusing to load the cargo.

But in another case, **Betini v. Gye** (1876, I.Q. BC198) The plaintiff an actor and a musician agreed to sing at contracts and operas under the direction of the defendant. One of the terms of the contract was that the plantiff should be in London atleast six days before the commencement of the engagement for the purpose of rehearsals. The plantiff actually arrived only two days before the performance and the defendant cancelled the contract. The court held that the term only a "warranty" and that the defendants must fail.

Even in a case where there is a breach of condition the aggrieved party may waive his rights and claim the lesser remedy namely damages and not the repudiation, of the contract. Sec. 13(1) lays down as follows, "Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition to elect to treat the breach of the condition, as a breach of a warranty and not as a ground for treating the contract as repudiated.

A further point may be noted in Sec.13(2) that there are certain cases where, even for the breach of a condition the aggrieved party may not be allowed to repudiate the contract. The qualifications and conditions imposed will be readily understood by reference to Sec.13(3). Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated unless there is a term of the contract express or implied to that effect.

Hence under sec .13(2) a breach of condition has always to be treated as a breach or warranty and this section does not give the option to repudiate the contract. They may be treated as above only under these two cases (1) where the buyer as accepted the goods and the contract split up (2) where the contract is for specific goods and the property there has already passed to the buyer. The remedy in these cases is confirmed only to damages.

The buyer is deemed to have accepted the goods when he intimates to the seller that he has accepted them or when the goods have been delivered to him and does any act in the relation to them which is inconsistent with the ownership of the seller. e.g. where he uses them, or where after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.

Conditions and warranties

Taken at their face value sec.2 provides that he stipulations in a contract of a sale may be either conditions or warranties, or depending upon the condition of parties. But as noted earlier stipulations as to the time for performance viz., Delivery of goods, have been held to be conditions. The positions however, was made clearly by the judgement of the court of Appeal in **Bowes v.Shand** (1877) 2 A.C. 455. To appreciate the decision it s necessary to note sec.11 of the Sale of Goods Act. Unless a different intention appears from the term of the contract stipulations as to time of payment are not deemed to be essence of a contract of sale. Whether any other stipulation as to time is or the essence of the contract or nor depend on the terms of the contract".

4.17 IMPLIED CONDITIONS AND WARRANTIES

In a Contract of Sale, Conditions and warranties can be expressed or implied. Express conditions and warranties are those which have been expressly agreed upon by the part at the time of the contract of sale.

Implied conditions and warranties are those which the law incorporates into the contract unless the parties stipulate to the contract. The provisions of sections 14 to 17 are examples of the various conditions and warranties which are implied in every contract of sale. In the absence of contract to the contrary, it may be seen that stipulations relating to title merchantability, identity etc., are treated as implied conditions, and the stipulation relating to quite possession and freedom from charges and encumbrances are treated as implied warranties. Implied conditions and warranties may be expressly disclaimed by agreement or they may be impliedly waived. They may be cancelled or varied by an express agreement or by the course of dealings or by usage and custom.

It is a well established rule that in a contract of sale the buyer should use his own judgement and should not expect the seller to depreciate his own wares. This is founded on the well *known maxim "caveat emptor"*. Caveat Emptor means let the buyer beware i.e. the buyer must take care. This general rule casts an obligation on the buyer to ascertain and ensure that he is purchasing the right quality of goods, there being no duty on the part of the seller to point out the defects in the goods he is buying. The original rule however was gradually modified and the law to an extent protects the buyer by implying certain conditions and warranties in all contracts of sale. These are contained in sections 14 to 17 of the Sale of Goods Act. We shall now consider in detail the scope of each provision.

4.18 IMPLIED CONDITIONS (Secs. 14 to 17)

1. Condition as to Title Section 4 (1) enacts as follows : Unless a different intention appears from the contract, there is an implied condition that seller has a right to sell the goods in the case of a contract of sale and he will have a right to sell the goods in the case of an agreement to sell at the time when the property is to pass".

The condition implied by sec. 14 (1) will manifestly be broken jif the goods sold belong to a third party. Title to goods should subject not only at the time of entering into the contract but also at the time of passing of the property. This is Rowland v.Divall (1923. 2KB 500). A bought a motor car from B and used it for four months. B had no title to the car. A was forced to return the car from B and used it for four months. B had no title to the car. A was forced to return the car to the true owner. Here, as there was a breach of implied condition regarding the title, A could recover the purchase money paid.

4.19 CONDITION AS TO DESCRIPTION (Sec. 15)

By Sec. 15 of the Sale of Goods Act, it is provided that, "Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall corresponding with the description and if the sale is by sample as well as by description, it is sufficient that the bulk of the goods correspond with the sample, if the goods do not also correspond with description.

This condition will normally be implied where the buyer has not seen the goods and relies solely on the description given by the seller and the failure to supply the thing answering the description in the contract amounts to non-performance of the contract itself if goods are sold by sample and after delivery if the buyer finds the goods delivered do not answer to the description he may return them or refuse to take delivery. This implied condition as to description applies to all cases where the purchaser has not seen the goods, but is relying on the description alone. Thus in **Vorley v. Whipp** (1900) I.Q.B 53, the plaintiff agreed to sell a second hand reaping machine which the defendant had never seen and which the plaintiff stated to have been newly bought in the previous year, and was used to cut only 50 to 60 acres. When the machine was delivered the defendant complained of its extreme antiquity and returned it to the plaintiff as not answering the description. The plaintiff sued for the price and the defendant pleaded that there had been a breach of the condition implied. Held, it was sale of goods by description, and the article not having satisfied the description the defendant was entitled to reject it.

In **WALLIS v. PRAT** (1911) A.C. (894), the agreement was for the sale of English sainform seed" exhibited by sample. The seller gave no warranty, express or implied, as to growth, description or any other man. The sample as well as bulk actually supplied turned out to be giant sainfoin not having satisfied the description of goods there was a breach of condition and that the buyer could recover damages.

In Bowes v. Shand (1877 2A.C 445) the learned Judge observed: "If you contract to sell peas, you cannot oblige a party to take beans. If the description of the article tendered is different in any respect it is not the article bargained for and the other party is not bound to take it".

It will be observed that when the sale by sample as well as by description, it is not sufficient that the bulk of the goods corresponds with sample. The crucial condition is that the goods must correspond with description. The mere fact that the goods sold are merchantable. If they do not correspond with the description, does not necessarily compel the buyer to accept them.

The word "description" used in section 15 included not on the description or class of goods also it refers to the quality or fitness place of shipment, time of dispatch or delivery, made of packing etc, for example in In **Re Moore & Co and Landauer & Co** 1921 KB 519, where the contract was for the purchase of 3,000 tins of canned fruits from Australia, to be packed in cases each containing 30 tins, th seller delivered a substantial portion in cases containing 24 tins. The court held that the method of packing was a part of description and the buyers were entitled to reject the whole consignment.

4.20 CONDITIONS AS TO QUALITY OR FITNESS

As seen above the common law rule with regard to the quality or fitness of the goods for the purpos for which they are purchased in caveat Emptor i.e. buyer beware. It is the duty of the buyer to investigate and satisfy himself whether the article will be suitable for the purpose of which he requires it. In the words of Eastwood. "It was for the buyer to make himself acquainted with qualities and defects of the goods which he contemplated purchasing". This maxim **"caveat emptor"** is adopted as normal terms of the contract by the Sale of Goods Act. By Sec.16 of the Sale of Goods Act, it is provided that, "Subject to the provisions of this Act and of any other law for the time being in force there is no implied warranty or conditions as to the quality of fitness; for any particulars purpose of goods supplied under a contract of sale". Exception appended to this rule under sec. 16 may now be analysed.

4.20.1 Exception (i)

Where buyer expressly or by implication, makes known to the seller the particular purpose for which the goods are required so as that the buyer relies on the seller's skill or judgement and the goods of a description (which it is in the course of the seller's business to supply whether he is the manufacturer or producer or not, there is an implied condition that the goods shall be reasonably fit for such purpose. Of course in the case of contract for the sale of a specified article under its patent or other trade name there is no implied condition as to its fitness for any other particular purpose. 16 (1).

By the ~~strict~~ wording of the section not only the buyer makes his purpose known to the seller, but he must thereby" show that he relies on the seller's skill or judgement "Where the article can be used for only one particular purpose the buyer need not tell the seller the purpose for which he requires the goods. In Priest v. Last (1903) 2K.B. 1483, the facts were as follows:

The purchaser of a hot-water bottle was told by the seller that it was suitable for hot water, but not for boiling water. When his wife used it burst, and injured her. Held, the seller was responsible for damages. Where the article can be used for a single purpose, such as hot-water bottle the purpose of which is self evident, in such cases the reliance on the seller's skill and judgement follows as almost irrestible inference.

But in the case where the goods are capable of more than one use then the buyer should make known to the seller his purpose, and then only he can depend upon exception. If he fails to disclose the condition as to fitness it will not be implied. This he will discharge either by telling the seller of his particular purpose or by proving facts, such as the seller, acquaintance with the nature of his business from which the requisite knowledge may be inferred. An examination of the following case may be instructive.

In Jones v. Padgett (1890) 24 Q.B.D. 650, there was a sale by sample of indigo cloth to a tailor who required the cloth for the purpose of making it into liveries. The purpose was not made known to the seller. The cloth was unfit for that purpose owing to a latent defect. Held, the buyer could not reject the contract.

The Act expressly provides however, that the conditions of fitness shall not be implied if specified article is sold under its patent or other trade name. When the buyer relies on the trade name rather than on the skill of the seller, it would be clearly unjust to burden the seller with responsibility of fitness. To meet this kind of situations a provision is added to the first exception. The provision states that in the case of a contract for the sale of a specific article under its patent or other trade name, there is no implied conditions as to its fitness for any particular purposes.

The doctrine of caveat emptor has been revised by sec. 3 of the Supply of Goods (Implied Terms) Act, 1973 under English Law. Sec. 3 now favours the consumer and provides that the condition as to fitness will apply even when the sale is under trade name.

Exception (ii) Implied Condition As to Merchantable Quality

By Sec. 16(2) of the sale of Goods Act it s provided that; Where the goods of bought by description from a seller who deals in that goods of that description whether he is the manufacturer or producer or not, there is an implied condition that the goods shall be of merchantable quality; provided that, if the buyer has examined the goods, there shall be no implied condition as regards defects which such examination ought to have revealed. It will be observed that neither this nor the preceding subsection applies to contract between private persons, but only to cases where the goods are bought from a seller whose business it is to deal in such cases.

In **Henry Kendall & Sons v. William Lilly Co & Sons Ltd** (1969) 2. A.C. 31 Lord Reid said, "Merchantable" can only mean "commercially saleable". Further in order to be "merchantable" the article must be immediately saleable under the description by which they are known in the market.

In **Grant v. Australian Knitting Mills.** (1936 A.C. 65) the plaintiff buyer purchased some woolen underpants from a company dealing in those goods, and after wearing them contracted a skin disease due to a defect n their manufacture. Held, the article was not merchantable as they could not be worn next to the skin, and that the company, which sold them was liable to pay damages.

In **Godely V. Perry** (1960 I.W.L.R. 9), the above principle was followed. The defendant, who sold toys displayed in his shop window some plastic toy catapults. The plaintiff, a boy of six, saw them, entered the shop and bought one for six pence. While he was using it, it broke and he was struck in the left eye, which had to be removed. The defendant was held liable and it was manifest that the catapult was not of merchantable quality. It may, however, be said that if the buyer has examined the goods there shall be no implied condition as regards defects which such examination ought to have revealed.

Further point to be observed in this connection is Sec.111 of the Contract Act (which has been repealed) laid down that "On the sale of provisions there is an implied warranty that they are sound". The provisions supplied must not only answer to description and be unmerchantable but also wholesome. Specific reference to this condition though not made in the Sale of Goods Act the condition as to merchantabilty must be deemed to include fitness for consumption in the case of provisions. Thus where "X" purchased milk from "Y" a milk dealer, the milk contained typhoid germ. X's wife on taking the milk, got infected and died. Held X was entitled to get damages – **Frost v. Aylesbury Dairy Co.** 1905 K.B. 608.

The term merchantable quality is defined in sec. 7(2) of the (English) Supply of Goods implied Terms Act, 1973, which provides that the goods shall be fit for the purpose of purposes for which goods of that kind are commonly bought.

4.20.2 Packing of goods

Packing of goods is also equally important under the condition 'merchantability'. For example in **Morelli v. fitch and Gibbions** (1928 2.K.B. 636), the plaintiff purchased a bottle of Shone's Ginger Wine. When he attempted to open the bottle with a corkscrew the neck of the bottle broke off, and the bottle fell to the ground cutting the plaintiff's hand. The court held that the seller was to answer for plaintiff's injuries.

Exception (iii) An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade Sec. 16(2).

So much is reasonably clear, that though the general principle of caveat emptor has been recognized in India by sec. 16 of the present Act, it is conditioned by the above referred exception which has modified the effect of the rule to a great extent. It is pertinent to stress that the old common law rule of caveat emptor has become so attenuated by exceptions implied by law on the ground of commercial equity that it has been said that it should now run "caveat venditor", (seller beware).

4.21 CONDITIONS IN A SALE BY SAMPLE

Sec. 17 of the Sale of Good Act provides for a sale by sample. In such a case there is an implied condition, first that the bulk shall correspond with the sample in quality, secondly, that the buyer shall have a reasonable opportunity of comparing the goods with the sample. These two conditions may not, however, afford adequate protection to the buyer.

The object of a sample is to present to the eye the real meaning and intention of the parties with regard to the subject matter of the contract which it may be difficult or impossible to express in words, but the buyer is not expected to pull to prices in order to search for latent defects. There is therefore a further implied condition namely that the goods may have any defect rendering them unmerchantable which would not be apparent or reasonable examination of the sample.

In Nichol v. Goods (1845) 154 E.R. 426 there was sale of 'foreign refined rape oil" warranted only equal to sample. The oil tendered at the same as the sample but it was not foreign refined rape oil" being a mixture of it and other oil. It was held that the seller was liable, and the buyer could refuse to accept.

4.22 IMPLIED WARRANTIES

Before concluding the subject of conditions and warranties two more essential implied warranties may be noted here. The Sale of Goods Act contains provisions designed to product a buyer whose possession or ownership is disturbed which will be implied in a contract of sale unless a different intention is apparent.

4.22.1 Warranty as to Quiet Possession

Sec. 14(b) lays down that there is in every contract of sale, an implied warranty that the buyer shall have and enjoy quiet possession of the goods. Being a warranty its breach as seen above entitles the purchaser to claim damages but he cannot repudiate the whole contract. The meaning of the warranty implied by sec. 12(2) is clear. In **Mason v. Burnigham** (1942) 2 K.B. 545 the Court of Appeal applied the above principle. The plaintiff bought a second hand typewriter from the defendant. It was later found to have been stolen and the plaintiff accordingly sued for damages.

4.22.2 Warranty Against Charges And Encumbrances

Sec. 14(C) lays down that there is an implied warranty that the goods shall be free from any charge or encumbrances in favour of any third party not declared or known to the buyer before or at time when the contract is made". The warranty as specified in this section amounts to a promise by the seller that the buyers possession shall not be disturbed by reason of the existence of an encumbrance. There will be a breach of it if the buyer is compelled to discharge any such encumbrance. It should be noted that the above referred warranties and conditions will be implied even in case where some of them have been expressed, provided that the conditions or warranties which are expressed are not inconsistent with implied warranties and conditions Sec. 16(4). It is profitable to attempt a precise enumeration of implied warranties by usage of trade.

Check Your Progress

1. Define Sale.
2. Define Goods
3. Distinguish between sale and agreement to sell
4. Define condition
5. What is a warranty?
6. What is implied condition as to quality?
7. What is meant by Caveat Emptor and state its exceptions

4.22.3 By Usage of Trade

An implied warranty as to quality of fitness for a particular purpose may be annexed by usage of trade. Sec. 16 (3).

Where the goods are dangerous and the seller knows that the buyer is ignorant about the dangerous nature of the goods the seller should warn, the buyer about the probable danger. This point had arisen in the difficult case of Clarke Vs. Army and Navy Co-operative Society Ltd.

A sold a tin of disinfectant powder to C.A. knew that the tin was to be opened with special care, otherwise it might prove dangerous. He also knoew that C was ignorant about it. He did not warn C.C. opened the tin and his eyes were injured by the powder. Held, A was liable as he should have warned C of the probable danger.

The most important question relating to the transfer of ownership in goods will be analysed in the next unit.

4.23 SUMMARY

In this unit the definitions of sale and agreement to sell, the differences between them, implied conditions and warranties in a contract of sale have been discussed. If there is a breach of condition and warranty what is the effect of such breach also explained in this unit with illustrative cases.

4.24 KEYWORDS

Fastened	-	fixed or hold in place
Barter	-	exchange
Subsidiary	-	controlled by another company
Unascertained	-	could not ascertain
Consensual	-	involving or relating to consent
Stipuation	-	specific term in an agreement

4.25 ANSWERS TO CHECK YOUR PROGRESS

1. Refer 4.2
2. Refer 4.8
3. Refer 4.3
4. Refer 4.15

5. Refer 4.15
6. Refer 4.20
7. Refer 4.20

4.26 MODEL QUESTIONS

1. Define sale and distinguish it from contract of work and labour.
2. Define 'Goods' what are the different types of goods.
3. Write a note on document of title to goods.
4. What are the implied conditions and warranties in a contract of sale?

UNIT – 5

SALE OF GOODS

Sale of Goods (contd.)

INTRODUCTION

In the previous unit we have studied the definition of sale, agreement to sell and conditions and warranties. Continuing the topic Sale of Goods Act, in this unit we are going to discus how the property in the goods pass from seller to buyer in the case of ascertained and unascertained goods, what are the rights and duties of the seller and buyer and lastly about various rights available to unpaid seller.

UNIT OBJECTIVES

- to understand when the property in the goods pass from the seller to buyer
- to study the scope of risk prima facie passes with ownership.
- to analyse the various rights and duties of seller and buyer.
- to study the various rights of unpaid seller

UNIT STRUCTURE:

5.1 TRANSFER OF PROPERTY AS BETWEEN SELLER AND BUYER

It is to be recalled here that the main difference between a sale and an agreement to sell is that ownership is transferred in the former, while it is not transferred in the latter and it is a question of construction of a contract in each case at what stage the property shall pass and a question of fact in each case whether that stage has been reached. There is no difficulty when the parties have expressed their intention in express and clear terms. When however, they have not done so, the intention must be gathered from the whole agreement, and the courts have for this purpose adopted some rules of construction which are set out in Secs. 20 to 24. These rules apply only where there is no intention to the contrary.

Sec. 19 days down :

(i) "where there is a contract for the sale of specific or ascertained goods, the property in them is transferred to the buyer at such times as the parties to the contract intend it to be transferred.

(ii) For the purpose of ascertaining the intention of the parties, regard shall be had to terms of the contract, the conduct of the parties and the circumstances of the case.

(iii) Unless a different intention appears, the rules contained in Secs. 20 to 24 are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer.

Goods are said to "ascertained" when they are identified in accordance with the agreement after the contract of sale is made. (*In relate* (1927) I. Ch 606)

In order to decide the intention of parties the following rules are applicable.

5.1.1 When goods are in a deliverable state :

In an unconditional contract of sale of specific goods, which are in a deliverable state, property in the goods will pass from the seller to the buyers as soon as the contract is made and sale is effected, unless a different intention appears from the dealing of the two parties. Time for the payment of the price or delivery of the goods shall be immaterial. Property in deliverable state passes as soon as the contract is made if it is a case of an unconditional contract of sale of specific goods. "Deliverable State" is defined by Sec.2(3) thus: Goods are said to be in a deliverable state when they are in such state that the buyer would be bound under the contract to take delivery of them.

In Turby v.Bates, a case of sale of one lot of fire clay at certain price per ton requiring the buyer to weigh them and have the same transported, it was held that property passed as soon as the contract was made. However,in Zagury v.Furnell, relating to sale of goat skin where there was a custom of trade requiring the sellers to count them and when the goods were destroyed by fire before this was done, it was held that the title had not passed to the buyer under the contract of sale and the loss must be to seller's account.

5.1.2. When the seller has to do something :

Where there is a contract for the sale of specific goods and the seller is bound of do something for putting the goods in a deliverable state, the property will pass when such thing is done and buyer has notice thereof (Sec. 21).

Illustration: A, a ship-builder, contracts to sell to B, for a stated price, a vessel which is lying in A's yard; the vessel to be rigged and gifted for a voyage, and the price to be paid on delivery. Under the contract, the property in the vessel and the risk do not pass to B until the vessel, has been rigged and fitted and notice thereof is given to B.

In a case where the seller had to bag the rice and book it on the railway and dispatch it as and when the wagons become available and then deliver the railway receipt to the buyer, it was held that until the goods were loaded in wagons and dispatched, they were not in a deliverable state; it was held that it was the seller's duty to get the wagons.

Thus in Acraman v. Morice, (1849) 8 C.B. 499, there was a sale of timber and according to the custom, the seller has to sever portions rejected by the buyer at his own expense it was held that the goods are not in a deliverable state till the timber was so cut and that ownership did not pass till then.

5.1.3 When goods are to be measured etc.,: When there is a contract for the sale of specific goods in a deliverable state, bus something has to done by the seller to ascertain the price, e.g. weighting measuring or testing the goods, the property in the goods will pass from the seller to the buyer when that thing is done and the buyer bas notice of it. (Sec.22)

It should be observed that this section does not apply when the thing which has to be done is to be done by the buyer and not by the seller.

5.1.4 Sale of unascertained goods: Where there is a contract for the sale of unascertained of future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer (Sec.23) Such assent may be express of implied, and may be given either before or after the appropriation is made.

It is to be noted here that this rule applies to unascertained of future goods sold by description. Appropriation of goods here means separating the goods form other goods so as to determine and identify the actual goods to be delivered.

Appropriation should be unconditional and it can be done either (i) by the seller with the buyer's consent, or (ii) by the buyer with the seller's consent. Normally goods are in the seller's possession, and therefore, he appropriates the goods. But *in those case where the buyer is acting as the warehousemen, he may appropriate* the goods with the consent of the seller.

The property will pass from the seller to the buyer when:-

- (a) goods of the same description
- (b) in a deliverable state
- (c) are unconditionally appropriated to the contract, and
- (d) by one party with the consent of the other,

5.2 RIGHT OF DISPOSAL (JUS DISPONDENDI):

Where the seller delivers the goods to the buyer or to a *carrier or other* bailee for the purpose of transmission to the buyer, and does not reserve the right of disposal, he is deemed to, have unconditionally appropriated to goods to the contact. The seller is said to have reserved the right of disposal (Jus despondeni) where his intention shows that he has an intention not to part with the control over the goods till the fulfillment of certain conditions. where the seller has taken the railway receipt or bill of lading in his own name or where he has taken it *in the name of the* buyer but has delivered to his bank with the instructions that the document is to be delivered to the buyer only when he makes payment of the price or accepts the bill of exchange the right of disposal is said to have been reserved. The present Sec. 23 is to be read with Sec. 25. As noted above, the main object or reserving the right of disposal of goods is generally to secure that the price shall be paid before the property passes to the buyer. *Such a question is* of great importance when a seller has dispatched goods to a purchase in a distance place, and the latter become insolvent before paying for them, because *if the vendor has effectually* reserved the Jus despondendi he can reclaim the goods. The law *on this point is* stated in sec. 25 as follows:

In a contract of sale *specific goods or where goods are* subsequently appropriated *to the contract the seller may, by the terms of the contract* or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled. In such a case, even though goods are delivered to a buyer, or to carrier or other bailee for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer, until the conditions imposed by the seller are fulfilled. (Sec.25 cl.1.)

Where goods shipped or delivered to a railway administration for carriage by railway and by the bill or lading or railway receipt, as the case may be, the goods are deliverable to the order of the seller or his agent, the seller is prima facie deemed to reserved the right of disposal". (Sec.25 cl.2.)

Where the seller of goods draws on the buyer for the price and transmits to the buyer the bill of exchange together with the bill of loading or, as the case may be the railway, receipt to secure acceptance or payment of the bill of exchange, the buyer is bound to return the bill of lading or the railway receipt if he does not honor the bill of exchange and if be wrongfully retains the bill of lading or the railway receipt, the property in the goods does not pass to him".

The rules stated above clearly show that the appropriation must be made with the assent of the other party. This point of law is vividly illustrated by the case of Alkinson v. Bell, the contract was for the sale of machines made by the seller. The seller packed the machines and before sending them asked the buyer to name conveyance by which they should be sent. there was no reply form the buyer, and it was held that there was no appropriation as the buyer had not assented.

Appropriation of goods can be made in any one of the ways mentioned under: (a) by separating the quantity contracted from the other goods, or (b) by putting quantity contracted for in suitable receptacles. The other mode of appropriation is generally made by the seller by delivering goods to a carrier or other bailee for transmission. A common carrier is one who always remain ready for hiring to transport the goods of anyone who desires to employ his, from one place to another.

(5) Before concluding this part of discussion there is something to be said about goods sent "on approval" or "on sale or return" when the goods delivered to the buyer on "approval" or "on sale or return" basis, the property in the goods will pass from seller to the buyer, when the buyer accepts or approves of the goods or adopts the transaction by doing any other act, e.g., pledges the goods or retains the

goods or retains the goods without giving notice of rejection beyond the period fixed or a reasonable period if no time is fixed. (Sec.24)

Illustration : Jewellery was sent by A to B "on sale or return" B pledged the jewellery with C.C, could recover the price of jewellery from B.

5.3 C.I.F. CONTRACT :

The letters C.I.F. stand for cost, instruction and freight. CIF, contract is one in which the price agreed to be paid by the buyer covers insurance and also freight. This type of contract is mainly resorted to by traders who are residing at distant and different places separated by sea. Again, in foreign transactions, tow things are guarded against namely: (i) the insolvency of the parties, and (ii) the perishing of the goods though no fault of either party. Seller is very anxious to remain the owner of goods until payment is made whereas the buyer wants to take delivery of goods immediately on paying the price. Hence the object is two fold under this type of contract. the 'modus operands' of C.I.F. contract may now be explained as under:

Firstly the seller makes an invoices of the goods showing the price to recovered the buyer (The invoice shows the cost of the goods). Secondly, to ship at the port of shipment goods of the description contained in the contract. If the goods shipped do not correspond with the contract description, there is a breach on the contract and the buyer may reject them and sue for damages. Thirdly, to procure a contract of affreightment (bill or lading) under which the goods will be delivered at the destination named in the contract. The bill of lading shows inter alia the date of shipment and freight. Fourthly, to arrange for an insurance upon the terms of the contract in the trade which will be available for the benefit of the buyer. Fifthly, with all reasonable dispatch to sent forward and tender to the buyer, these shipping documents namely, the invoice the bill of lading and policy of insurance, so that the delivery of these documents amounts to delivery of goods purchased, placing the goods at the buyer's risk. Generally these documents will be sent to bank at the place of the buyer and he will have to pay the price to the bank and the take delivery of the documents from it. If the seller does not tender the documents within a reasonable time, that may amount to be breach of contract. When goods are actually shipped and documents are received by the buyer, the possession and property pass to the buyer. The corollary to the above point is that during the voyage, the goods are at the risk of the buyer. This risk will in ordinary cases be covered by the insurance. A buyer under a C.I.F. contract has two rights. He has the right to reject the documents if they are not complete and in order. Again he can also reject the goods if they are not in perfect condition.

Is a C.I.F. contract a contract for the sale of documents?

It is sometimes said that a C.I.F. contract is a contract for the "sale of document" rather that a sale of goods, but it is not so. The fact, hower, remains that though the goods are deliverable by means of documents, it is not, a mere sale of documents. It is a sale of goods and delivery of documents is symbolical of delivery of the goods. This was clearly stated by Chakravarthi. C.J., in Joseph pyke and Sons V. Kedarnath (1959) Cal 328 Even after the shipping documents are presented to the buyer and even after he has paid the price, he still retains the right to examine the goods shipped to him and to reject them, if he finds any deficiency in regard to either quantity or quality. Thus the liabilities of the seller do not altogether end with the shipping of the goods and the dispatch or delivery of the shipping documents relating to them. For the reasons stated above, a C.I.F. contract is a sale of goods, and not a mere sale of documents.

5.4 F.O.B. AND F.O.R. CONTRACTS :

The letters F.O.B. stand for " Free on board." But in the case of a contract for sale of goods which are to be sent by rail, the letters F.O.R. "free on rail" are used. the seller in a F.O.B contract puts the goods on board at his own expense. Immediately the goods are put on board, the property and the risk, pass to the buyer. The goods are at the buyer's risk and more over he is responsible for the freight and subsequent charges including insurance. But the seller has in such a case on give notice to the buyer so as to enable him to insure the goods on voyage. The same principles would equally be applicable to F.O.R. contracts (Free on Rails) who the goods are sent by railway. Even in this type of contract risk of transit, and the burden of freight in F.O.R. are to be borne by the buyer. This does not mean that the buyer has to supply the railway wagons. However, one distinction between F.O.B. contract and F.O.R. may be noted here with special importance. Whereas in a F.O.B. contract there is normally an obligation on the part of the buyer to name the ship, there is no corresponding obligation, apart from special agreement, to name the railway.

5.5 EX-SHIP CONTRACT :

The phrase ex-ship denotes that the delivery has to be made to the buyer from a ship at a place where it is usual for the delivery of goods of the kind in question. So the seller has to deliver the goods to the buyer at the port of destination. In this type of contract, the ownership will not pass until actual delivery and the goods will be at the seller's to insure the goods to protect his interests. Even if the buyer has paid the price against the documents, the buyer does not thereby acquire an interest in the goods or even an insurable interest therein.

5.6 RISK PRIMA FACIE PASSES WITH OWNERSHIP:

As already observed the question whether property has passed is important, firstly, in considering upon when loss will pass in the event of the destruction of the subject matter and, secondly, in determining their rights of disposal of the goods although the price remains unpaid. The general rule, is that in the absence of special terms, the risk follows the property. Thus, after the passing of the property, if the goods are destroyed by fire or accident, the goods are at the buyer's risk and he has to bear the loss. This principle of law is stated in Sec. 26.

"Unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not. Provided that, where delivery has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault. Provided also that nothing in this section shall affect the duties or liabilities of either seller or buyer as a bailee of the goods of the other party".

5.7 TRANSFER OF TITLE :

As a general rule, it is only the owner of goods who can alone sell the goods. This is expressed by the maxim nemo dat quod non habet and as stated by Willis, J., is that "no one can convey a better title than what he has". The general principle is that a seller can not pass a valid title better that he himself has, in goods sold. But an innocent purchaser must be protected when he purchased the goods from person in actual possession with the consent of the owner. Sec.27 of the Sale of Goods Act incorporates this general rule of law. "Subject to the provisions of the Act and of any other law of the time being in force, where the goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods that the seller had, unless the owner of the goods is by his precluded from denying the seller's authority to sell". But though the general rule is as stated above, the owner may be estopped by his conduct from denying the seller's title and setting up his title against the buyer. This is an exception provided in Sec. 27. To the rule laid down in Sec.27 these are the following exceptions.

5.7.1 **Sale in Market Overt:** In England, a person acquires a good title to the goods purchased by his in market overt. Market overt is an open, public and legally constituted market. The purchaser acquires a good title to the goods, provided he buys them in good faith and without notice of any defect or wan of title on the part of the seller. This is an additional exception peculiar to England and does not apply to India.

5.7.2 **Sale by mercantile agent:** A Mercantile agent is one who has, in the customary course of his business as such agent, authority either to sell goods or to consign goods for the purpose of sale or to by goods, or to raise money on the security of goods. (Sec.2, cl.9) Thus essential elements of this exception are: (i) The mercantile agent must be in possession of goods or documents of title to the goods "Document of title to goods" according to the Act, includes a bill of lading, dock warrant, ware-house-keeper's certificate, wharfinger's certificate, railway receipt, warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession of control of goods or authorizing or purporting to authorize, either by endorsement or by delivery, the possess of the document has to transfer or receive goods thereby represented. (Sec.2(4). Delivery with in the meaning of Sec.2 (2) means voluntary transfer or possession form one person to another. (ii) The possession must be one with the consent of the true owner. (iii) The sale must be in the ordinary course of business of a mercantile agent. (iv) The buyer must act in good faith and (v) The buyer should not have notice that the seller had no authority to sell.

5.7.3 Sale by a Co-owner: A Co-owner who is in sole possession of the goods with the consent of all the co-owner, passes a goods title to the buyer purchasing in good faith and without notice that the seller had no authority to sell. (Sec.28)

5.7.4 **Sale by person in possession of goods under a violable contract:** When the seller of goods has obtained possession thereof under a contract voidable under Sec.19 or Sec 19-A of the Indian Contract Act, 1872, but the contract has not been rescinded at the time of sale, the buyer acquires a good title to the goods, provided he buys them in good faith and without notice of the seller's effect of title (Sec.29) A contract is voidable on the ground of fraud, misrepresentation, coercion, or under influence, this rule presupposes a contract and will not apply unless there is a contract. This exception applies only to the cases of viodable contracts and void contracts are not converted by this section. The buyer does not acquire good title, where the possession of the good is obtained under void contract.

5.7.5 **Sale by seller in possession of goods after sale:** Where a person, having sold goods, continuities or is in possession of the goods or of the documents of title to the goods, the delivery or transfer by that person or by a mercantile agent acting for him, of the goods or documents of title, under any sale, pledge or other disposition thereof, shall have same receives in good faith and without notice of the previous sale (Sec.30 (1). This is to be emphasized that the seller must be in possession of the goods as seller and not in any other capacity as bailee or hirer etc. It is immaterial that the property in goods has already passed to the first buyer.

5.7.6 Sale by buyer in possession of goods: As in the above case where a person having bought or agreed to by goods, options, with the consent of the seller, possession of the goods or documents of title to the goods, the delivery or transfer by such person or by a mercantile agent acting for such person of the goods or documents, by way of sale, pledge or other disposition thereof will be valid and effective if the person receiving the same acted bona fide and without notice of the seller's lien. A mere agreement for sale of pledge will not suffice. (Sec. 30)

5.7.7 Unpaid seller's right or re-sale: (Sec.54c.3) Where an unpaid vendor of goods who has exercised his right of lien or stoppage in transit, can even though the ownership in them has passed to the buyer, re sell the goods and conveys a valid title to another buyer, though no notice of resale has been given to the original buyer.

5.7.8 Sale under the Provisions of other Acts: (a) A purchase of goods for value from pawnee who is selling goods under default of the pawnor shall acquire a valid title to the goods, (Sec.176 of the Indian Contract Act) (b) Purchaser of goods from a finer of lost goods shall acquire a valid title provided the sale made by the finder is valid (Sec.169 of the Contract Act). (c) Sale by an official Receiver or Assignee or Liquidator of a company will give to the purchaser a valid title.

These are the exceptions to the general principle where the buyer will get a better title than what the seller himself had. Under the circumstances stated above the transfer of title to goods by non- owner will be held valid.

5.8 PERFORMANCE OF A CONTRACT OF SALE

General rules and principles of Contract Act with regard to the performance of a contract will be applicable there also. Secs.33 to 44 of the Sale of Goods Act, provides further rules with regard to the performance of a sale of goods contract.

The two parties to a contract of sale are the seller and buyer, and each has his duties and obligations to perform. It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance, with terms of the contract of sale (Sec.31) Unless otherwise agreed and delivery are concurrent conditions, that is, they both take place at the same time and they have to be performed simultaneously. The seller must be ready and willing to give delivery in exchange for the price, and the buyer must be ready and willing to pay the price in exchange for possession of the goods.

Delivery can be effected in the manner provided by contract: Delivery is the voluntary transfer of possession from one person to another (Sec.2 (2) of the Sale of Goods Act) Sec.33 of the present Act provides; "Delivery of goods sold may be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorized to hold them on his behalf". Delivery to a wharfinger or a carrier may be actual constructive or symbolic. Actual or physical delivery takes place when the goods are handed over by the seller to the buyer or his agent authorized to take possession of the goods. constructively delivery takes place when the same person who was having possession previously continues in possession for and on behalf of another person form a particular time. Here what is involve is only a change in the legal character of possession. There is neither change of physical possession of goods nor delivery of a symbol, but there is an acknowledgement by the person in possession that he holds them on behalf of another. Delivery of the key of a godown or warehouse is symbolic delivery of the goods therein. Here the goods themselves are not delivered. Delivery of a bill of lading properly endorsed is an example of symbolic delivery. But delivery of a key, however does not operate as delivery of the goods under the lock if it does not in fact give complete access to them.

Part delivery has the same effect for the purpose of passing of property in the goods as a delivery of the whole. But delivery of a part with an intention of severing it from the whole, does not operate as a delivery of the remainder. Where the goods are in the hands of a third person, there can be no delivery to the buyer unless the third person acknowledge that he holds them on behalf of the buyer.

Apart from any express contract, the seller of goods is not bound to deliver them until the buyer applies for delivery. The demand for delivery should be made at a reasonable hour. What is a reasonable time is question of fact. Unless otherwise agreed, the expenses incidental to placing the goods into a deliverable state shall be borne by the seller. Seller is not bound to carry goods to the buyer's place of business or residence unless otherwise agreed upon. He should place the goods at the disposal of the buyer. In the absence of a contract the mode of delivery may be governed by the usage of trade. Delivery of the goods is to be made at the place where the goods are lying at the time of sale unless other wise agreed upon. If the goods were not in existence then, they are to be delivered at the place at which they are produced. (In this context, refer certain types of commercial contracts i.e., C.I.F.F.O.B and F.O.R. discussed earlier).

5.9 RIGHTS AND DUTIES OF THE SELLER AND THE BUYER

Rights of buyer against seller: The first and foremost right of the buyer is to claim delivery of goods as per the terms of the contract. As already seen, it is the seller's duty to deliver the goods and it is the duty of the buyer to accept and pay for them. *The following are the chief rights that the buyer can claim against the seller-*

(1) Regarding quantity the delivery should be made of the exact quantity purchased by the buyer. Where the seller delivers to the buyer a quantity of goods less than he contract to sell, the buyer may reject them, but if the buyer accepts the goods so delivered he shall pay for them at the contracted rate. Where the seller delivers a quantity larger than that he contracted, the buyer may accept the goods included in the contract and reject the rest or he may reject the whole. If the buyer accepts the whole of the goods so delivered, he shall pay for them at the contract rate. Where the seller delivers to the buyer the goods he had contracted to sell mixed with goods of a different description not included in the contract the buyer may accept the goods which are in accordance with the contract and reject the rest or may reject the whole. These rules are subject to usage of trade, special agreement or course of dealing between the parties.

(2) **Instalment deliveries (Sec.38)** – The buyer is not bound to accept delivery thereof by instalments unless otherwise agreed. In the case of delivery by instalments, whether the default of the buyer in paying for one or more instalments, or the default of the seller in delivering one or more instalments of the goods gives a right to repudiate the entire contract, or give rise only to a claim for compensation, is a question depending on the terms of the contract and circumstances of the case.

(3) **Right of examining the goods** : Where goods are delivered to the buyer which has not previously been examined, he is not deemed to have accepted them unless and until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract. When the seller tenders delivery of goods to the buyer he is bound on request to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract. Buyer shall be deemed to have accepted the goods only when – (i) he intimates the seller of his acceptance of the goods delivered to him; (ii) he has been given reasonable opportunity or examining the goods; (iii) he deals with the goods in a manner inconsistent with the ownership of the seller i.e, resells or pledged the goods or makes some alteration in the goods. (Sec.42)

(4) **Buyer not bound to return goods:** (Sec.43) Buyer is not bound to return those goods to the seller which he has right fully rejected. Seller after getting intimation of his rejection shall have to bring back the goods at his own cost.

(5) The buyer can sue the seller in damage for wrongfully neglecting or refusing to deliver goods (Sec.57)

(6) Subject to the provisions of the specific Relief Act, the court may order specific performance of a contract to deliver the specific or ascertained goods. This remedy in many cases is discretionary and it will be granted when it is proved that damages would not be an adequate remedy.

(7) When a warranty is broken by the seller or where the buyer elects or is completed to treat any breach of a condition as a breach of warranty the buyer may have any one of the following rights -

a) he can set up the breach or warranty in diminution or extinction of the price; or

b) he can sue the seller for breach or warranty

(8) In the case of anticipatory breach, the buyer can either treat the contract as subsisting or terminate the contract and sue for damages. (Sec. 61) This is the rule laid down in Frost v. Knight (1872. L.R. 7. Ex.III)

(9) Where the buyer has already paid the price, and the seller commits default in delivering the goods, the buyer can claim refund of the price with interest on the same, at such rate as the court thinks fit, from the date on which the price was paid. (Sec.61)

Liability of buyer for neglecting or refusing delivery of goods: When the seller is ready and willing to deliver the goods and request the buyer to take delivery, and the buyer does not within a reasonable time after such request take delivery of the goods, he is liable to the seller for any loss occasioned by his neglect refusal to take delivery, and also for a reasonable charge for the care and custody of the goods. Provided that nothing in this section shall affect the rights of the seller where the neglect or refusal of the buyer to take delivery amounts to a repudiation of the contract. (Sec.44)

The following may be considered as an additional duty of the buyer. Where the seller of goods agrees to deliver them at his own risk, at a place than that where they are when sold, the buyer shall, nevertheless, unless otherwise agreed, take any risk of deterioration in the goods necessarily incident to the course of transit. (Sec.40)

Rights of the seller: (1) Suit for price: When the ownership in the goods has passed to the buyer and the buyer neglects or refuses to pay for the goods, the seller can sue him for the price. Sec.55 (1).

(2) **Suit for damages for non-acceptance:** The seller can sue for damages for non-acceptance where the buyer wrongfully neglects or refuses to accept and pay for the goods. (Sec.56).

(3) Even though ownership has not passed if the purchaser agreed to pay the price, independent of delivery of the goods, and failed to do so, the seller can sue for the price of the goods, though the goods had not been delivered. Sec.55 (2)

(4) The seller can also sue for interest for the price, from the date on which the price is payable. Sec. 61 (ii) (a)

(5) When the whole of the price has not been paid, he is an unpaid seller within the meaning of Sec.45 of this Act and he can claim the following rights, notwithstanding that the property in the goods has passed to the buyer: (a) Right of lien, (b) Right of stoppage of goods in transit, and (c) Right of re-sale.

5.10. RIGHT OF UNPAID SELLER OR VENDOR

Who is an unpaid seller? unpaid seller means a seller- 1) who has not been paid or tendered the whole of the price of the goods sold: 2) Who had received a bill of exchange or any other negotiable instrument as conditional payment but which is subsequently dishonoured. The term seller in this case will include every person in the position of a seller e.g. agent of the seller (Sec.45)

5.11 UNPAID SELLER'S LIEN:

"Subject to the provisions of this Act, the unpaid seller of goods who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases, namely: (a) where the goods have been sold without any stipulation as to credit; (b) where the goods have been sold on credit, but the term of credit has expired; (c) where the buyer become an insolvent" - Sec.47 (1)

Sec. 2 (8) of the Act defines an "insolvent" as a person "who has ceased to pay his debts in the ordinary course of business, or cannot pay his debt as they become due, whether he has committed on act of insolvency or not"

Lien is a right of an unpaid seller to retain possession the goods which are under his actual possession until he is paid or tendered the price of the goods. This kind of lien postulates that property in the goods has passed, but possession has not passed. Right of lien will not be affected by the fact that he has parted with the documents of title provided the goods remain in the actual possession of the seller. This right may be exercised even where he is holding the goods with the consent of the buyer as his agent or bailee. From the above, it is clear that the lien or an unpaid vendor is a particular lien, and it is further a personal right which can be exercise only by him, and not by his assignment or his creditors, moreover, this right is also indivisible and so unpaid seller's right of lien extends only to the whole of the goods in his possession. He may reuse to deliver a part of the goods on payment of a proportionate part of the price by the buyer. Where unpaid seller has made part delivery of the goods, he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstance as to be an agreement to waive the lien. (Sec.48) The unpaid seller of goods, having a lien thereon does not lose his lien by reason only that he has obtained a decree for the price of the goods. Sec.49(2)

When lien is lost? -Unpaid seller loses his lien in the following cases (Sec.49) when he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods; here the right of lien is no doubt lost, but the right of stoppage in transit will be available; (b) when the buyer or his agent lawfully obtains possession of the goods; (c) by waiving the right of lien. It may also be noted that the right of lien, if once lost, will not revive if the buyer re-delivers the goods to him for any particular purpose.

.12 STOPPAGE IN TRANSIT:

This is of course, the second of the three right of an unpaid seller. This right onsists in stopping the goods while they are in the possession of a carrier, or odged at any place in the course of transmission to the buyer, and resuming ›ossession thereof, and insolvent and the seller being unpaid then the seller has a right to stop the goods in transit although he has parted with goods, The reason behind this doctrine of stoppage in transit is, that one man's goods shall not be applied to the payment of another man's debt. Therefore when the seller remains unpaid after parting with the goods and the buyer becomes insolvent, the seller can effectively exercise the right of stoppage in transit. As we have seen this right comes only when the right of lien ends or is not available, i.e when the seller has parted with the possession of goods. The right of stoppage in transit is only against the goods. Goods are said to be "in transit" when they are in the possession of a third party e.g., a railway company or a shipping company, after the seller has parted with their possession, and before the buyer has acquired possession of them. As we shall see under Sec.51. this right is just an extension of the unpaid seller's right of lien. It arises when the seller has lost the opportunity of exercising the right of lien, i.e. the goods are no more under his physical control.

The right of stoppage in transit can be exercised when the following conditions are satisfied. (1) the seller must be unpaid (2) the buyer must have become an insolvent: (3) the seller must have parted with the possession of goods: and (4) the goods must be in the course of transit.

5.12.1 Lien and stoppage in transit distinguished: (a) Though both the rights arise only when the property in the goods has passed to the buyer yet the right of lien can be exercised only when the goods are in the actual possession of the seller, while the right of stoppage in transit can be enforced so long as the goods have not reached the possession of the buyer through the seller has parted with their possession (b) Right lien can be exercised even if the buyer is not insolvent but right of stoppage in transit is available only when the buyer becomes an insolvent. (c) The essence of right of lien is to retain possession but the essence of right o stoppage in transit is to regain is possession. (d) When the right of lien ends, th right to stoppage transit begins. But the right of stoppage in transit begins when th right of lien ends.

It may further be emphasized that the exercise of the right or stoppage in transit does not mean that the seller gets the sale cancelled or that the property re-vests in him. The seller merely gets the right re-possess the goods. It is clear from the above point, that right is exercised subject to the provisions of the Act. Seller will lose this right when the buyer who has obtained document of title assigns or pledges or sells the goods for value to a bonafide transferee.

5.12.2 Duration of transit: Sec.51 The question of "duration of transit" is important for the reason that this right can be exercised only when goods are in "transit" Guiding rules are furnished under Sec.51.

Goods are said to be in the course of transit form the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent on his behalf takes delivery of them from such carrier or bailee. This point was clearly explained in G.I.P. Railway v. Hanumandas. In this case the seller delivered the goods to a railway company for being transported to the buyer. On arrival at the destination, the buyer paid the freight to the railway company and loaded the goods, in his carts, but before the carts left the compound, the company received a telegram to stop the goods. But the company failed to stop, it was sued for damages. The court held that transit was at end as soon as the goods were handed over to the buyer. Following are the cases where transit is presumed to be at an end and the seller's right of stopping the goods in transit terminates.

5.12.3 Transit will be at an end: When the buyer or his agent obtains delivery of the goods before the arrival at the appointed destination, or (2) when after the arrival of the goods at the appointed destination, the carrier of other bailee, acknowledges to the buyer or his agent that he holds the goods on his behalf or (3) When goods are delivered to a ship chartered by the buyer it is a question depending on the circumstances of the particular case, whether they are the possession of the maste as a carrier of as agent of buyer, or (4) where the carrier or other bailee wrongfully refuses to deliver the goods to the buyer of his agent, or (5) where part delivery of the goods has been made to the buyer for his agent under such circumstance as to show an agreement to give up possession of the whole of the goods, the transit will be at an end for remainder of the goods which are yet in the course of transit.

Transit does not come to an end when the goods have been rejected by the buyer and the carrier or the bailee continues in their possession. The fact that the seller refuses to take them back will be immaterial for ascertaining the duration of transit.

5.12.4 How stoppage in transit is effected: Sec.52 of the Act lays down the following rules on this point.

"(1) (i) The unpaid seller may exercise his right of stoppage in transit:

(a) either by taking actual possession of the goods, or

(b) by giving notice of his claim to the carrier of other bailee in whose possession the goods are.

(ii) Such notice may be given either to the person in actual possession of the goods or to his principal. In the later case the notice, to be effectual, shall be given at such time and in such circumstances, that the principal by the exercise reasonable diligence, may communicate it to his servant or agent in time to prevent a delivery to the buyer.

(2) When notice of stoppage in transit is given by the seller to the carrier or other bailee in possession of the goods, he shall re-deliver the goods to, or according to the direction of the seller. The expenses of such re-delivery shall be borne by the seller".

Effect of Sub sale or Pledge by buyers: To the rule that the seller's right or lien and stoppage in transit are available against all persons who acquire an interest in the good, there are some exceptions.

(1) Where the purchaser who has obtained the documents of title regarding the goods has transferred them to second person who purchased them without any notice of the prior sale, then the second purchaser will get an absolute title over the property.

(2) Where the unpaid seller has allowed or consented to a second sale.

(3) Where the second transfer is by way of pledge together with other goods, the unpaid seller can ask the pledge to satisfy his debt only against the other goods. This is called the right of marshalling of securities.

5.13 RIGHT OF RE-SALE:

Sec.54, mainly deals with the right of re-sale by an unpaid seller who has exercised his right of lien or has exercised the right of stoppage in transit and resumed possession of the goods. A Contract of sale is not repudiated by the exercise of the right of lien and stoppage in transit.

Where the goods are of a perishable nature or where the un-paid seller who has exercised his right of lien or stoppage in transit gives notice to the buyer of his intention to re-sell, the unpaid seller may, if the buyer does not within a reasonable time pay or tender the price, re-sells the goods within a reasonable time and recover from the original buyer damages for any loss occasioned by his breach of the contract. But the buyer shall not be entitled to any profit which may occur on the re-sale. If such notice is not given, the unpaid seller shall not be entitled to recover such damages and the buyer shall be entitled to any profit, if any, on the re-sale.

Where an unpaid seller who has exercised his right of lien or stoppage in transit re-sells the goods, the buyer acquires a good title thereto as against the original buyer, not withstanding that no notice of re-sale has been given to the original buyer..

Where the seller expressly reserves a right of sale in case the buyer should make default and, on the buyer making default, re-sells the goods, the original contract of sale is thereby rescinded, but without prejustice to any claim which the seller may have for damages.

5.14 AUCTION SALE:

Rules regarding sale by auction are laid down in Sec.64. of the Act. Sale by auction is a public sale, where the goods are sold to the highest bidder. Following are the rules regarding auction sales:

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

(b) the sale is complete when the auctioneer announces its completion by the fall of the hammer or in any other customary manner; and, until such announcement is made, any bidder may retract his bid:

(c) a right to bid may be reserved expressly by or on behalf of the seller and where such right is expressly so reserved, the seller or any other person on his behalf may, bid at the auction:

(d) any sale contravening the above rule may be treated as a fraudulent by the buyer:

(e) the sale may be notified to be subject to a reserved or upset price: and

(f) if the seller makes use of pretended bidding to raise the price, the sale is voidable at the opinion of the buyer.

A bona fide agreement between persons not to bid against each other at an auction sale is called as "knock out" agreement. Such an agreement is perfectly valid.

With this we end the discussion on the law relating to sale of goods.

5.15 SUMMARY

When property in the goods passes from seller to buyer in the case of specific goods and uncertain goods are well explained in this Unit with illustrations and cases. The maxim nemo dat quad non habet i.e laws no one can concept a better title than what he has himself has been analysed and the exceptions for the rule have been elaboratly discussed. The rights and duties of seller and buyer have been listed out in this unit. Lastly the most important rights of unpaid seller has been explained. You are requested to study the unit carefully and understand the concept.

Check Your Progress

1. What is meant by ascertained goods?
2. What is right of disposal
3. Explain FOB and FOR contracts
4. What is meant by sale in market overt?
5. Explain stoppage in transit
6. When transit comes to an end?
7. What is Auction sale

5.16 KEY WORDS

Ascertained	-	find out for certain
Rigged	-	arrange in a dishonour way to gain and vantage
Appropriated	-	suitable or proper

transmission	-	the mechanism by which power is transmited
endorsement	-	acting of endorsing
constructive	-	serving a useful purpose
repudiation	-	refused to accept

5.17 ANSWER TO CHECK YOUR PROGRESS

1. Refer 5.1
2. Refer 5.2
3. Refer 5.4
4. Refer 5.7.1
5. Refer 5.12
6. Refer 5.12.3
7. Refer 5.14

5.18 MODEL QUESTIONS

1. When property goods passes from sell to buyer in the case ascertained and un ascertained goods
2. Explain CIF, FOB and FOR contracts
3. 'Risk prima facie passes with ownership' discuss
4. "No one convey a letter title that what he himself has" – Explain the rule and state exceptions.
5. What are the rights duties of buyer and seller?
6. Discuss the various right of unpaid seller?

UNIT – 6

LAW OF PARTNERSHIP

INTRODUCTION

A contract of partnership is a special branch of the law of Contracts and the law relating to it in India was originally contained in Chapter XI (Section 239 to 266) of the Indian Contract Act, 1872. this chapter XI of the Contract Act has been repealed and replaced by the Indian Partnership Act IX of 1932. The present enactment is practically a replica of the English Partnership Act, 1890, except for a few principles specially incorporated to suit the peculiar conditions prevailing in India.

UNIT OBJECTIVES

- to understand the definition of partnership and its essential in gredients.
- to analyse the characteristics of partnership
- to understand difference between partnership and co-ownership, company and joint family firm.
- to study the different types of partnership
- to study the relation of partners to each other.
- to understand the scope of implied authority of a partner.

UNIT STRUCTURE

Introduction

Objectives

6.1 Partnership – Difference between English Law and Indian Law

6.2 Definition of partnership

6.3 Essential characteristic of partnership

6.3.1. Relation between persons

6.3.2. An agreement of Contract

6.3.3. Pooling resources

6.3.4. Business

6.3.5. Carried on by all or any one of them act for all (Mutual Agency)

6.3.6. Sharing profits

6.4 Mode of determining existence of partnership
6.5 Partnership distinguished from other Associations.
6.6 Firm name
6.7 Different types of Partnership
6.8 Formation of partnership
6.9 Agreement
6.10 Consideration for an agreement of partnership
6.11 Capacity of parties
6.12 option to repudiate
6.13 Partnership property
6.14 Partnership by holding out.
6.15 Doramant or sleeping partner
6.16 Illegal partnership
6.17 Relation of partners to each other
6.18 Relation of partnership to third parties
6.19 Notice to acting partner
6.20 Liability of partner to third persons
6.21 Summary
6.22 Keywords
6.23 Answers to Check your progress
6.24 Model Questions

6.1 DIFFERENCE BETWEEN ENGLISH LAW AND INDIAN LAW

Now we can note the important points of difference between the English law and Indian Law.

(a) Much importance is given to the Indian Act to the personality of the firm., than in the English Act. It appears from the English Act, that the provisions relating to introduction, expulsion, retirement, insolvency and death of the partners are to be found scattered in the above Act. But we find under the Indian Act all the above referred provisions are grouped in Chapter V of the Indian Act, entitled "incoming and outgoing partners".

(b) The Indian Act specially provides that the goodwill of a firm is an asset and provides for it s disposable during dissolution of the firm which the corresponding English Act failed to do.

(c) The present Act makes considerable changes and adds provisions for voluntary registration of firms. In this respect also English Act has no corresponding chapter, as the law relating registration of firm names is to be found in the Registration of Business Names Act of 1916.

To put briefly the chapter on "Registration of firms" and on "Incoming and Outgoing partners" are the special and important features of the Indian Act.

6.2. DEFINITION OF PARTNERSHIP:

Though there are several definitions of partnership, it is better at this stage to discuss briefly a few of them.

The English Partnership Act, define partnership as "The relation subsists between persons carrying on business in common with a view of profit".

The simplest definition is given by Sir. F. Pollock. His definition runs as follows; "The relation which subsists between persons who have agreed to share the profits of business carried on by all, or behalf of all them".

Sec. 236 of the Contract Act (repealed section) define them as "the relation which subsists between persons who have agreed to combine their property, labour or skill in some business and to share the profits thereof between them",

Sec. 4 of the Partnership Act defines thus "Partnership" is the relation between persons who have agreed to share the profits of a business carried on by or any of them acting for all".

Persons who have entered into partnership with one another are called individually partners and collectively a firm and name under which their business is carried on, is called, the firm name'.

This definition (Sec.4) has the merit of widening the definition on partnership than the previously contained the Indian Contract Act according to which "Partnership" is called the relations which subsists between persons who have agreed to combine their property labour or skill in some business, and to share the profits thereof between them. Stated in other words, under Sec.236 of the Indian Contract Act it was inter alias necessary to agree to combine property labour and skill. The limitation thus effected by these words has been removed and now there need only be an agreement to share the profits of a business.

We can now confidently assert that this definition includes all the essential elements contained in all the definitions quoted by Lindley, the only exception being dement of the sharing of losses. The agreement to share losses is not essential. Where nothing is said as to sharing of losses, it is implied in a partnership deed. But sharing of losses may be regarded as consequential upon the sharing of profits. The essential motive in making a partnership agreement is the making of profit and this has been clearly brought out in the definition.

6.3. ESSENTIAL CHARACTERISTICS OF PARTNERSHIP :

The definition in sec.4 contains three elements: (i) There must be an agreement entered into by all the persons concerned: (ii) the agreement must be to share the profits of a business; and (iii) the business must be carried on by all or by any one of the persons concerned acting for all.

6.3.1. Relation between persons : Partnership is the name for the abstract legal relationship subsisting between a number of persons and actually not the collective name of all partners as is sometime wrongly presumed. It is essential that there must be more than one persons to constitute a partnership, as a person cannot become a partner with himself. sec.41 of the present Act also provides that when the number of partners in a partnership gets reduced to one by dealth or insolvency, it would cease to be a partnership. Essentially there must be two or more persons to constitute a partnership. The partnership Act does not say anything about the maximum number of partners but sec. 11of the Companies Act, 1956 lays down the maximum number at 10 for a partnership carrying on banking business and at 20 for a partnership carrying on any other business for gain. Accordingly, a partnership consisting of more than the maximum stated above and formed for the purpose of carrying on business with a view to gain is an illegal association.

6.3.2. An agreement or Contract : The second *essential is that this* ıssociation of two or more person should be in pursuance of an agreement or contract, express or implied; to dose not arise from *status. This is an important* feature that distinguishes it from various other relations which arise by operation of law and not from agreement.

A and B purchase a tea shop and incur additional expenses for purchasing utensils etc. contributing half of the total expenses and the shop is leased out on a daily rent which is divided between them both. A and B are co-owners, and not partners (**Govindan Nair** v **Nagahbushnammal**). The co-owners do not simply by reason of their community of interest become partners. Where, for instance two brothers jointly inherit house and to effect repairs to it and from time to time the brothers looks into the accounts and share the rents after payments of the taxes and the cost of repairs, the two brothers do not ipso facto become partners. Here the relationship is in one arising from a contract.

6.3.3. Pooling resources: As has been already seen under repealed section 239 of the Contract Act "Partnership is a contract of two or more competent persons to place their money, effects labour and skill of some or all of them, in lawful commerce or business, and to share the profit and bear the loss in certain proportion". Invariably, it may be common in every partnership that the partners, inter se would agree to pool their resources, i.e., *property, labour or skill*. But as seen above according to a strict view of the law, such contribution is not necessary. Modern judicial opinion clearly rules out the necessity for participation in the business by a partner by a partner and insists only on the undertaking of liability by him. It must be noted the simplified definition of partnership under sec. 4 of the present Act, is on the lines of the English Act. According to this definition, partnership is the relation which subsists between persons carrying on a business in common with a view of profit.

6.3.4. Business : It is better at this stage to speak of 'pooling resources'. It is essential that the agreement between the agreement between the partners to pool the resources must be carry on some 'business'. *Partnership implies* business and where there is no combination to carry on business there is no partnership. "Business" according to sec.2 (b) or the Partnership Act, includes every trade, occupation or profession and again sec. 8 makes provision of a person to become a partner with another person in a particular adventure or undertaking. This kind of partnership is called "Particular partnership". Persons may be partners for a single voyage of a ship or single contract to construct a theature or for one performance of a play. It need hardly be stated that all requisites of a partnership must be present before a transaction between two persons limited to a single adventure is held to be a partnership.

6.3.5 Carried on by all or any of them (Mutual Agency) : In this busy modern economic world, it is increasingly and exceedingly difficult for us to do everything by ourselves and we have necessarily to delegate some of our acts to be performed by another. This is particularly important in the business world. As we know our economic structure of today rests upon the theory that one person may act for and in the place of another. Today, by virtue of agency device one man can make the contracts of a hundred men or one can be in a hundred places at the same time. The underlying and fundamental principle which constitutes partnership is the idea of "Agency" and it is, therefore, often, said that "the law of partnership is a branch of law of (Principal and agents) agency". Law of partnership may truely be termed as an extension of the general principles of agency. The business of the partnership can be carried on by all the partners together or any one of them. Mutual agency is a very important test of partnership and in fact is the foundation of a partner's liability. Partners in a firm embrace the character both of a principal and of an agent. Each partner is both principal and agent for himself and others. The peculiar position of a partners is that he is an agent binding the other partners who are in the partnership business. Each partner is again a principal who in turn is also bound by similar acts of the other partners. Thus an implied agency follows from their relationship as partners and sec. 18 of the Partnership Act, says a partner is an agent of the firm for the purpose of the business of the firm. Thus the idea of (mutual) agency or representation of each partner by all or some of the partners in the partnership business, is a very important characteristic of partnership. The statement in **Emperor v Jwala Prasad** (1924 All.181) that the law of partnership is only a branch of the law of agency only fortifies this essential ingredient of a partnership. It is again not necessary, that every partner must be actively concerned with the conduct of the management of the business of the firm. What is essential according to the section is that the business is carried on, on behalf of all the partners. So, the fact that partners have agreed that the management of the firm is to vest with one of the partners does not negative the existence of the partnership.

6.3.6. Sharing profits : As states above, the essence of a partnership is the attempt to make profit in business for the partners and to distribute amongst themselves the profits. 'Profits' is not defined in the Act but it means the excess of returns 'net profits' i.e. excess of returns over advance, the excess of what is obtained over the cost of obtaining it; Though sharing in the profits of a business is essential, it does not conversely follows that every one who is getting a share out of the profits is a partner. A person may in many other ways, tale a share in the profits of a business. A manager with a share of profits may claim to be a servant of the firm and not a partner.

The word 'persons' in sec.4 only suggests natural or artificial i.e., legal persons. A person cannot be a partner with a wakf, as a wakf is not a person. As a firm is not a person it is not entitled to enter into partnership with another firm, or Hindu undivided family. The definition of the word "person" in sec.3(42) of the General Clauses Act, 1897 cannot be imported here as it is entirely different and totally repugnant to the partnership.

6.4. MODE OF DETERMING EXISTENCE OF PARTNERSHIP

Sometimes it becomes very difficult to determine whether a group of persons running a business constitute a partnership firm or not. A careful reading of the definitions of partnership gave above only reveals that the necessary element of partnership is an agreement among the partners to share profits. As seen above, the chief motive in making a partnership agreement is the making of profits and this has been clearly brought out in the definitions discussed earlier. Though sometimes losses may be inevitable and unavoidable, generally, no one into partnership with another to suffer losses. The reasoning for excluding loses from the definition is that an agreement to share the losses is not so essential and where nothing is said as to the sharing of losses it so implied in a partnership deed. In **Rose v Parkyns,** Jessel M .R stated the law as follows: "It is said that the mere participation in profits interse affords cogent evidence of partnership". The court quite obviously came to the same conclusion in **Waugh v Carver** and it was held that all persons sharing profits in a business were liable as partners to outside creditors, whatever might be the terms between them and the persons actually conducting the business.

The principle was followed in subsequent decisions in England till 1880 when it was changed by the decision of the House of Lords in the leading case of Cox v Hickman (1861). In this case Lord Crawford laid down the principle that sharing of profits of an undertaking is not of itself a partnership though the existence of partnership may often be inferred from it. In that case, certain traders being in difficulties assigned all their properties to trustees, empowering them to carry on the said business. One Cox, who was a creditor trustee did not take part in that business, but he was sought to be made liable as a partner, for liabilities contracted by the trustees. Held, he was not liable, on the ground that the right to participate in the profits was in general a sufficiently accurate test for deciding whether a person was in law a partner or not, but it was not conclusive. It was said that real of partnership liability was whether the trade was carried on, on his behalf i.e., whether he stood in the relation of principal towards the persons acting ostensibly as the traders, by whom the liability has been incurred and under whose management the profits have been made. Again in this instant case the creditors were not partners in the business. The trade was not carried on account if the creditors but the trade still remained the trade of the debtors. The debtors were still the persons solely interested in profits, save only that they had mortgaged them to their creditors.

The principle laid down in the above case was followed and reaffirmed by another leading case Mullwo March Co v Court of wards (1872 L.R 4 P.C 418) The Privy Council laid down that the questions whether the relation of partnership does or does not exist "must depend on the real intention and contract of the parties".

The law as stated above has been restated in sec. 6 of the Indian Partnership Act. This Sec. 6 is a statement of English rule of law contained in Cox v Hickman (1861) 8 H.L.C 268. In fact it provides the test for determining the existence of partnership and it runs as follows: In determining whether a group of persons is or is not a partner in a firm regard shall be had to the real relation between the parties, as shown by all relevant facts taken together .

The sharing of profits or of gross return arising from property of persons holding a joint or common interest in that property does not of itself make such persons as partners- (Explanation 1).

The receipt by a person of a share in the profits of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business does not itself make him a partner with the persons carrying on the business-(Explanation 2).

Some of the illustrations appended to this section will be helpful to understand the real nature of partnership. Accordingly, the receipt of such share of payment does not itself make the receiver a partner with the persons carrying on the business, particularly, in the under mentioned cases (a) by a lender of money to persons engaged or about to engaged in any business;(b) by a servant or agent as remuneration; or (c) by the window of a deceased partner as annuity or (d)by a previous owner of the business, as consideration for the sale of good will or share thereof. From the decided cases it can be said that a mere statesmen that the parties are to be partners will not necessarily constitute then partners in law.

6.5. PARTNERSHIP DISTINGUISHED FROM OTHER ASSOCIATIONS

6.5.1. Partnership and Co ownership : Partnership can be differentiated from co-ownership in several respects. Co-owners of a property does not in itself constitute a partnership between co-ownership whether they share any profit arising from it or not. Thus, for example if A and B who jointly inherit a house from C let out the same to a tenant, divide the rents, then A and B are co-owners of the house, but not partners, for the idea of representation of one person by the other is absent. the principal pints of difference between co-ownership and Partnership are as follows:

	Partnership	**Co-ownership**
1.	It always arises from an agreement (Contract)	Co-ownership is not necessarily the result of agreement : it may arise by operation of law of succession and by status.
2.	It involves community of interest i.e., the sharing of profit and losses.	It does not always involve this element.

3.	A partner cannot without the consent of his partners, transfer his interest or share to a stranger.	One co-owner can transfer his interest without the consent of others.
4.	Each partner is an agent of the other partners and hence he is capable of binding the other.	A co-owner has no implied authority to bind the other co-owners.
5.	A partner, being an agent of the other partners, can exercise right of lien on the partnership properties.	A co-owner has no lien.
6.	A partner is entitled to claim share of the profits out of the properties sold upon dissolution of the firm in specie i.e. he can not get the firm's property divided in its existing state.	But a co-owner has a right of division in specie.
7.	Partnership necessarily involves working for gain.	A Co-ownership need not necessarily exist for the sake of gain.

The first four factors distinguishing partnership from co-ownership, have been cited with approved by the supreme court in champran Cane Concern v. State of Bihar (1964 S.C.R 921).

6.5.2. Partnership and a club or society : Social service associations, sport club debating societies etc, are not therefore partnership. the idea of forming such association is to provide some common advantage to the members and such there is no intention to provide some common advantage to the members such there is no intention to carry on business. Hence the members of a club are not liable to continue to the losses of the club beyond the amount of the agreed subscription payable according to rules. An inevitable interference is that the managing committee has no authority to pledge the credit of the members, and make them liable for the debt contracted.

6.5.3. Partnership and incorporated company : The point of difference between a company and a partnership firm can be stated in detail.

	Partnership	Company
1.	A firm has no separate legal entity but only consists of several partners who collectively form the firm.	A company has got an artificial personality capable of acquiring rights and incurring obligations in its own name.
2.	Each partner is jointly and severally liable for the liabilities of the firm.	Each member or shareholder will be held liable only up to the extent of the shares taken by him. Liabilities of the company have to be realised from the assets of company.
3.	The concept of mutual agency (each partner is the agent of the other) is of much importance to a firm.	No shareholder is considered to be agent of other members.
4.	A partner cannot assign his share to a stranger without the consent of the other partners.	Generally speaking shares held by a shareholder are freely transferable.
5.	Dealth or insolvency of a partner or retirement dissolves the firm.	These matters, as a general rule, do not affect its existence.
6.	Registation of partnership is optional.	The very existence of a company depends upon incorporation and registration as required by the Companies Act.

6.5.4. Partnership and joint family firm : A brief reference to the joint Family firm may now conveniently be attempted here. For a long time a doubt was entertained whether the law of partnership could or could not be applied to joint family firms. aspect is of for reaching importance owing to the existence of several Hindu families in India whose family occupation is unquestionably trade or traditional business. The joint family system is the cherished institution of the Hindus. When a Hindu joint family carries of its traditional trade or business for the benefit of all members drawing its capital from the joint family fund, it if called a Hindu joint family firm. Though striking resemblances in certain respect exist between these two types of film it has been laid down in various decisions, as well as by sec, 5 of the Partnership. Act that a Hindu Joint trading firm is not a firm within the meaning of the act. The foundation of partnership rests on agreement or contract whereas a joint family is joint family is the result of status and arises by virtue of his birth. This is aptly brought out by sec. 5 of the Act and it reads as follows.

"The relation of partnership arises from contract and not from status: and in particular, the members of Hindu undivided family carrying on family business as such, or a Buddhist husband and wife carrying on business as such, as not partners in such business". This provision result of voluntary agreement. As already seen, this provision is included to prevent all possible doubts. It is further to be noted that there is no parallel provision in the English Act.

In an illuminating brief statement Mayne traces the underlying features of a joint Hindu Family in these words; "Where a managing members of a joint family enters into to partnership with a stranger the other members of the family do not ipso facio become partners in the business so as to clothe them with all the rights and obligations of a partner". In such a case the family as a unit does not become a partner but only such of its members as in fact enter into a contractual relation with the stranger".

Incidentally we may now turn to judicial decisions to determine its precise import. An illustrative statement of the nature of joint family firm is to be found in the judgement of the Supreme Court in Commissioner of Income tax, Madhya Pradesh v. Hukumchand Mannalal and Co (A.I.R 1971 S.C. 883) The Supreme Court observed: "One or more members of a Hindu undivided family may enter into a contracted relation in the nature of a partnership with a stranger and they "qua" the stranger become partner. The Contract Act imposes no disability upon them in the matter of entering into a contract inter se or with a stranger. If the relationship as is referred to in sec. 4 of Partnership Act exists, partnership will not be invalid because two or more of the persons who agreed to the profits of the business are the members of a Hindu undivided family. The case referred above related to the question of granting registration of a firm Hukumchand Mannalal and Co and the registration was granted.

	Partnership Firm	Joint Family Firm
1.	It comes into existence as a result of a contract of agreement.	It results from status.
2.	Admission of a new partner with the partnership could be only with the consent of the other partners.	But the membership in the joint family is automatically increased by new births in the family.
3.	Death of a Partner disrupts the unity and further dissolves the firm.	Dealth of a co-partner of Hindu joint family does not dissolve a Hindu joint family business.
4.	Each partner being an agent the other could act on behalf of the others so as to bind the partnership. Each partner is personally liable for the debts of the firm.	It is only the Manager (Kartha) in a joint family firm who could act so as to bind the other members. It is only the manager who is personally liable for the firm's debts. The other members may become liable to the extent of their shares in the family firm unless they join with the manager in contracting the debts, or ratify the same subsequently.
5.	Each partner is entitled to pledge the credit of the firm.	The manager is the only person entitled to pledge the credit of the family.

6.	A member of either sex can be a partner in a firm.	Only male members can be members of a joint Family firm.
7.	Every partner can demand for dissolution and ask for accounts of past profits and losses.	No such right exists for a members of a joint family firms. He is entitled to ask for a partition of the existing assets.
8.	Insolvency of a partner prevents him from continuing to be a member of the firm .	It is otherwise in the case of joint family firm.
9.	A minor may be admitted by the other partners to the benefits of the partnership.	A minor automatically becomes entitled to the benefit of a trading family merely by reason of his birth in the family.
10.	It continues to be alive until it is actually dissolved by the act of parties or by a decree of court.	Disruption of joint family business takes place by the mere filing of a suit for partition.
11.	A partnership is governed by the provisions of the Partnership Act.	Rules of Hindu law govern a joint Family firm.

6.6. FIRM AND FIRM NAME :

As already observed persons who have entered into partnership with one another are called individually partners. And collectively "a firm" and the name under which their business is carried on is called the "firm name" (Sec. 4). In law "a firm" is *only convenient* phrase for describing the two or more persons who constitute partnership and it should be remembered that a firm has not got any legal entity, nor is it a person as in a corporation; it is a collective name of members of a partnership. Further as the definition connotes, it is extremely difficult to think of the firm apart form be members constituting it. It is to be emphasized that only for the purpose of the Indian Income Tax Act, it is an entity quite distinct from partnership composing it.

In fact the language in use of mercantile circles does not tally with this legal notion and more often it may be easily misled. It is undoubtedly convenient to speak of the firm's properly, and debts of the firm, but these are not legal phrases and are countenanced by the Act to a limited extent. Moreover, these phrases have no recognition in a court of law. The legal notion has been succinctly expressed thus. "The firm cannot possess property, therefore, it cannot be a debtor or creditor. The rights which a partner, enjoys, and the duties which he owes are enjoyed against and owed to the other partners, and not to the firm and if an action between the partners be necessary to enforce such rights and duties the individual partner and not the firm are parties to the action". "This passage vividly brings out the point of difference between legal and mercantile notion. In the mercantile world a firm is looked upon as a person, apart from its individual members, whereas it is not so in the eye of law. Again mercantile notion allows a partner to be debtor or creditor of the firm. Lastly, according to the mercantile circles, a firm continues to survive not with standing the death or retirement of a partner. These factors are at variance with legal notions. To quote the words of James, L.J. "For the purpose of determining legal rights there is no such things as a firm known to the law". However in practice under the law of procedure, actions may be brought by and against in the name of the firm and even between firms and their members (refer to Order 30 of the Civil Procedure Code, 1908).

Firm name is only an abbreviated form for collectively designating all the partners. In other words, it is only a short way of expressing the names of all the partners. When Raman and Sankar carry on business in partnership as "Raman and Co" the tide only suggests the names of partners. The names representing the firm may be anything either imaginary or real provided they do not violate the rules relating to trade name or good will. Under no circumstance they with a firm of repute already in existence with a similar name. The word "limited" shall not be added to the firm name for the Companies with limited liability registered under that Act, enjoy the privileges of having the liability of their members limited. By sec. 53 Cl (3) of the Act, names suggestive of any patronage by Royality or the Government should not be used. As per the section a firm name shall not contain words like "Crown", "Emperor", "King", "Queen", "Royal", etc. So also it shall not use words expressing or implying the sanction, approval or patronage of

Government except when the State Government signifies to the use of such words as part of the firm name by order in writing.

6.7. DIFFERENT TYPES OF PARTNERSHIP

6.7.1. Partnership at will : Where no provision is made by contract between partners for the duration of their partnership or for the determination of their partnership, the partnership, is called partnership at will (Sec. 7). This section in short, suggests the mode of dissolution. We have to refer to sec. 43 which speaks about dissolution to examine its precise. Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned to from the date of communication of the notice.

6.7.2. Partnership for a fixed term : The parties are at liberty to fix or specify the duration of the partnership or say nothing about it. When the partner specify a particular period for which the partnership shall be in existence, it is called a partnership for a fixed term. A partnership for a fixed tam as distinguished from one at will, cannot be dissolved at the will of one or more of the partners. When the stipulated term is over the partnership comes to an end.

6.7.3. Particular Partnership : A person may become a partner with another person in particular adventures or undertaking (sec. 8). This kind, of partnership is provided under sec. 8 to meet cases which are probably much more frequent in India than in England. A particular partnership could presumably last only so long as the business is not completed. At the essential elements which constitute a partnership must be present before a partnership between two persons limited to single adventure can be held to be a partnership. For illustration, two persons may be partners for one dramatic performance or limited to the purchase and sale of a building so also where two persons agree together for the purchase of a particular thing in an auction sale with a view to make all sales jointly for getting profit, the position of the parties will be deemed to be that of partners.

6.7.4. Limited Partnership : Indian law does not recognize limited partnership, but as we have frequently referred to English law also throughout our lessons it may not be out of place to mention here some of the important provisions of the English Limited Partnership Act. 1907. The position of limited partnership is between a partnership and a limited company. Every limited partnership must be registered. A limited partner is one who is not liable for the firm's debts beyond that amount. Sec 4 of the Act contains the important rules and it reads. "A limited partnership must consist of one or more persons called general partners who shall beliable for all debts and obligations of the firm and atleast one may be a limited partner". A limited partner must not take part in the management of the partnership business, and has no power to bind the firm. But he may advise with his partners thereon. Neither notice nor death, insanity or insolvency will dissolve the firm.

6.7.5. Sub-partnership : It may be noted here that where a member of the firm agrees to share the profit derived by him from the partnership with a stranger, there arises a sub-partnership between the contracting member and the stranger. This land of partnership is one implied by law. It is implied in the sense when any one of the original partner transfer his interest in the partnership property by sale, mortgage or otherwise to a stranger. Such stranger is said to be a sub-partner although he is in no sense a partner an the original firm. He his no rights against the firm, nor he is liable for its debts. In short the assignee is entitled only to the assigned rights and not to the general rights of a partner. These sub-partners are not counted as partner for the purpose of maximum membership limit in that firm.

6.8. FORMATION OF PARTNERSHIP

As already pointed out in a contract of partnership all the essential elements required for a valid contract should exist. Sec. 3 of the Partnership Act provides that the unrepealed provision of the contract Act shall be applicable to partnership firms.

6.9. AGREEMENT

While discussing the essentials of a contract of partnership, we have briefly discussed the importance of an agreement between the persons entering into the partnership. The terms of the offer and acceptance may usually be written down. The instrument contributing the agreement is invariably called the 'deal of partnership' it may be noted here that laws does not insist it to be in writing. It may very well be oral. The present Act does not expressly make registration compulsory, nor does it provide any penalty for registration as does the English law, but it introduces certain disabilities which make registration as much essential an one time or other. In fact the Act bas more effectively ensured the registration of firms without making it compulsory. So, it is clear that a deed of partnership need not be registered according to the provisions of the Registration Act unless the above referred to deed of partnership creates, transfers or effects an interest in immovable property.

It may be repeated here that partnership has the foundation in the mutual confidence between the partners. It is well settled that a partnership agreement can be prescribed on the ground of fraud or misrepresentation by the partner misled. Besides this right a partner can claim the important rights given below of right of lien of the surplus assets of the firm for purchase price paid by him for his share and for his capital contribution to the firm; b) right to rank as creditor of the firm in respect of any debts of the firm paid by him; c) right to be indemnified by the partners guilty of the fraud or misrepresentation against the debts of the firm.

6.10. CONSIDERATION FOR AN AGREEMENT OF PARTNERSHIP

Law of partnership can rightly be regarded as an extension of law of agency. Each partner being an agent and principle at the same time of the other, that detriment suffered by each because of the association with the other of others is treated as sufficient consideration to support a Partnership Agreement.

Looking at the scheme of the India Act, a person may be in some cases admitted to an existing partnership with an already established business. In consideration of the payment of an amount known 'Permium' for the benefit of the other existing partners generally. Difficult and complicated problems may arise as to what should happen to the premium, if the firm happens to be dissolved earlier. It is better to quote sec. 51 in this context which provides the return of permium. It runs as follows.

"Where a partner has paid a permium on entering into partnership for a fixed term, and the firm is dissolved before the expiration of that term, otherwise than by the death of a partner, he shall be entitled to repayment of the premium or of such part there of as may be reasonable, regard being had to the terms upon which he became a partner to the benefit of time during which he was a partner, unless (a) the dissolution is mainly due to his own misconduct or,

(b) the dissolution is in pursuance of agreement containing no provision for the return of the premium or any part of it.

Thus we find in the section three exceptions to the above stated rule of refund of premium. In Wilson v. Johnstone (1873) 16 Eq 606. Sir John Wicknes said that in order to amount to misconduct there must be a repudiation of the partnership contract on the claimant's part as amount to a wilful and deliberated throwing up of his rights as partner. It is further necessary to prove that the misconduct complained of must be in the conduct of the partnership. In Yates v. Cousins, it was laid down where a firm is dissolved on the ground of neglect in the conduct of business on the part of the partner paying premium, be is not entitled to claim apportionment of premium.

6.11. CAPACITY OF PARTIES

Certain persons are by law incapable wholly or in part, of building themselves by a promise or enforcing a promise made to them. The general rules governing capacity of parties (Sec. 11 & 12 of the Contract Act) are applicable to partners as well. According to sec. 11 of the Indian Contract Act a minor is incapable of entering into a contract and if he does enter, that contract is altogether null and void. This was the ruling laid down by the Privy Council in the leading case of Mohori Befee v. Dharmodas Ghose (1903, 30 Cal. 539 PC). We have already noticed that the very definition of partnerships pre-supposes the existence of a valid agreement and a minor is therefore incompetent to create the relationship of partnership. Analysing these points it is sufficiently dear that It minor cannot be a partner in a partnership firm. We have seen in the case of an Agency a minor can be an agent, though not a principal. As agency rules are extended and applied to this branch of law of partnership a minor may be admitted to the benefits of a partnership already in existence if all the partners agree, though he cannot be a full fledged partner. By sec. 30 of the Partnership Act a minor is allowed to have the benefits of a partnership on certain terms and conditions. The rights and liabilities of a minor admitted to the benefits of partnership under sec. 33 are as follows:

1) He has a right to receive a share in the property and of the profits of the firm as agreed between the parties. He is not personally liable for the acts of the firm, where his share alone is liable.

2) The minor partner has no right to sue the other partner or an account or payment of his share of the propriety or profits of the firm except when he seven his connection with firm. In that case the amount of his share will be determined in accordance with the sec. 48 which deals with the mode of settlement of accounts among the partners.

6.12. OPTION TO REPUDIATE

On his attaining majority, the minor is entitled to exercise an option, either to continue his membership in the firm or to repudiate. Such option must be exercised at any time within six months after his attaining the age of majority and to that effect he must give a public notice. If he fails to give any such notice he automatically becomes a partner on the expiry of six months.

If he elects to become a partner, on his attaining majority his rights and liabilities will be similar to those of a full fledged partner. He is personally liable to third parities for all acts of tile firm, since he was admitted to the benefits of partnership.

Where such minor elects not tot become a partner then his rights and liabilities shall continue to be those of a minor upto the date of public notice. His share shall not be liable for any acts of the firm done after the late of the notice. He shall be entitled to use the partners for his share of he property and profits.

It will be relevant here to point out the essential features of English law in this context.

According to English law, a minor can enter into a partnership and the contract is binding on him unless he repudiates it before or within a reasonable time after his attaining majority. Though an infant may be a partner in a firm, he cannot be sued for partnership debts contracted during his minority - Goode v. Harissom (1821).

When the partnership was dissolved before a minor admitted to its benefits, become a major, partnership has become non-existent and it is legally impossible for him to become a partner of the dissolved firm by his not exercising the option after becoming major under sec. 30 (5) of this Act. Naturally he may not be adjudicated insolvent by the very acts of insolvency committed by the major partners of the firm. The Supreme Court laid down this principle in Shivaganda v Chadrkant (AIR. 1965 S.C. 212). The entire scheme of sec. 30 of the Partnership Act provides the existence of a firm and definitely nullifies any theory of its application to a stage when the firm ceased to exist. One cannot become or remain a partner of a firm that does not exist.

6.13. PARTNERSHIP PROPERTY

Sec.14 of the Act speaks about the property of the firm. The assets of a partnership will be formed by the following properties taken together (i) All property rights and interest in property originally brought into partnership stock. (ii) All property acquired by purchase or otherwise, by or for i.e. on behalf of the firm. (iii) the Goodwill of the firm.

Subject to contract between the partner the property of the firm shall be held and used by the partners exclusively for the purpose of the business.

The term 'good will' referred to here is not defined by the Act. Goodwill is ill fact a commercial term rather than a legal term. To determine its precise meaning one has necessarily to study the character and nature of the business to which it is attached. Moreover, the goodwill of a firm is composed of a variety of elements and is certainly bound to differ in its composition in differrent trades and different business in the same trade. It may further be noted that "goodwill" has no meaning what so ever except in connection with a continuing business. It is often considered that the location, the service, standing of the business. the honesty of those who run it and the Jack of competition and many other factors go individually or together to make up goodwill, though location plays a considerable part.

In the words of Lord Eldon "the good will of a trade or business every advantage which has been acquired by carrying on the business whether connected with the business bas been carried on, or with the name of the firm by which it has been conducted" Crutwell .v. Lye "Goodwill" is therefore a thing very easy to describe, but very difficult, indeed, to decline. It bas been precisely stated by Lord Machaughton, 'Goodwill is the whole advantage, what ever it may be of the reputation and connection of the firm". Its value, in fact, consists in the probability of a particular set of customers continuing to be customers not with standing a change in firm or place of business. Sometimes it may be due to the result of the general public patronage and encouragement which a business from constant and habitual customers. Happily, the Act makes if clear that goodwill is recognized as part of the assets of a partnership.

6.14. PARTNERSHIP BY HOLDING OUT OR BY ESTOPPEL:

It has been repeatedly said that the law of partnership can be treated as an extension of the law of agency. We have studied under the "Law of Agency" what is called, agency by estoppel. A similar principle is provided in case of partners too, under Sec. 28(1). Sec. 28 (1) of the Partnership Act states that, any one who by words spoken or written or by conduct represents himself, or knowledge permits himself to be represented to be a partner in a firm, is liable as a partner in that firm to anyone who bas the faith of any such representation given credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person for giving credit". The rule is laid down in the section is really a part of the law of estoppel. In the leading case Sarat Chandra. V. Gopal Chandra their Lordships of the Privy Council laid down thus, "The principle underlying in the rule of estoppel is that would be most inequitable and unjust if a person, who by representation has induced another to act as he would be not otherwise have done, were to be allowed to deny or repudiate the effect of his former statement to the loss and the injury of the person who acted on it". Thus it is clear that this section in particular is based on the principle of equity. The above stated rule of estoppel is contained in Sec. 155 of the Indian Evidence Act.

It is obligatory on the part of the retiring partners to give a valid and due notice to that effect to the persons who have dealing with that firm. Otherwise he will be held liable and responsible as if he is containing as a partner. Instances. usually arise where a partner, having retired from the firm allows his name to be used as a partner in the bills, letter heads etc., of the firm and if he does not take reasonable and suitable steps to stop his name being so used, he will be a partner by holding out. He will be labile to creditors who have lent on the faith of his being a partner.

In this respect, we should not be both as exception as provided under the sec. 28(3): The position of a deceased partner is different from that of a retiring partner,

(i) The first exception is that the above given rule does not apply it case of death of one partner. Generally, it so happens that after the death of a partner the firm is dissolved and the partnership firm came to an end and hence there is place for estoppel to apply. Where after a partner's death the business is continued in the old firm name, the continued use of that name or of the deceased p8.rtnerS name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the firm done after his death.

(ii) The second exception is that doctrine 'holding out' is not applicable to liability for civil wrong or torts committed on behalf of the firm, because such liability does not rise on account of any given to the firm Smith .V. Bailey (1891)2, Q.B. 423.

It is noted be here the liability of exception to creditors who have no knowledge of his retirement rests upon the continuing authority of the other partners, of other partners, to bind the firm by their acts. i.e. on the principle of estoppel. But liability based upon estoppel is quite different from that of the actual partners and the creditors cannot therefore sue them all the basis of each liability being different. This rule indirectly suggests, that the creditors is given the option to sue, either the members of the old firm of the partners of the new firm. This may illustrated with the fact of an important and leading case.

Scarf v. Jardine (1882 7AC 345): The plaintiff, Scarf was one of two partners in the firm Rogers and co. when the plaintiff retired without notice to the creditor, the partnership continued its business with a new partner under the old firm name. It so happened that the defendant, one Jardine, sold goods to the firm without notice of Scarf's retirement. In a suit by Jardine old goods to the price against the other member of the firm. It was held that the creditor (Jardine) could make the ex-partner (Scarf) and his other co-partners liable on the principle of estoppel or make the present liable on the basis of actual facts (as they are now actual partners). He could not sue them all.

6.15 DORMANT OR SLEEPING PARTNER :

Before passing on the main subject our discussion, we shall briefly discuss about dormant or 'Sleeping partner' . the dormant partner is one who is not generally known to be a partner. The mere fact that the a partner does not appear as such and is not taking any interest or any active role in the business of the firm would not free him from liability for he undoubtedly, occupied the position of an undisclosed principle and the movement he his discovered to be a partner, he can be held liable. Regarding his right to retirement, they can very well retire from a firm without giving notice to the world. It is accordingly, well settled that no creditor however can hold a retired partner liable whom he was not known to be a partner before the change in the firm and who ceased to be a partner in fact when the actual credit was given. The reason for this is that a sleeping partner, who was never be known to creditor as a partner has never been given credit by third parties. Proviso to sec.32 expressly provides the above stated principle. The following illustration will be helpful in understanding the principle.

Illustration : A B and C ate partners. C is a sleeping partner who bas been known by creditors to be a partner of A and B. C retires without giving notice of his retirement. C is not liable of subsequent debts incurred by A and B.

6.16. ILLEGAL PARTNERSHIP:

The contract of partnership like any other contract, must be free from any taint of illegality. A partnership is deemed illegal in the following cases.

a) When it consists of more that twenty members in cases of ordinary business or ten in the case of banking business.

(b) If it is for an illegal purpose. In general a partnership may be illegal if it is formed for a purpose forbidden by the current nations of morality, religion or public policy. Any agreement which contravenes the policy of the law as contained in an Act of a legislature or which has for its object the carrying on business in contravention there to is illegal. So an agreement of partnership may be illegal by reason of Sec. 23 of the Indian Contract Act, 1872 or of any other Act of the legislature condition of a license granted under the provision Of an Act. For example Ganpathi .V. Kurella, where a contract of a contract of partnership country to the terms of an abkari license was held illegal.

Further, you may note, while two countries are at war, a partnership formed between persons resident in the country, for the purpose of trading with an enemy's country is illeagal.. A partnership will be declared illegal if formed for the purpose of deriving profit from a criminal offence e.g. from struggling robbery, theft etc.,

The consequence of an illegal partnership is that its members have no remedy against each other for contribution or appointment in connection with the partnership dealings. Its members can not maintain any action in respect of any transactions trained With the illegality. An agreement for illegal partnership will not be enforced even if it has been party performed. The third party or one who is not a party to the illegality can sue the illegal firm.

6.17. RELATION OF PARTNERS TO EACH OTHER:

It may be recalled here tha mutual trust and confidence is the sole basis of partnership and we have further noted that the relation of partnership comes into existence by an agreement between the partners. Inevitably an agreement may provide of the mutual rights and duties of the partners 'immerse'. The partners can very agree at the time of formation of the partnership about the conduct and management providing their respective right and duties in the partnership deed' which is also called 'partnership articles'. The partnership agreement may be expressed or implied and it may be varied with the constant of all the partners agreement may be expressed or implied by a course of dealing but the mutual rights and obligations determined by the parties are subject to the provisions of the Act (sec. 11) Where, however, partners fail to provide for any of these things, in order to avoid the difficulty arising in such cases the rules laid down in the Act (Sees. 9 to 7) and liabilities of the partner 'inter se' with relation to the partnership business as contained in Sec. 9 to 17 can easily be grouped as follows.

6.17.1. Good faith Sec.9: A partnership contract is a contract of unberrimae fidei i.e, a contract of utmost good faith and therefore see,9 of the Act clearly lays down "partners are bound to carry on the business of the firm to the greatest common advantage (b) to be just and faithful to each otter and (c) to reader true accounts and full information of all things affecting firm and partners of his representative'. It is an absolute and mandatory provision and it is not possible to dispense with this provision. No partner can contract himself out even an agreement with the consent of other partners.

6.17.2. To Indemnify (Sec. 10) : Every partner shall indemnify the firm for any loss caused to it by fraud in the conduct of business of the firm. This liability is absolute and in sec .9 it is not possible for any partner to escape liability by contracting himself out of it. So a clause in the partnership deed exempting a particular partner from liability to the firm for loss caused by his fraud shall be invalid and unenforceable.

6.17.3. To account for the profit of a competing business : We know that an agreement in restraint of trade is void under sec. 27of the Indian Contract Act, but sec 11 (2) of Partnership Act permits an agreement between partners that a partner shall not carry on any business other than that of the firm while he is a partner. This principle has been a gain endorsed by Sec. 15 (b) In the absence to the contract to the contrary, if a partner carries on any business of the same nature and, competing with that of the firm. he shall account for any to the firm, all profits made by him, in that business. Further Sec. 53 deserves our attention in this matter. It provides that after a firm is dissolved, every partner or representative may in the absence Of a contract between the partners to the contrary restrain any other partner or his representative from carrying on a similar business in the firm name or from using any of the property of the firm for his own benefit, until, the affairs of the firm have been completely wound up : provided that where any partner or his representative has bought the goodwill of the firm, nothing in this/section shall affect his right to use the firm name.

6.17.4. Conduct Of Business (Sec. 12) : Subject to contract between the partners (a) every partner has a right to take part in the conduct of the business. (b) every partner is bound to attend diligently to his duties in the conduct of the business. (c) any difference arising as to ordinary matters connected with the business may be decided by a majority of the partner, and every partner shall have the right to express his opinion before the matter is decided but no change may be made in the nature of the business without the consent of all the partners and

(d) every partner has a right to have access to and to inspect and copy any of the books of the firm.

6.17.5. Mutual rights and liabilities (Sec. 13): In the actual management of the business the partners right and liabilities regarding remuneration and profits are as' follows. (a) A partner is not entitled to receive any remuneration for taking part in the conduct of the business (b) The partners are entitled to the losses sustained by profits earned and shall contribute equally to the losses sustained by the film (c) Where a partner is entitled to interest on the capital subscribed by him such interest be payable only out of the profits. (d) A partner making any payment or advance beyond the amount of capital is entitled to interest at the rate of six: percent per annum.

6.17.6. Mutual rights of indemnity: Sec. 13 further provides additional rules regarding mutual rights of indemnity between the firm and the partners. We may now deal with them. The firm shall indemnify the partner in respect of payments made and liabilities incurred by him in the ordinary and proper conduct of the business. It is also applied for doing an act in an emergency for protecting the firm from loss, if it is such as a prudent man would do in his own case under similar circumstances. Accordingly, a partner shall indemnify the firm for any loss caused to it by his willful neglect in the Conduct of the business of the firm.

6.17.7. To account for private profits- Sec. 16 : a) A partner shall be liable to account for and pay to the firm my private profits derived from the transactions of the firm the use of the property or good will of the firm.

Illustration: A and B were in partnership. A while purchasing sugar for the firm supplied his own sugar without the consent of B. A shall be required to make over the whole of his profit from this transaction to the firm.

It may not be out of place here to have some idea of the main features of the English law on this point. By virtue of Sec. 29 (I) of the English Partnership Act, 1890 states, every partner must account to the firm, for any benefit derived by him without the consent of the other partners from any transaction concerning the partnership or from any transaction concerning the partnership or from any use by him of partnership property, name or business connection.

The scope and extent of this section has been recently considered in Pathirana V. Pathirana (1967. I.AC 233). The principle contained in the section has been affirmed by this case.

6.17.8. After a change in the firm (See. 17): It will be noted here when a change occurs in the constitution of the firm and yet it carries on business. the partners who continue the business will in eye of law be a new and different firm, which is called a reconstituted firm. The circumstances by which it may happen are follows. (a) by new members coming in; or (b) by some partners going out either by death or retirement; or (c) by the firm being carried on after the expiry of a fixed term: or (d) by the partnership carrying on additional undertakings.

In the above cases the rights and obligations of partners in the reconstituted firm remain the same as they were before. But again this rule is subject to contract between the parties. In the case of a firm carrying of business even after the expiry of the fixed time the rights and liabilities will continue only so far as it is consistent with a partnership at will.

6.18. RELATION OF PARTNERSHIP TO THIRD PARTIES

6.18.1. Scope of authority of partners: It is needless to point out again that the law of partnership has been said to be a branch of the general law of agency. According to Sec. 18 of the Partnership Act, A partner is the agent of tile firm for all purpose of the business of the firm. This section in particular expressly recognizes the above said doctrine. A partner indeed virtually embraces the character both. of a principal and of an agent. He is an agent in the sense that whatever he does in relating to the partnership, he and the other partners are held liable for his acts. He is a principal in the sense that whatever the other partner do in matters connected with the partnership he is liable with other partners for their acts. In Short, each is bound by the other's contract in carrying on the trade as much as a principal would be by the act of an agent. In Baird's case Sir W.M. James LJ. observed 'Ordinarily partnerships are by the law assumed and presumed to be based on mutual trust and confidence of each partner in the skill, knowledge and integrity of every other partner. As between the partner and the outside world such partner is the unlimited agent of every other in every matter connected with the partnership business, or which he represents as partnership." Keeping in mind the above stated principles it is highly necessary to fix the scope of authority of a partner.

Sec. 19 (1) read with Sec.22 provides positive rule of implied authority given to a partner. Opening words of Sub-Section (1) of this section provide subject to the provision of Sec.22, the act of a partner which is done to carry on in the usual way, business of the kind carried on by the firm binds the firm. Further, it must have been done in the name of the firm or in any other manner expressing or implying an intention to bind the firm. In other words, if the act of a partner is of a nature which is common in the type of business carried on by the firm and is done by him in the usual way of carrying on the particular partnership business, it will bind the other members of the partnership business as well. Such authority, of a partner is called his ostensible or apparent or implied or implied authority. The word "implied" is favored by Lindley and it appears to be more appropriate man other words' ordinary', 'apparent' and "ostensible". It is further a well settled rule that each partner is an agent only in and for the business of the firm and hence his acts beyond that business will not bind the firm. In judging whether or not the partners had implied authority, we have to see whether an act comes within the actual or ostensible authority.

Every partner of an ordinary trading partnership has implied power in the absence of express prohibition to bind the firm by drawing accepting or endorsing bills of exchange and endorsing promissory notes in its name and for the purpose of the firm in the ordinary course of business, but not otherwise. But in the case of non-commercial natural non-trading partnership which does not involve any selling of goods. It has been held that a partner will have no ostensible authority to borrow, pledge, or to make issue negotiable instruments.

The rule of law on this point regarding the implied authority of a partner as stated above, is subject to the rule laid down in Sec 22 and it provides: In order to bind a firm, an act or instrument does or executed by a partner or other person on behalf of the firm shall be done or executed in the firm name or in any other manner expressing or implying an intention to bind the firm. The cumulative effect of this section (Sec 22) gives a narrow and restricted application of the principes of agency in partnership. Sec.20 expressly provides that the partners may by contract between themselves extend or restrict the impaled authority of any partner. No doubt, there arrangements are intended for that own interest. Proviso to Sec.20 safeguards the interest of third person. When partners have agreed to restrict to curtail the ostenable authority between the partners an act of one partner done within the scope of the implied authority, but beyond the actual authority fixed by the contract would be binding on the members of the firm. But if the third party knows of the restriction or if he does not believe that parson to be partner, the act may not bind the firm.

Sec. 19 (2) in fact, stipulate some restrictions. In the absence of a custom or usage of trade to the contrary, the implied authority of a partner does not empower him to do the following (a)submit a dispute relating to the business of the firm to arbitration. (b)open a bank account on behalf of the firm in his own name(c) compromise or relinquish any claim or portion of a claim by the firm (d) withdraw a suit or proceeding filed on behalf of the firm (e)admit any liability in a suit or proceeding agent the firm (f) acquire immoveable property on behalf of the firm. (g) transfer immovable property belonging to the firm, or (h) enter into partnership on behalf of the firm.

In order to carry out the above referred purposes, express authority must be given to one or more of the partner or all of them must join together for doing such functions. From the above principles we have no hesitation in coming to the conclusion that, the very application of the principles of agency is given a limited and restricted scope in partnership.

6.18.2. Emergency Powers: A partner has authority, in an emergency to do all such acts for the purpose of purpose of protecting the firm from loss as would be done by a person of ordinary prudence in his own case and acting under similar circumstances, and such acts bind the firm (Sec.21) We can equate this right given to a partner, as the same given to an agent to act as an agent to necessity. In this respect English law is different and it does not permit a partner to bind the firm by acts done in an emergency for saving the firm from loss. It may be noted, he will be entitled to indemnity from his co-partners for the acts done by him to protect the business.

6.18.3. Effect of admission by a partner: An admission or representation made by a partner concerning the affairs of the firm is evidence against the firm, if it is made in the ordinary course of buslness (Sec.23). This is again an instance of the application of the general rule of agency.

6.19. Notice to acting partner: Notice to a partner who habitually acts in the business of the firm or any matter relating to the affairs of the firm operates notice to the firm except in the case of a fraud on the firm committed by or with the consent of that partner (Sec.24). The The general rule is that a notice as agent of matters connected with his agency is notice to the principal. As partnership is one branch of the law of agency, it allows that notice to one partner is notice to the firm. The conditions necessary for the application of this section are provided by the section itself. They are as follows: (a) That the partner is one who habitually acts in the business of the firm (b) That the notice to him relates to the affairs of the firm (c) that no fraud is committed by or with the consent of that partner.

6.20. LABILITY OF PARTNER TO THIRD PERSONS

6.20.1. Nature and scope of the liability : Every partner is liable, jointly will all the other partners and also severally, for all acts of the firm done while he is a partner (Sec.25). Sec.2 (a) defines an act of the firm as an "act or omission by all the partners or, by any partner or agent of the firm. Which gives rise to a right enforceable by or against the firm". This rule that the liability of a partner for the act of the firm is joint and several is further supported by Sec.43 of the Contract Act which declares that joint promises of every kind create a joint and several obligation in the absence of express agreement to the contrary.

We have already seen that a partnership has no legal entity. So, when a partnership firm X,Y,Z enter into a contract with another person A, it is deemed that there are promisors namely X,Y and Z. It is to be noted sue any one of them or all of them and failure to sue or implead all of them is no bar and defence to a suit against so me only.

Here again, the English law on this point is quite different. In England, however the liability of a partner for the debts and obligations of the firm is only joint but not joint and several. This rule of law on this subject is firmly established since the decision of the House of Lords in Kendal v. Hamiltion (4A.C. 504). After his death his estate is also severally liable for the unsatisfied debts incurred by the firm while he was partner. Thus we note a striking difference between English law and Indian law. But under Indian law, we do not find any difference between contractual and tortious liability, it is always joint and several.

6.20.2. Liability of the firm for wrongful acts of a partner: Where by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party or any penalty is incurred, the firm is liable therefore to the same extent as the partner (Sec.26). The leading case of Hamulyns v John Houston & Co. (190[illegible] I.K.B.81) very well illustrates this rule. Here, one of the two partners of a firm induced the clerk of the plaintiff (Hamulyn) by bribes to disclose certain confidential information concerning plaintiffs business, which was competing with the business of the firm. The plaintiff consequently suffered actual damage. Held that they were (i.e. both the partners therein) liable and that obtaining the confidential information being with in scope of the partners authority, the other partner could not escape liability simply because the acts committed to procure were fraudulent. One important point to be noted here is that the rule again is based on the law of agency. So, a principal if liable for the fraud or other illegal acts committed by his agent is dome within general scope of authority given to him. One inevitable consequence that follows is that the risk lies with the principle, the person who has selected the agent. In the above given case, no doubt the other partner was a sleeping partner, yet he was held liable for acts of his partner committed in the course of the business of the firm. It may therefore be safely concluded that the liability of a partner equally extends to torts committed on behalf of the firm, even if they amount to crimes. As said earlier. Sec.26 of the Partnership Act incorporated the same rule.

6.20.3. Liability of firm for misapplication of funds by Partners: (Sec.27) where a partner acting within his apparent authority receives money or property from a third party and misapplies it, the firm is liable to make good the loss. So also where a firm in the course of its business receives money or property from the third party and money to property is misapplied it by any of the partners while it is in the custody of the firm, is liable to make good the loss.

6.20.4. Rights of a transfer of a partner's share: To conclude this part of our lesson, it remains to consider the important rights of a transferee of partner's share.

A partner may transfer his share of interest in the firm to a third person, absolutely or by way of mortgage or by way of security. It is to be noted that the transferee is not exactly in the position of the partner and he may be called a sub-partner it is necessary to analyses and consider his rights as are specially declared by sec.29. They are - (1) A transferee of a partner's interest if not entitled during the continuance of the partnership, to interfere in the conduct of the business or to require accounts to inspect the books of firm. (2) Such transferee is only entitled to receive the share of the firms (3) He is bound to accept the account of profits agreed to by the partners (4) if the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled to receive the share of the assets of the firm to which the transferring partner was entitled. For the purpose of ascertaining that share of the transferee may require an account from the date of the dissolution.

In the course of delivering the judgement, the court summarized in substance the principles of law on this point in the case of Narayanappa v. Krishnappa 1963 2. M.L.J (SC)60. The whole concept of a partnership is to embark, upon a joint venture, and for that purpose to bring in as capital money or even property movable or immovable. Once that is done according to Secs.14,15,29,37,38, and 48, it would cease to be the exclusive property of the partner who brought it in and it would be the trading asset jof the partnership. In which all the partners would have interest in proportion to their share to another, but what the assignee gets would be only that which is permitted under Sec.29 (II) that is to say, the right to receive the share of profits of the assigner, and accept the account of profits agreed to by the partners.

The law relating to the position of incoming and out going partners, dissolution of firm and registration of firm deserves very careful study and we shall take them up for discussion in the next unit.

Check Your Progresse

1. Define partnership
2. What is meant by mutual Agency test?
3. What are the difference between partnership and company?
4. Explain partnership of will
5. Write a note on partnership by holding out
6. When a partnership becomes a illegal?
7. Explain implied authority of a partner and state its limitations

6.21 SUMMARY

In this unit we have analysed the meaning and essential features of a partnership. So the main ingredient is mutual agency test. Each partner is a principal as well as an agent. In this context we have discussed the point in the light of Cox. V. Hickman case. The differences between partnership and other entities like co-ownership, company and joint family firm have been thoroughly discussed. In the topic different types of partnership, various types have been explained. How partnership is formed and what are the essential required have been analysed. Please read these topics carefully. In this unit lastly, relation of partners to each other, and liability of partners to third person have been discussed with the help of illustrative cases.

6.22 KEY WORDS

Inherit	-	derive from a person promptly or title.
Incorporated	-	formed into a legal corporation
Estoppel	-	prevented from denying a fact which has been already stated by a person
Dormant	-	inactive

6.23 ANSWER TO CHECK YOUR PROGRESS

1.	Refer to	6.2
2	Refer to	6.3.5
3.	Refer to	6.5.3
4.	Refer to	6.7.1
5.	Refer to	6.14
6.	Refer to	6.16
7.	Refer to	6.18 and 6.18.2

6.24 MODEL QUESTIONS

A. Short Answer questions

1. What are the differences between partnership and a company?
2. What are the differences between partnership and co-ownership.
3. Write a notes on partnership at will, partnership by holding out.

B. Long Answer Questions :

1. "The law of partnership is but an extension of the law of principal and agent"- discuss.
2. Distinguish between partnership and Hindu Joint family business.
3. Discuss the relation of partners with each other.

UNIT - 7

LAW OF PARTNERSHIP (CONTD.)

INTRODUCTION

In this unit the rest of the topics relating to a partnership are discussed. The topic incoming and outgoing partners, how a new partner could be admitted and the procedure for retirement of partner, their rights and liabilities are discussed in detail. In the topic of dissolution of firm, the various modes of dissolution of partnership firm and when a firm could be compulsorily be dissolved and through court have been explained. Lastly, Registration of firm. Though according to Indian Law registration is not compulsory and it may be made at any time, the importance and necessity of registration will be clear by reading section 69. The section lays down the consequences non-registration. Please study these topics carefully and try to understand the legal provisions and its implications.

UNIT OBJECTIVE

- ➢ to understand the procedure of admission of a new partner
- ➢ another procedure of retirement of a partner
- ➢ to know their rights and liabilities
- ➢ to analyse the grounds for dissolution of firm
- ➢ to study the provisions relating to registration of firm
- ➢ to analyse the consequence of non registration of firm.

UNIT STRUCTURE

7.1. INCOMING AND OUTGOING PARTNERS

Rules relating to the coming in of a partner and the outgoing of a partner of partnership firm are dealt under chapter V of the Indian Partnership Act. Secs.31 to 38 contain a number of concise, propositions setting out the legal consequences flowing from change in the personnel of the firm where there is no dissolution. In the mercantile community in general and in the business, without any actual dissolution between the partners are most commonly seen and therefore, the discussion relating to the provisions of this chapter are of vital importance in practical use.

Any change in the relations of the partners which has not resulted in the dissolution of the firm will inevitably result in the 'reconstitution of the partnership firm'. Accordingly a firm will be reconstituted on the occurrence of any of the following events.

7.2. ADMISSION OF NEW PARTNERS :

As already observed, for introducing or admitting a new partner into the firm consent of all the existing partners is essential. But this rule is subject to two limitations. Firstly, it is subject to any prior contract made between the partners inter se. Secondly, this rule is again subject to the provision of Sec.30 regarding the admission of a minor to the benefits of the Partnership. The general ideal is that the partnership article permitting one partner to introduce a new partner is perfactly valid. But the newly admitted partner is not liable to any debts of the firm incurred, before he becomes a partner.

7.3. RETIREMENT OF A PARTNER : (Sec.32)

A partner may retire from the firm (a) with the consent of all the partners: (b) In accordance with an express agreement by the partner or (c) where the partnership is at will, by giving notice in writing to all, the other partners of his intention to retire.

It needs to be noted here that merely by retirement of a partner, a firm is not dissolved. To bring about a dissolution he must give notice of his intention to dissolve and in the absence of such notice, the old firm continues with the continuing partners as its members.

7.4 DISCHARGE OF A RETIRING PARTNER:

Regarding the liability for act of the firm done before the retirement of a partner, he continues to be liable for the same. But a retiring partner, may be discharged from any liability to any third party by an agreement made by him with such third party and the partners of the reconstituted firm. This is usually called 'novation' as contained in Sec.62 of the Indian Contract Act. "Novation" in the words of Underhill "is a tripartite agreement between the creditor, the partner who is retiring and the other partners, by which a new agreement with the creditor is substituted for the old one, releasing the retiring partner and accepting in his place the credit of the continuing partner's either alone or plus any new partners". Termination of partner's liability by novation is dealt under Sec.32 (2). It reads as follows: "A retiring partner may be discharged from any liability to any third party for acts of the firm done before his retirement by an agreement made by him with such third party and the partners of the reconstituted firm, and such agreement may be implied by a course of dealing between such third party and the reconstituted firm after he had knowledge of the retirement". The leading case on the scope of the liability of a retiring partner is Scarf v. Jardine.

Public Notice Necessary : Notwithstanding the retirement of a partner from a firm, he and the partners continue to be liable as partners to third parties for any act done by any of them which would have been an act of the firm if done before the retirement until public notice is given of the retirement. Sec.72 of the Act lays down the manner in which the public notice of certain matters relating to partnership firms, is to be given. Again, the notice as required by the Act (Sec.72) may be given by the retired partners or by any partner of the reconstituted firm.

While dealing with the position of a dormant partner, we have noted that he may, however, retire without giving notice to the world. The provision to sec 32 (3) goes further and says that a retired partner is not liable to any party who deals with the firm without knowing that he was a partner.

7.5. EXPULSION OF PARTNER :

It can be seen from sec.33 that the power of expulsion can be justified when the following essentials are satisfied: (a) A partner may expelled from the partnership if the partnership deed gives a power to do so. (b) That the power should be exercised by a majority of the partner and (c) The power should be exercised in good faith.

The essential justify the expulsion of partner only for the benefit of the whole body of partners and not for the exclusive benefit of individual partner. Thus it is an irregular expulsion is rendered inoperative. An expelled partner is placed on par with the retired as regarding his liabilities and future debts.

7.6. INSOLVENCY OF PARTNER :

Where a partner in a firm is adjudicated insolvent he cases to be a partner on the date of adjudication irrespective of the fact whether the firm is thereby dissolved or not. A brief glance over his section reveals that it is based on the principle that the Insolvency of partner serves his connection with the firm. Prior to the Partnership Act Insolvency of partner did not automatically dissolve the partnership but could provide only a ground for a dissolution at the suit of other partners. Now according to the new act, Insolvency of partner will automatically dissolve the partnership unless there is contract to the contrary.

When the contract between the partners the firm is not dissolved by the adjudication of a partner as an insolvent, sub-section of sec.34 contains two rules as follows: (i) The estate of the insolvent is not liable for any act of the firm done after the date of adjudication. (ii) The firm is not bound by the acts of the insolvent done after the date of adjudication.

7.7. EFFECT OF DEATH :

Where under a contract between the partners the firm is not dissolved by the death of partner, the estate of a deceased partner is liable for any act of the firm done after his death. (Sec. 35)

7.8. RIGHTS OF THE OUTGOING PARTNER TO CARRY ON COMPETING BUSINESS :

We have just seen that a partner may go out of the firm by retirement, or as a result of expulsion or by insolvency and naturally he will be attempted to start and carry on a business competing with that of the firm. Certain restrictions are therefore imposed by sec. 36 on the activities of the outgoing partners with the view to prevent unfair competition with the firm. The rules can be conveniently analysed and discussed as follows : An outgoing partner may carry on a business competing with that of the firm and he may allow his name advertised on a business. However, he may make an arrangement with his partners that on ceasing to be a partner he will not carry on any business similar to that on ceasing to be partner he will not carry on any business similar to that of the firm within a specified local limits. If the restrictions imposed are reasonable this agreement will be valid notwithstanding anything contained in sec. 27 of the Indian Contract Act, 1872. As already noticed such an agreement will not be void on the grounds of being in restraint of trade. But the restriction imposed should be reasonable and not injurious to the public.

As said earlier this section impose certain restrictions on the activities of the outgoing partners. Subject to a contract to the contrary, he may not: (i) use the firm name: (ii) represent himself as carrying on the business of the firm or (iii) solicit the customer or persons who were dealing with firm before he ceased to be a partner.

The general principle underlying this section is that an outgoing partner presumably received payment for the value of his share in the property, of the firm, and his property as we have considered earlier includes the goodwill of the firm. A retiring partner therefore, should be regarded as having sold his share of goodwill of the business along with his share in other assets to this fellow partners. He placed in the position of a person who sells the goodwill of his business to another. This rule is the same in the case of an expelled partner and an insolvent.

7.9. RIGHTS OF OUT GOING PARTNER IN CERTAIN CASES TO SHARE SUBSEQUENT PROFITS :

A brief analysis of Sec. 37 reveals the following prepositions in this matter. At the outset, we may noted that very often complicated question have arisen when a retiring or deceased partner's capital has been left in the firm's business without any settlement of accounts. In the absence of special agreement the out going partner or his representative is entitled to such share of profits made since he caused to be a partner as may be attributable to the use of his share of the property of the firm or to interest at the rate of six percent per annum on the amount of his share in the property of the firm.

In Crowshay .v. Collins, A, B and C were partners in a manufacture of machinery. A was entitled to three eight of the partnership property and profits. A became bankrupt, and B and C continued the business without paying out A's share of the partnership assets or setting account with his estate. A's estate was held entitled to three eight of the profits made in the business from the date of his bankruptcy until the final liquidation of the partnership firm.

Quite obliviously, in some cases the outgoing partner is given an option to choose any one of them. This rule is subject to a correct to the contrary among the partners.

In most of the cases by contract between the partners, an option may be given to surviving or continuing partner to purchase the interest of a deceased or outgoing partner. In such case, if that option or election is properly exercised the above given rights are not available to the deceased partner's estate of the outgoing partner or his estate. It is significant to note that the given rights will be enforced in case the terms of the contract are not complied with. His proper remedy is to have the account settled on principle enacted in his section.

7.10. REVOCATION OF CONTINUING GUARANTEE BY CHANGE IN FIRM :

In the previous units regarding kinds of guarantee, you would have noted continuing guarantee and is one which runs or covers a series of transactions. The relevant section for the purpose of our discussion is sec. 38 and the principles given in this section though appear to be complicated and subtle, are in fact simple and self explanatory. A continuing guarantee is one given on account of personal confidence and so, where the member of the firm are changed, the risk of the surety is thereby altered and consequently the guarantee is revoked. Sec.38 runs as follows : A continuing guarantee given to a firm or to a third party in respect of the transactions of a firm, is in the absence of an agreement to the contrary revoked as to future transactions from the date of any change in constitution of the firm. Thus it is clear that the revocation commences "from the date of any change in the constitution of the firm". Further it applies to future transactions.

It is highly useful and necessary to refer to the only Indian decision reported on this section – Neel Comul Mookerjee .V. Bipro Dass (1901) 28 Cal 597. A becomes surety to the firm of "N.C. Mookerjee" for B's conduct as cashier to the firm. The constitution of the firm is subsequently changed, and its name is altered to "N.Mookerjee & son". A is not liable for B's defalcations subsequent to the change.

7.11. DISSOLUTION OF A FIRM

Complete breakdown of the relation of partnership between all the partners in certain circumstances may be unavoidable and inevitable. Great importance is in fact given under Chapter VI of the Act to the dissolution of a firm. Accordingly, the present Act has introduced a distinction between the "dissolution of partnership" and "dissolution of firm" and certainly it is a welcome addition to Indian law.

7.11.1. Dissolution of partnership : Dissolution of partnership may legitimately involve a change in the relations of the partners but in the ultimate analysis it does not end the partnership. This we may conveniently refer to as 'reconstitution of firm' and the cases in which such change can be affected has been discussed under the heading "Incoming and Out going partners". For example, where X,Y, and Z were partners in a firm and X died or retired or was adjudged insolvent the partnership firm would come to an end, but, if the partners had agreed that the above referred contingencies would not dissolve the firm then on then on the happening of any of these events the "firm" or as the act puts it, a "reconstituted firm" might continue under the same firm name. In other the words the mere severance of the partner only does not amount to "dissolution of a firm" because the partnership of a firm may advantageously still continue even though one of partners has died, retired or expelled.

Dissolution of Firm : Accordingly to sec .39, "The dissolution of partnership between the partners of a firm is called the dissolution of the firm". In the case of the dissolution of a firm because the business of a firm is followed by winding up of the firm. The assets are consequently realized and the liabilities are laid off. These attendant and surrounding circumstances may legitimately lead to the conclusion that the firm has been dissolved.

From the above discussion the following inference may be derived. The dissolution of a partnership of a partnership may or may not include dissolution of the firm, but the dissolution of the firm necessarily means the dissolution of the partnership as well. Stated briefly, every dissolution of firm means disolution of partnership but not vice versa.

Modes of dissolution of a firm: The next thing that has to be considered is the methods of dissolution which is of a paramount importance in mercantile community in particular. The dissolution of partnership usually takes place in any one of the following narrated circumstances.

(a) By mutual consent (Sec 40): (b) Compulsory dissolution by operation of law (Sec.41): (c) Automatically on the happening of certain contingencies (Sec. 42): (d) Optionally in case of partnership at will (Sec. 43) (e) judicially by a decree of the court (Sec.44)

7.11.2. Dissolution by agreement: Sec 40 of the Act provides that a firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners. As a partnership is the result of an agreement between all the partners, in the same way it can also be dissolved by all the partners agreeing to a dissolution and the agreement referred to here may be either express or implied. Where the original partnership articles contain terms regarding dissolution in writing using unambiguous words, there is no difficult. But the difficulty arises in cases where the agreement is oral. On this issue, the Supreme Court decision in Erah F. D. Mehta v. Minoo F.D. Mehta (A.I.R 1971 S.C. 1653) is relevant. In this case, the Supreme Court considered whether a partnership constituted only of two partners and one who agreed to retire from the partnership, will amount to dissolution of the partnership as provided in Sec. 40 of the Act.

The appellant and the respondent were brothers and entered into an agreement to carry on in partnership business under (a) "Messrs. F.D. Mehta and Company; (b) The Great Western Stores and (c) Dr. Writers Chocolates and canning Company". One of the two partners agreed to retire from the business. The Supreme Court speaking through Justice Shaw held: When the partnership consisted of only two partners and one partner agreed to retire, there can be no doubt that it will amount to dissolution of the partnership.

7.11.3. Compulsory dissolution: A firm is compulsorily dissolved in the following instances. (1) By adjudication of all the partners or of all the partners but one, as insolvent, or (2) By the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry on in partnership. But if the partnership relates to more than one adventure, the illegality of one or more of them does not prevent the lawful adventures from being carried on by the firm (Sec.41)

We have noted earlier, that a firm is also dissolved on the adjudication of even one of its members as insolvent unless there is contract to the contrary. But a firm is compulsorily dissolved when all its partners (or all its partners but one) are adjudicated as insolvent, even if there be a contract to the contrary. So the dissolution under sec. 41 (a) the dissolution is automatic or compulsory.

7.12 ON THE HAPPENING OF CERTAIN OF CONTINGENCIES

Where provisions of sec. 41 are mandatory; the present sec. 42 lays down rules applicable only when there is no contract to the country. A firm is automatically dissolved on the happening of certain contingencies. The instances enumerated are as follows: (a) On the expiry of the term if the partnership is constituted for a fixed term (b) On the completion of the adventure or undertaking if formed for such purposes (c) By the death of partner (d) By a partner being adjudicated as involved. In these cases the partnership might continue on the basis of express agreement between the partners.

It is of vital importance to refer in this context the decision of the Supreme Court in Commissioner of Income Tax v. G.S. Mills (A.I.R. 1996 S.C. 24). In this case, the partnership consisted of two partners and one of the terms in the partnership was that on the death of any one of them, his nomince or legar representative should be entitled to step into his shoes. The question arose here whether on the death of any one of the partners his heir would be entitled to become a partner automatically. It is refreshing to note the authoritative exposition of law given by the S.C. in the above decision. Sec. 42 (c) can apply to a partnership were there are more than two partners so that if one of them dies, the firm is dissolved and if there is a contract hand, if the firm consists of two partners and one of them dies, the firm automatically comes to an end and there is then no partnership for a third party to be introduced therein. Under Sec. 42 (c) an agreement between the partners that on the death of one of them, his legal heir or nominee should take the place of the deceased, will not therefore have the effect of automatically making such heir or nominee a partner of the firm.

In this context it is again interesting to note the decision in M/s Mettupalayam Industrial Roadways P.Ltd and other v. Thiru. Mohommed Ismail

Rawther & Co., (1976 I.M.L.J. 447) in this case three partners were doing partnership business and after the death of one partner the question arose whether the surviving persons could continue if there should have been an agreement even implied (oral) or express that the death of a partner will not result in the dissolution of the firm.

Quite understandably, a partnership is a creation of contract and not one arising from status. This position is held to be sufficient to lead to the inference that the heirs of one partner could not become partner without their consent. Of course they at an join but then it would be a new partnership.

7.13. DISSOLUTION OF PARTNERSHIP AT WILL:

As repeatedly mentioned before where partners while entering into an agreement of partnership make no provision for the duration of their partnership, or for the determination of their partnership, the partnership is called "partnership at will" (Sec.7) Sec 43 provides for the dissolution of partnership at will. Where the partnership is at will; the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned from the date of communication of the notice. If a partner giving the notice dies in the course of the post, it has been held that the dissolution is by death and not by notice. It might also be well remembered that in case of partnership at. Will, the right of a partner to dissolve a partnership by notice is a legal right and not equitable one. Indisputably, a partnership at will is different from a partnership terminable by mutual agreement. Only in the latter case it is clear that it can be dissolved only by mutual consent and mere notice from a partner is not sufficient to dissolve the partnership, and it is interesting to note here that even the court cannot dissolve such a partnership unless the circumstances are such as to warrant dissolution under sec. 44 of the Act,

7.14. DISSOLUTION THROUGH COURT:

A partnership for a fixed term, as we have considered above, cannot be dissolved by the court at mere wish of one or more of the partners. Where it is not dissolved for any of the reasons above mentioned, it would be possible to dissolve it only by a court of law at the suit of a partner provided that any one of the prescribed conditions by sec. 44 is satisfied. Sec. 11 of the Act while allowing the partners to determine their respective rights and duties by contract, is in fact *restricts the scope of the contract entered into between them*. In other words, Sec. 11 makes the contract between the parties subject to the provisions of the Act. On the other hand we find that sec. 44 empowers the court to dissolve a firm on any of the specified grounds but Sec. 44 is not made subject to the contract between the parties. A careful study of these two sections reveals that Sec. 44 is one of the provisions of the Act where the contract of the partners is subject to the available right under Sec. 44. Again it is sufficiently clear that any clause in the partnership deed would not in any manner affect the right of the partners to institute a suit for dissolution, provided any of the ground specified in Sec. 44 are present. It is undisputed that a partnership stands dissolved only in the mode prescribed by Sec. 40 to 44 and not by forcible expulsion of a partner from the business in breach of the terms of partnership agreement. No doubt, this remedy of a suit is open to partnership of all kinds of partnership described in our previous lessons. It is of practical importance in the case of a partnership for fixed period. The circumstance under which a firm may be dissolved by the court are provided by sec. 44 and they are as follows:

"At the suit a partner, the court may dissolve a firm on any of the following grounds namely: (a) that a partner has become of unsound mind, in which case the suit may be brought as well by the next friend of the partner who has become of unsound mind as by any other partner: (b) that a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as partner: (c) that a partner, other than the partner suing, is guilty of conduct which is likely to affect prejudicially the carrying on of the business, regard being had to the nature of business. (d) that a partner, other than partner suing willfully or persistently commits breach of agreement relating to the management of the affairs of the firm of the conduct of his business or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him (e) that a partner, other than the partner suing has in any way transferred the whole of his interest in the firm to a third party or has allowed his share to be changed under the provisions of Rule 49 of Order 21 of the First Schedule to the Code of Civil Procedure, 1908 or has allowed it to be sold in the recovery of arrears of land revenue of any dues recoverable as arrears of land revenue due by partner: (f) that the business of the firm cannot be carried on save at a loss: (g) an any other ground which renders it just and equitable that the firm should be dissolved."

We have noted above under sec.44 (c) that the misconduct prejudicial to the partnership business is made a ground of dissolution. In an interesting English case where one partner was convicted for travelling in a train without a ticket and with intent to defraud, the conviction was held to be a valid ground for an action for dissolution (Carmichale v. Evans (1904) I.Ch 486) In the same manner a partner's adultery with his Co-partner's wife is good ground and sufficient justification for dissolution under this clause. The words "just and equitable" are wide in their amplitude and do not prevent the court from taking into consideration even factors subsequent to that suit. In Babu Piaery Lal v. Kanahayal Lal (1953) U.P. 43 where the dissolution was sought by four out of nine partners holding nearly a half share and the evidence clearly showed that there was lack of co-operation or mutual confidence, and the disputes between the partners had been many and chronic. It was just and equitable ground to order dissolution. Thus this section given the court extensive powers of dissolution.

7.15. CONSEQUENCES OF DISSOLUTION:

In this context an increasingly pertinent question is being raised in respect of consequences of dissolution and undoubtedly it is the most important of the basic issues in the law of partnership. In order to analyse all the consequences as a result of the dissolutions of partnership firm, we have to probe deeper into the relevant provision of the Act. They are herein analyzed as follows:

7.15.1. Liability for acts after dissolution: As per sec. 33 it is to be emphasized that despite dissolution, the partners cannot escape their liability to third parties for their acts done even after the dissolution of the firm when such public notice of dissolution is not given by the partners. The necessity of giving a public notice after dissolution of a firm is well emphasized and if the partners fail to give publicities, then they will continue to be liable to third parties. Third persons dealing with the firm are entitled to assume, until a public notice is given that the partners continue to be each other's agent and the partnership still continues though it has been actually dissolved. This section provides that the liability is only for acts which if done before dissolution would have been acts of the firm. This provision corresponds with similar provisions made under sec. 32 (3) in respect of an expelled partner. Notice as required by sec. 72 is public notice and the same must be published in the local official Gazette and in at least one same must be published in the local official Gazette and in at least one vernacular newspaper of the district where the firm has its principal place of business. In case of registered firm notice should be given to the Registrar of firm also. The notice as provided by this section may be given by any of the partners. Thus sec. 45 introduces that what is known as continuing liability of partner till notice is given and the provision to the action provides for three exceptions to the general rule.

Exceptions : (i) No notice is necessary to terminate liability of a deceased partner for debts contracted by the firm after his death (ii) The estate of a partner who is adjudicated insolvent is not liable for the acts done after the date on which he ceases to be a partner i.e., the date of adjudication (iii) In the case of a dormant partner on dying or retiring his estate will cease to be liable for the subsequent acts of other partners from the date of the dissolution of the firm even with out notice.

2) Winding up of the firm : Ordinarily the dissolution of the firm results in termination of the relationship of partnership and ultimately it causes the dissolution of partnership between the partners. But their rights and obligations continue for the purposes of winding up of its business after dissolution. Thus dissolution of firm does not bring about the final settlement of the affairs of the firm. It becomes necessary that the affairs of the firm should be wound up, the assets released the liabilities discharged the debts paid out surplus if any, distributed to the partners or their representatives according to their respective rights. All these matters have to be carried by means of separate proceeding known as "winding up" Sec. 46 provides to the same effect and lays down the rule on dissolution of firm. Each partner is entitled to enforce the winding up of the firm by requiring the other partners to apply the property of the firm in payment of the debts and liabilities of the firm and by distributing the surplus among the members of the partnership. The right recognised by this section can be enforced by bringing a suit called "a suit for an account". Suit for partnership accounts will only lie when it is followed by a prayer for dissolution.

But as pointed out earlier the authority of a partner in the relations of partners inter se will continue after dissolution only to the extent necessary for winding up the affairs of the firm and for completing transactions pending at the time of dissolution (Sec. 47). It should be noted however the partners are not bound by such acts of a partner. If he is adjudicated insolvent unless they have held him out as a partner.

7.16. PARTNER'S LIEN:

"The provisions of Sec. 49 should be borne in mind here. Sec.46 gives recognition to the right of a partner to have the assets of firm released and in the first place applied in payment of the debts and liabilities of the firm. Such right of a partner is known as a partner's lien. The above referred to right is in the nature of an equitable lien or a quasi lien which has nothing to do with possessory lien. But as pointed out in Babu v. Gokuldas (1930 Mad 393) by the Privy Council, it is merely a convenient mode of referreing to the right and the word "lien in relation to partners" is not used in its technical sense. Again an equitable lien must be carefully distinguished from the possessory lien in that the former attaches independently of any possession of property. This lien is available after dissolution not only on the other partners who have taken over the business and assets of the firm, but also exists equally against all persons who acquire the property with notice of the lien. A partner's lien during the attaches to all partnership property for the time being and partnership is not therefore lost by the substitution of new stock-in-trade for old. But after a partnership has been dissolved, the lien is confined to what was partnership partnership property at the time of dissolution and does not extend to what may have been subsequently by the persons who continue to carry on the business in the same manner, the lien is lost by conversion of the partnership property into the separate of another partner by agreement at the time of dissolution.

Settlement of Accounts: Sec:48 lays down the rules regarding the mode of settling the accounts of the dissolved firm. In settling the accounts of a firm after dissolution the following rule shall, subject to agreement by the partners, be observed.

(1) Sub-section (a) of Sec.48 provides that losses, including deficiency of *capital are to be paid first* out *of* profits *then* out *of the* capital and lastly, if necessary by the partners from otheir separate property pro rate.

(2) Application of assets: Sub-Section (b) provides the assets including original contributions of partners; and subsequent contributions, if, made are to be distributed in the following order.

(i) in paying the debts due to third parties (ii) in paying the partner rateably advances made by them as distinguished from their contributions towards the *capital (iii) in paying the partners rateably what is due to them* on account of capital. (iv) if there is surplus, to be divided between the partners in the proportions in which they were entitled to share profits.

The difficult case arises where partners have advanced unequal capital and agreed to share losses and profits equally. The leading case on this point is Garner v.Murrary (1904) 73 L.J. Ch 66) and some of these rules mentioned above found application in this case. The facts of this case are three persons G,M, and W entered into partnership under a parole agreement that the capital of the business should be contributed by them in certain unequal shares, but that profits should be divided equally. Upon dissolutin of the partnership after satisfying all *liabilities to creditors* and the advances of two of the partners, the assets were found insufficient to make good the capital and considerably a larger sum was due in respect of capital to G than, to M. It was held, firstly that every partner was bound to contribute equally to make up the deficiency, and secondly, if one partner failed to contribute towards deficiency; the other partners were not bound to contributed in respect of the defaulter.

This section corresponds to sec. 44 of the English Act and the importance of sec. 48 lies in the fact that it provides in very clear terms the manner of making up losses, and distribution of the assets of the firm.

7.17. PAYMENTS OF FIRM DEBTS AND SEPARATE DEBTS (SEC.49)

Where there are joint debts due from the firm and also separate debts due from any partner, property of the firm shall be applied in the first instance in payment of the debts of the firm, and if there is any surplus, then the share of each partner shall be applied in payment of his separate debts or paid to him. The separate property of any partner shall be applied first in the payment of separate debts, and the surplus (if any) in the payment of the firm.

7.18. PERSONAL PROFITS AFTER DISSOLUTION:

Sometimes even after the dissolution of the firm till they have been finally wound up, the surviving partners on the representatives of the deceased partners may carry on the business of the firm. In such cases Sec. 54 insists that personal profits made by them by such means before the firm is fully wound up must be accounted for by them to the other partner's estate. It is to be noted that this rule is again subject to a contract to the contrary. It is well to remember the rule contained in sec. 16 which can be treated as complementary to sec 50. Sec. 53 in addition to the right, provides a power absolutely from using the firm name or property until the windings up is completed. In such cases the provision to sec. 50 protects the rights of any partner, or his representative who has bought the goodwill of the firm and this section shall not affect his right to use the firm name.

7.19. SALE OF GOOD WILL AFTER DISSOLUTION:

A brief reference has been attempted regarding "good will" of a firm earlier. In settling the accounts of a firm after dissolution, the good will shall, subject to contract between the partners, be included in the assets and it may be sold either separately or along with other properties of the firm (Sec.55(1)).

Further sub-section (2) of Sec. 55 provides that where the good will of a firm is sold after dissolution a partner may carry on a business, competing with that of the buyer and he may advertise such business but the seller of good will cannot unless there is an agreement to the contrary (i) use the firm name. (ii) represent himself as carrying on the business of the firm, or (iii) solicit the custom of persons who were dealing with the firm before its dissolution. This rule was firmly established by Trego v. Hunt (1896 A.C. 7). If from the fact and circumstances of the case such restrictions and limitations are reasonable they will not be invalid notwithstanding the provisions contained in Sec. 27 of the Contract Act.

7.20. REGISTRATION OF FIRMS:

The rules regarding Registration of Firms are dealt under chapter VII of the Indian Partnership Act and the scheme of this Chapter is a welcome feature to Indian law. The main object of this Act is to safeguard the interests of the public against firms carrying on business under the name which does not disclose to the public the identity of the actual partners. The object of introducing the chapter is to place the information regarding the affairs of the firm and incidental matters within easy reach of the public, who want to deal with them and registration of firms, will immensely help the third person dealing with a firm to know who are partners in that firm. Though these sections taken together provide for acts which are of a ministerial nature, certain sections are so framed as to affect the rights of partners and against third parties. We will herein analyse the relevant provision in this context.

7.21. APPOINTMENT OF REGISTRARS:

The State government may appoint Registrars of Firm for the purpose of registration of firms and may define the areas within which they shall exercises this powers and perform their duties. The Government may by notification in the official Gazettee, direct that the provisions of this chapter shall not apply to that State or to and part thereof specified in the notification. Incidentally the Government shall provide rules prescribing the fees which is to be paid for registration of any document and also for the details regarding the form and procedure for registration.

7.22. MODE OF REGISTRATION:

Sec. 58 lays down that a firm may be registered at any time by sending by post or delivery in person, to the Registrar of Firms, a statement containing the following particulars signed by all the partners or by their agents. The statement as well as application form shall be in the prescribed form and accompanied by the prescribed fee. The following particulars should be noted in the statement: (a) the firm name (b) the place or principal place of business of firm name (c) the name of any other place where the firm carries on business, (d) the date when each partner joined the firm, (e) names in full and permanent addresses of the partners and (f) the duration of the firm.

When the Registrar is satisfied that the provisions of Sec. 58 have been duly complied with, he shall record an entry of the statement in a register called the Register of Firms and shall file the statement (Sec.59). Subsequent alterations in the names of partners, name of the business etc., shall also be noted in the register by the Registrar. Rules regarding these matters are contained in Sec.60 to 62. The Registrar can rectify errors in entries made by him with regard to documents. To a limited extent the register of Firms is a public document. This is open to all persons for inspection on payment of the prescribed fees. Sec.68 provides that the original documents filed with Registrar of Firms shall be conclusive proof of facts stated therein. Furnishing false statement of particulars will lead to punishment with three months imprisonment or with fine or with both. No penalty as such for non-compliance with the provisions of registration is provided for in Secs. 58, 60, 61 and 62 since they appear to be enabling provisions. Here Sec. 69 imposes sufficient punishment, by refusing the assistance of courts to firms which are not registered and to partners of such firms. Perhaps the intention of the legislature was that no servere punishment was needed to induce or encourage firms to get themselves registered. Again it is well to remember here that this Act came into force on 1st Oct 1932 but the operation of Sec.69 only had been postponed till 1st, Oct 1933. It was perhaps thought that this gap would enable the existing firms to get themselves registered in that brief interval.

As has been said earlier in England the law relating to registration is codified in the Registration of Business Names Act, 1916. According to Sec. I of the Act change in name has to be duly informed to the concerned authority under the Act. In Sey mour v.Cherikeef (1946) 175 L.T. 31, it has been held that a married women who does not register her married name after marriage and continues trading under her maiden name was guilty under Sec.1.

7.23. EFFECT OF NON-REGISTRATION:

If one is asked to point out a provision in the Chapter on Registration which shows the effectiveness of provisions of the Partnership Act as a whole, one would unhesitatingly and unerringly point out sec.69 which lays down the consequences of non-registration of a firm. Though registration of firm is optional the cumulative effect of the rules as stated in this section is such that a partnership firm shall practically choose to get firm registered sooner or later. Further, it is due to the special merits of registration as stated in this section. It does not make the partnership agreement or a transaction between the partner and third person void due to non-registration. It simply suspends the right of suit, if the firms is unregistered or failed to comply with the provisions of this section. So it may be stressed, that in case any partnership firm is not registered it never means that it is illegal. The object of enacting this section is to encourage registration of firms by imposing a disability in the case of firms which are not registered.

The necessity of registration will be clear from the following discussion. Sec.69 lays down the consequences of non-registration of a firm as follows (1) "No suit to enforce right arising from a contract conferred by this Act shall be instituted in any court by or on behalf of any person suing as a partner in a firm against the firm or any person alleged to be or to have been a partner unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm. (2) No suit to enforce a right arising from a contract shall be instituted in any court by or on behalf of a firm against any third party unless the firm is registered and the persons suing are, or have been shown in the Register of Firms as partners in the firm 3) The Provisions of Sub-secs (1) and (2) shall apply also to a claim of set-off or other proceeding to enforce a right arising from a contract, but shall not affect:- (a) the enforcement of any right to sue for the dissolution of a firm or for accounts of a dissolved firm, or any right or power to realise the property of a dissolved firm or (b) the powers of an Official Assignee, Receiver, or Court under the Presidency Towns Insolvency Act, 1909, or the Provincial Insolvency Act, 1920, to realise the property of an involvement partner (4) This section shall not apply; (a) to firms or to partners in firms which have no place of business in the said territories to which the Act extends or whose places of business in the said territories are situated in areas to which by notification under Sec.56 this chapter does not apply or (b) to any suit or claim of set-off not exceeding one hundred rupees in value which, in the Presidency Towns, is not of a kind specified in Sec.19 of the "Presidency Towns Small Causes Courts Act, 1883, or outside Presidency Towns, is not of a kind specified in the second Schedule to the Provincial Small Causes Courts Act, 1887, or to any proceeding in execution or other proceeding incidental to or arising from any such suit or claim".

The significance and scope of this section may elaborately analysed as follows: (a) Sub-sec (1) of section 69, bars the right of a partner of an unregistered firm from suing as a partner for the enforcement of any right against the firm or any person alleged to be or have been a partner in the firm. The difficulty caused by this rule may overcome by getting the firm registered at any time before the suit is field. But it will be highly impossible when there is dispute, all the members are not likely to join the application for registration.

b) Sub-section (2) of sec.69 lays down the rule that a firm which has not been registered shall not be able to file a suit to enforce a right arising from a contract until the firm is registered. So it may be pointed out that a suit can be brought only by or on behalf of a registered firm and that also by persons whose name appears as partners in the register of firms.

Further, sub section (3) states, the partner in an unregistered firm shall, when sued, not be entitled to counter claim or to claim of set-off. The expression, "claim of set-off" means that if an unregistered firm is sued by a third party to recover a sum of money the firm cannot say that the money owing by a third party to the firm should be set off against the claim.

The section, however provides certain exceptions: (1) Non-registration does not affect the right of a third party to sue or proceed against the firm or its partners.

(2) The right of a partner of an unregistered firm to sue and obtain a decree for dissolution and accounts of the firm remains unaffected. Sec.69 (3) (a).

(3) The official assignee, receiver or court acting for an insolvent partner may bring an action for realisation of the insolvent's share whether the firm is registered or not. (Sec.69 (3) (b).

(4) An unregistered firm or its partners may sue or claim a set-off where the subject matter of the suit does not exceed Rs.100 in value (Sec.69 (1) (b).

It was held in Ponnuchamy v. Muthuswami Gounder (I.L.R) 1942 Mad. 335 that Sec.69 of the Act is mandatory. Registration of the firm is condition precedent to the right to institute the suit and the court has jurisdiction to proceed with the trial when the condition precedent has not been fulfilled. However, registration can be

Check Your Progresse

1. Explain the procedure of admission of a new partner
2. What are the rights of a retiring partner?
3. What are the various modes of dissolution of partnership?
4. Explain partner's lien
5. Discuss the essential requirement of Registration of firm
6. What are the effects of non-registration of a firm?

effected at any time and it is not necessary that the firm should be registered from its beginning. The provision only requires registration before the filing of suit. If a firm has not been registered at the time of the presentation of the plaint, but is registered subsequently the only course open to the court is to dismiss the suit.

It may be noted here, in England under Registration of Business Names Act (1916), every firm having place of business in United Kingdom and carrying on a business under a business name not identical with the usual name of the persons concerned, is required to be necessarily registered. Provision is also made for exhibiting the registration certificate in a conspicuous place failing which partners will be liable for a penalty.

The effects of non-registration can be concluded by quoting the following passage "No member of an unregistered firm can enforce his rights under the partnership contracts against either the firm or any present or past member of it. So also the firm cannot sue its customers on their contracts.

The firm remains liable to be sued by persons outside it and cannot plead a set off". So no partner can enforce his right against the others (while the firm is continuing) in a court of law by means of a suit and that the firm also cannot enforce its claim against third parties.

7.24 SUMMARY

The provisions relating to the incoming and outgoing of the partners were discussed elaborately in this unit. The retiring partners rights to carry on the business that of the firm and his right to share subsequent profits have been explained. In the topic dissolution of firm, how firm could be dissolved by different methods and dissolution through court have been analysed. Lastly we have seen the topic registration of firm and the effects of non-registration.

7.25 KEY WORDS

reconstitution	-	change the form of an organisation
tripartite	-	three parties to an agreement
dormant	-	inactive

expulsion	-	act of expelling or leave out
bankrupt	-	not having money to pay one's debt.

7.26. ANSWER CHECK YOUR PROGRESS

1. Refer 7.2
2. Refer 7.8 and 7.9
3. Refer 7.11
4. Refer 7.16
5. Refer 7.22
6. Refer 7.2.3

7.27 MODEL QUESTIONS

1. Discuss the procedure of admitting a new partner
2. What are the rights of a retiring partner?
3. When would the court order dissolution of a firm at the suit of a partner?
4. State how far registration of a firm is essential. Point out the effects of non-registration.
5. What are the various modes of dissolution of firm? Distinguish between dissolution of a partnership and dissolution of a firm.

UNIT - 8

LAW OF NEGOTIABLE INSTRUMENTS

INTRODUCTION:

Negotiable instruments are essentially the most common credit devices created by mercantile community in particular and utilised in business world today to a greater extent for the speedy settlement of manual accounts of businessman. Basically, safe transport of money can be easily attributed to the negotiable instruments. Much of the importance of negotiable instruments lies in the fact that they are more readily transferable than ordinary claims or contract rights and that the transfer of a negotiable instrument may very well acquire greater rights than an ordinary assignee.

The law in India relating to negotiable instruments is contained in the Negotiable Instruments Act of 1881. This present Act came into force on the 1st day of March 1882. A peep into the history of this law reveals that before the enactment of this act the Law Merchant of England governed negotiable instrument in addition to local usages relating to instruments in oriental languages. However it is open to the parties to exclude by any words in the instruments expressing an intention that the legal relation of the parties shall only be determined by the Act and not by the said customs and usages. We shall analyse the rules pertaining to negotiable instrument in this and in the succeeding unit.

UNIT OBJECTIVES

- to analyse the definition of negotiable instrument and various kinds of negotiable instrument
- to study the definition of promissory note, Bill of Exchange and cheque its features and the differences
- to understand who is a holder and holder in due course.
- to know various types of instruments.
- to study the essential elements of a negotiable instrument.

UNIT STRUCTURE

8.1. DEFINITION OF NEGOTIABLE INSTRUMENT :

In the words of Judge Wallace, "Negotiable instrument is one, the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defect of title in the person from whom he book it; from which it follows that an instrument cannot be negotiable unless it is such and in such a state that a true owner could transfer the contract or engagement contained therein by simple delivery of the instrument".

To put in other words a negotiable instrument is a piece of paper which entitles a person to a specified sum of money and which is furthermore easily and readily transferable from one person to another by simple delivery or by endorsement and delivery. Thus, negotiable instruments are written promises or orders to pay money, such as promissory notes, bills of exchange and cheques when in proper form may be transferred from hand to hand as substitute for money. Again the person to whom it is transferred becomes entitled to the money as well as the right to further transfer it. Hence negotiable instrument is a chose-in-action with a great element of negotiability attached to it. It is matter of familiar knowledge that no one can became the owner of property unless he purchases it from the true owner or with his authority. The maxim of law, as already noted, is "nemo dat quod non habet" (no one can convey a better title than what he has) But to this rule, negotiable instruments constitute an exception. It is this special and distinct feature of negotiability which distinguishes an ordinary chose-in-action from a negotiable instrument. The authoritative definition given by Judge Wallace supports this proposition

The great element of negotiability is the acquisition of property by your own conduct, not by another's that if you acquire it bonafide and for value, nobody can deprive you of it. Raphal .V. The Bank of England (1855) 104 R.R. 638, illustrates this point: In a bank robbery, some bank notes of the Bank of England were stolen. The bank which prepared and distributed a list of the stolen notes, sent one such list to the plaintiff. The plaintiff was a money changer in Paris and received the list prepared by the bank. Twelve months after the receipt of this notice, a man came to the plaintiff to exchange a bank of England forgotten it, cashed the note. The note later turned out to be a stolen one. Held, the plaintiff was entitled to its payment, for he has taken the note in good faith. He was no doubt some what negligent, but he had acted honestly.

The above stated principle is applicable only when it can be transferred like cash by simple delivery. If, in addition to delivery it requires endorsement, then it is not negotiable till it is properly indorsed. Whistler .V. Forster is an authority for this proposition. In this case, one G by practicing fraud, obtained a cheque from the defendant Forster. The cheque was made payable to G or his order. G, to satisfy his own debt, gave the cheque to the plaintiff but failed to indorse it. The plaintiff had no notice of the fraud then but, before he could obtain G's endorsement, he was given notice of the fraud. Held the plaintiff could not get a valid title. Eric, C.J. said "According to law merchant, the title of a negotiable instrument (payable to order) passes by indorsement and delivery. A title so acquired is good against all the world provided the instrument is taken for value and without notice of any fraud plaintiff's title here, therefore, was to be rendered valid by indorsement; but at the time he obtained the indrosement, he had notice that the bill had been fraudulently obtained by G from the defendant".

From the above, it is thus clear that a negotiable instrument is a thing having the characterstics of money or cash, and it is also contract or chose-in-action.

The essential features of a negotiable instrument are as follows:

(1) As it represents a debt, it is a contract to pay money.

(2) As stated above, the property in it can be transferred from hand to hand by delivery or indorsement and delivery (Whistler. v. Forster) without any formalities e.g. writing, stamp etc.,

(3) A bonafide transferee for value of a negotiable instrument will get a good title even though there was some defect in the title of the transferor.The transferee of a negotiable instrument can sue for enforcing any right or claim on the basis of the instrument in his own name.

(4) No notice as such is to be given to the debtor as in the case of an ordinary assignment. Further it can be transferred ad infinitum till the date of maturity.

(5) As it has got special rules of evidence (e.g., a presumption to the effect that consideration has been paid under it: that has to be paid only for the amounts endorsed and that it is executed on the day on which it purports to have been executed). It is capable of any proof.

(6) Holder of the instrument is entitled to prompt and immediate payment, for a dishonour for non-payment of a negotiable instrument means the

ruin of credit of all persons more particularly the parties to the instrument either as executants or as endorsees.

(7) It enables the holder of the instrument to get payment at any moment even before the time fixed for payment in the instrument and therefore it can be treated, as good as cash.

8.2. KINDS OF NEGOTIABLE INSTRUMENTS:

According to sec.13 "a negotiable instrument means a promissory note, bill of exchange or cheque payable *either to order or to bearer"*. Besides these types, there are several other negotiable instruments under English law (1) Bank notes. (2) Dividend warrants, (3) Share warrants, (4) Treasury bills, and (5) Debentures payable to bearer are treated and recognised as negotiable instrument, In *Bechuanaland Exploration Co v.London Trading Bank* (1898, 12Q.B.658) it was held that new types of negotiable instrument may be recognised by courts, if by mercantile practice they are treated as such even though of recent origin. Bill of lading and dock warrant as we know are documents of title relating to the goods and these documents present some of the special characteristics of a negotiable instrument. But they lack the essential attribute of negotiability. These instruments may, therefore be treated as quasi-negotiable. From this discussion two things are clear. Even the section makes it clear that instruments payable to order are also negodtiability, (ii) indeed every document which entitles a person to a sum of money and transferable by delivery, is deemed to be called "negotiable instrument". In the first instance that an order instrument can only be negotiated by indorsement and the indorsement must be genuine.

In Smith's LEADING CASES it is said, "when an instrument is by the custom of trade transferable in this country like cash, by delivery and is capable of being sued upon by the person holding it pro-tempore (for the time being) then it is entitled to the name negotiable instrument, and the property in it passes to a bonafide tansferee for value"

Negotiability by Estoppel: Instances can be found where instrument have been considered and treat as negotiable instruments not because of any specially recognised usage or custom relating to them but mainly on the ground that the persons using such instruments are estopped from disputing their negotiable character against a bonafide transferee for value (**Goodwin v. Toberts**, 1876 A.C.476). Negotiability by estoppel does not mean that the instrument in questions is negotiable but only that the party sued upon it cannot defeat the title of the bonafide holder for value because the form of the document of the conduct of the party sued amounts in law to a representation that the holder shall have the right to enforce the instrument irrespective of any defect of the title on the part of the transferor. This is subject to the condition that the instrument should be complete and on further formality be required on the face of it entitle the transferee to full rights. In the case of company issuing debentures in a form whereby they bind themselves to pay the amount to the bearer, estoppel is applied.

8.3. PROMISSORY NOTE:

Section 4 defines promissory note as follows: "A promissory note" is an instrument is writing (not being bank note or a currency note) containing an undertaking signed by the maker to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument."

Madurai – 21

22-11-2007

On demand I promise to pay Mr. Narayanan or order

Rs. 5000/- (Rupees Five thousand only) with interest

at the rate of 9% per annum for value received.

Stamp.

(sd.) Regunath

Essentials of a promissory note :

1. It must be in writing.

2. It must contain an unconditional undertaking to pay.

3. The promise must be to pay money only.

4. The amount must be certain.

5. The name of the maker must be certain.

6. It must be signed by the maker.

7. The payee's name must be certain.

8. Bank notes and currency notes are specifically excluded from the definition of promissory note but a Government promissory note comes within the definition

8.4. BILL OF EXCHANGE

Definition: Sec.5 defines bill of exchange. "A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain, or to the bearer of the instrument".

A promise or order to pay is not conditional within the meaning of this section and sec. 4 by reason of time for payment of the amount or any instalment there of being expressed to be on the lapse of a certain period or after the occurance of a specified event which, according to the ordinary expectation of mankind is certain to happen, although the time of its happening may be uncertain.

The sum payable may be 'certain' within the meaning of this section and sec.4 although it includes future interest or is payable at an indicated rate of exchange, or is according to the course of exchange and although the instrument provides that, on default of payment of an instalment, the balance unpaid shall became due.

The person, to whom it is clear that the direction is given or that payment is to be made, may be a "certain person within the meaning of this section although he is misnamed or designated by description only".

It is to be noted here that a bill of exchange is called a draft.

A typical form of a Bill of exchange is given below.

Rs. 5000/- Madurai

[stamp] 4th January 2008

On demand pay K.R. Sambasivan or order the sum of Rs. 5000/- (Rupees one five only for value received).

To

M. Suresh, (Sd.) S. Manoharan

74, Dadar

Mumbai

This is only the general form of a bill of exchange, and no particular form is prescribed. Again here this is an order bill payable of demand. If instead of the words "on demand" words indicating the time when the bill should be paid are used. e.g., pay three months after date it will be treated as an order bill payable at a fixed time. In the later case, instead of being made payable to a particular individual, the bill may be made payable to bearer by so expressing it.

Parties to a Bill of Exchange: From the above analysis it may be seen that there must be three parties to a bill of exchange. (i) The drawer, (ii) the drawee and (iii) the payee. These parties may be conveniently referred to as original parties to a bill an exchange.

8.5. ESSENTIAL ELEMENTS OF A BILL OF EXCHANGE:

1. It must be in writing.

2. The words used in the bill of exchange must amount to an order to pay. Though the order to pay is in the form of a request the terms must be imperative. The order must be conditional as between the parties (drawer and drawee). The payment of amount, should not be made to depend on the happening of any contingency or the fulfillment of a condition. So also an order to pay out a particular fund is not unconditional.

3. Speaking generally, there should be three parties to the instrument, viz, (a) drawer; (b) drawee; and (c) payee. The person who makes the bill of exchange is called the drawer. The person to whom it is addressed is called the drawer. Payee is the person to whom or to whose order the money is by the instrument directed to be paid. All the parties specified here must be named or indicated with reasonable certainty. Sometimes we can also notice two or more drawees as joint drawees. Where an order is addressed to two drawees in the alternative or in succession one after the other it will not be a bill of exchange. In some cases, the drawer and the payee are the same persons as where a bill is drawer "pay to me or my order". Here the number of parties are reduced to two (parties). But without this minimum of two there cannot be a bill of exchange. Thus *Cruchely v. Clarence* (1813) 14 R.R. 596, the dependent issued a bill without inserting the name of any payee and the court said: a bill of exchange drawn and issued in blank for the name of any payee may be filled up by a bonafide holder with his name and will bind the drawer". Lord Ellenborough said: It is the same thing as if the dependant made the bill payable to bearer. As stated earlier, the drawer may be the same person as the drawee or a fictitious person, or one not having capacity to contract. In this case, the holder is given the option to treat the instrument either as a bill of exchange or a promissory note. In such a case the bill is usually treated as "ambiguous instrument".

An interesting situation may be noted in the case of negotiable instruments because of the presence of three parties in it as noted above. In the above given specimen of a bill of exchange (Manoharan) is, called the drawer, the person who "order" to pay M. Suresh is called the drawee and the person named in the instrument to whom or to whose order the money is by the instrument directed to be paid (K.R. Sambasivan) is called the payee. The payee or if the bill is endorsed, endorsee, is called holder of the bill.

4. A bill of exchange must be signed by the maker or drawer. Failure to affix signature will turn the instrument incomplete and hence it will be considered as an inchoate bill. The signature can be made by a sign or a mark or an impressed stamp. Suppose, a person is authorised to sign a bill he can sign the bill. For example, a bill issued by a corporation may have the corporate seal. Usually it may be signed by an officer of the corporation.

5. The order contained in a bill of exchange must be to pay a certain sum of money only. The sum of money payable must also be certain if the instrument contains promise to pay something else instead of money or something in addition to money, it will not be a bill of exchange. The sum payable may be certain although, it includes future interest or is payable at an indicated rate of exchange or is according to the course of exchange, and although the instrument provides that, on default of payment of an instalment, the balance unpaid shall become due, in case of discrepancy, the amount stated in word will prevail.

6. The payee to whom the money is to be paid must be made certain. Sometimes a bill may be drawn payable to bearer, or to the order of the drawer, a third person or to the drawee in some cases. In case it is not payable to the bearer the payee must be indicated with reasonable certainty. It may be payable to two or more payees jointly, or in the alternative to one of two or more several payees.

7. Lastly, it can be made payable "on demand" or at a fixed or determinable future time where it is expressed to be payable on demand or at sight or on presentment or where no time is expressed, then the bill is payable on demand it is payable at determinable future time when it is expressed to be payable at a fixed period after date or sight or on or at a fixed period after the occurrence of a specified event which is sure to happen, though the exact time may be uncertain.

From the above discussion, it is clear that the parties must be certain, the order must be certain and the sum payable must be certain. Though a bill is not invalid by reason that it is not dated it is infact, essential for counting the maturity of the bill. A bill is not treated invalid by reason than it fails to specify the place where it is drawn or the place where it is payable. Place of issue is important to distinguish whether it is an 'inland' or a 'foreign' bill. It is further to be noted that consideration will always be presumed in the case of negotiable instruments. It is not necessary that the bill must specify the value or consideration received. To be admissible in evidence it must be stamped whenever required by the provisions of the Stamp Act.

8.6. DIFFERENCE BETWEEN PROMISSORY NOTE AND BILL OF EXCHANGE

1.	In a promissory note there are only two parties.	In a bill of exchange there are three parties.
2.	The liability of the maker is primary from the beginning.	Once the bill is accepted the liability of drawer is secondary.
3.	It contains an unconditional undertaking to pay.	Unconditional order to pay.
4.	Presentment for payment is not necessary to render the maker liable.	Presentment for acceptance is necessary.
5.	The rules relating to presentment for acceptance, acceptance *supra*, protest and bills in sets are not applicable to promissory notes.	They are applicable to bills.

8.7. CHEQUE :

Section 6 defines cheque "a bill of exchange drawn on specified banker and not expressed to be payable otherwise than on demand." In other words cheque is a special kind of bill of exchange and possesses all the requisites of a bill.

Cheque may be "bearer cheque" or "order cheque". The former is expressed to be so payable or on which the last or only indorsement is an indorsement in blank. An "order-cheque" is one which is expressed to be payable to a particular person, without any words prohibiting transfer or which is expressed to be payable to the order of a certain person.

8.8. DIFFERENCE BETWEEN CHEQUE AND BILL OF EXCHANGE :

	Cheque	Bill of Exchange
1.	A cheque is always drawn on a banker.	A Bill of Exchange may be drawn on any person including a banker.
2.	Payable immediately, days of grace is not applicable.	Unless otherwise provided three days of grace is applicable.
3.	Requires no acceptance.	Must be accepted before the acceptor can be made liable on it.
4.	Cheque is drawn on the funds of the drawer in the hands of the banker.	Not so.
5.	No notice of dishonour required for cheque.	Notice of dishonour is necessary.
6.	Drawee is not discharged by the delay of the older in presenting it for payment except when drawer has sustained loss by delay.	Must be present for acceptance at maturity for payment otherwise he loses his remedy against the drawer and the prior endorsees.
7.	At any time before payment it can be countermanded.	Cannot be done so.

Drawee in Case of Need: When in the bill or in any indorsement thereson the name of any person is given in addition to the drawee to be resorted to in case of need, such person is called " drawee in case of need" (Sec.7). In English law he is called "referee in case of need" and by merchants "case of need". The name of "drawee in case of need" may be mentioned or inserted either by the drawee or by an endorser to be resorted to in case the bill is not accepted, or paid in the usual course: In some cases the drawee on whom the bill is drawn may not be willing to accept and pay the bill. Here, anticipating such an event, the drawer, may mention on the bill itself the name of another person who may be approached for acceptance and payment in case the drawee dishonours the bill. Where a drawee in case of need is named in a bill of exchange, or in any indorsement thereon, the bill is not dishonoured till it has been dishonoured by such drawee. It may be presented to him even without being "noted or protested" for dishonour by the drawee (Sec.116). Two important differences between English law and Indian law are as follows: (a) Report to the drawee in case of need is optional in English law, whereas according to Indian law, the holder must present the bill, whether for acceptance or for payment to the drawee in case of need. (b) A bill must be protested before it is accepted or paid by the referee in case of need. This is the position in English law. But previous protest is not essential according to Indian law.

8.9 ACCEPTOR AND ACCEPTOR FOR HONOUR:

After the drawee of a bill has signed his assent upon the bill, or, if there are more parties there of than one of such parties, and delivered the same, or given notice signing to the holder or to some person on his behalf, he is called the 'acceptor'. The acceptance of a bill is the significance by the drawee of his assent to the order given by the drawer. To establish a privity of contract it is essential that the drawee must accept the bill. Till then he is not a party to the transaction and therefore he is not held liable to make, the payment. The usual form in which the drawee accepts the instrument is by writing the word accepted across the face of the bill and signing his name underneath.

What will happen if the drawee does not accept the bill? Here the holder may require a Notary Public to note on the bill that it has been dishonoured by non-acceptance and to give a certificate to that effect. This is known as *'Protest'*. Subsequent to the acceptance, if the drawee becomes bankrupt or his credit is shaken, the holder may demand security from the acceptor. If the security is not given within a reasonable time. the holder can get a protest for non-acceptance of for better security and any person accepts it supra protest for honour of the drawer or of anyone of the indorsers such person is caned the acceptor for honour (Sec.7).

8.10. HOLDER:

The 'holder' of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession of the instrument and to receive or recover the amount due thereon from the parties to the instrument. Where the note, bill, or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction (See.8).

A holder must therefore have the possession of tile instrument under a legal title with additional right to recover the money in his own name. Hence, (a) the finder of lost instrument. (b) a thief (c) a payee prohibited by an order of the court from receiving the amount, (d) a payee who is agent of another, (e) a person taking under a forged indorsement are not holders within the meaning of the section because they have possession but they do not have any right to recover the money due thereon. A mere possession of a negotilble instrument does not make a person its bolder. The use of the phrase 'entitled in his own name' is significant. because of the institution 'benami'. The law relating to benami transactions have no application to negotiable instruments. Only a person whole name appears on the face of the instrument will be deemed to be a party to it.

The definition given above, and the discussion followed there, after go to support the proposition that only holder can bring a suit on a negotiable negatiable. Therefore, a promissory note was made in favour of the Karta of a Joint Hindu Family. It was held that Karta alone could bring a suit to enforce his rights even though it was in respect of a joint family claim. The section does not affect the devolution of rights by operation of law .

8.11. HOLDER IN DUE COURSE (Sec. 9):

'Holder in due course' means any person who for consideration became the possessor of promissory note, bill of exchange or cheque if payable to bearer, or the payee or indorsee thereof; if payable to order. before the amount mentioned in it became payable without having sufficient cause to believe any defect existed in the title of the person from whom he derived his title (Sec.9).

The recurring theme underlying the definition is that a holder in due course should possess the instrument in 'good faith and for value'. This phrase has been split up by Sec.9 into four elements all of which must concur to make a holder in due course. They are follows: (a) The holder must have taken the instrument for value. (b) He must have obtained it before it before its maturity. (c) The instrument must be completed and regular on its face. (d) He must have taken instrument in good faith and without notice of any defect either in the instrument or in the title of the person negotiating to him.

In English law, a holder in due course is popularly called bonafide holder for value notice. There is a fundamental difference between English law and Indian law in this regard. According to Sec.9, a holder in due course may be the possessor of a note, bill or cheque payable to bearer or the endorsee in other cases. Under English law 'a payee' is not treated as a holder in due course.

To put it briefly a holder in due course is not the same as holder though there is a general presumption that a holder as a holder in due course. In other words, every holder is not a holder in due course, and it is only the holder in due course, who is protected against all defects in the title of his predecessors. Further he is entitled to claim certain special privileged which a mere holder is not given.

The burden is on the transferee to satisfy that be is entitled in his own name to the possession of the instrument and that he has the right to receive the amount due on the instrument. In addition he has to satisfy all the requirements specified above. Again the degree of care to be taken is different under Indian and English law. Indian law requires that the holder in due course, should not only be honest in taking the instrument, but he should exercise diligence in assuring himself that there are no defects in title. Where a bill was drawn in favour of "A &. P.Co but was endorsed 'A & B', held; the bill was improper on the face of it and its holder is not a holder in due course. *Arab Bank Lt. V. Ross. 1952 Q B.*216. According to English law it is sufficient if he took the instrument bonafide i.e., for value and without knowledge of any defect in title though he may have had the means of knowledge if he had taken proper care Raphael and another v. Bank of England (1855) 17 C.B 161.

8.12. RIGHTS OF A HOLDER IN DUE COURSE:

It is well established that a holder in due course occupies a privileged position in law of negotiable instruments. His title to document is free from equities. Once he proves that he is a holder in due course his subsequent rights will be safeguarded even though there is a defect in the title of his transfer. In the first place, it is by virtue of right's he can enforce payment according to the apparent tenor of the instrument. Title is said to be defective when it is obtained by practising fraud, duress, force, fear or other unlawful means or for illegal consideration. These defences cannot be used against a bolder in due course. Sec. 53 says, that a holder of a negotiable instrument who derives title from a holder in due course has the rights thereon of that holder in due course. He can recover the full amount unless he was a party to fraud, or if the instrument, is negotiable by means of forged indorsement.

An inchoate stamped instrument converted into a bill for a sum not - authorised but covered by the stamp value will be enforceable by a holder in due course. (Sec.20). Every prior party to the instruments is liable to a holder in due course until the instrument is duly satisfied (See. 36).

Holder in due course can file a suit in his own name against the parties liable to pay. He is deemed prima facie to be a holder in due course. (Sec.118).

No maker of a promissory note and no drawer of a bill of exchange or cheque, and no acceptor of a bill of exchange for honour or the drawer shall, in a suit thereon by a holder in due course can be permitted to deny validity of the instrument as originally made or drawn. (sec. 120).

In the same manner, in a suit by a holder in due course of maker of a promissory note, or acceptor of a bill of exchange payable to order can deny the payee's capacity at the date of the note or bill, to enter the same (sec. 121).

The holder in due course can recover the amount on the negotiable instrument from any of the prior parties, even if it made with out consideration.

Indorser is not permitted as against the holder in due course to deny the signature or capacity to any prior party to the instrument (sec.122).

8.13. CLASSIFICATION OF INSTRUMENTS

8.13.1. Inland instrument : "A promissory note, bill of exchange or cheque drawn or made in India and made payable in or drawn upon any person resident in India shall be deemed to be an "inland instrument" (Sec. 11)

8.13.2. Foreign instrument : Any such instrument not so drawn made or made payable shall be deemed to be a "foreign instrument", (sec. 12).

Sec.11 suggests two kinds of inland instruments: (a) a bill of exchange drawn in India on a person resident in India and (b) a bill drawn in India and made payable in India though the drawee may be residing outside India.

Foreign instrument can also be classified into five categories: (a) a bill drawn in India, on a person residing outside India and made payable in India: (b) bill drawn outside India and made payable in India: (c) bill drawn outside India on any person resident outside India, (d) bill drawn outside India on a person resident in India: (e) bill drawn outside India and made payable outside India.

In order to avoid the risk of loss, usually foreign bills are drawn in sets. Sec.104 requires that foreign bills or exchange must be protested for dishonour when such protest is required by the law of the place where they are drawn. But it is not essential to have a protest for dishonour in case of an inland bill.

8.13.3. Bills in sets: Instead of being drawn as one document, a bill is usually drawn in several parts, especially when the bill has to be sent to one country or or another. Naturally foreign bills are drawn in sets because bills are to be sent over long distances. This is called as drawing a bill "in a set". Each part must be numbered and each part must contain a provision or reference to the others. Each part must contain provision that it shall continue to be payable only so long as other remains valid. All the parts together make a set, but the whole set constitute only one bill, and is extinguished when one of the part is discharged by payment (sec.132). Only one part requires to be accepted. The drawee is entitled to accept or endorses different part of the bill in favour of different persons, he and the subsequent endorsers of each part are liable on such part as if it were a separate bill (Exception to sec.132).

As between holders in due course of different parts of the same set he who first acquired title to his part is entitled to the other parts and the money represented by the bill (sec. 133).

8.13.4. Inchoate Bill : Where one person signs and delivers to another a paper stampted in accordance with the law relating to negotiable instruments then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives Prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount covered by the stamp. The person so signing shall be liable, upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount; provided that no person other than a holder in due course for such amount shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid there under (sec.20)·

An inchoate or incomplete instrument is therefore, one in which the amount to be paid or the name of the payee, are not specified or partly mentioned, on a stamped paper signed and delivered a person intending by a person intending that the blanks, should be filled up and a complete instrument created, and accepting the liability of a drawee, acceptor or indorser there under. Legal recognition is thus given by this section to the settled practice of traders who lend their credit by simply signing on blank stamp paper to be afterwards filled up as a complete instrument.

8.13.5. Ambiguous Instrument: (Sec.17) An Inchoate instrument should be differentiated from an ambiguous instrument. In this instrument, the court is guided by the principle that a construction most favourable to the validity of the instrument, the court recognizes the right of a holder to fill up the blanks in an incomplete negotiable instrument in accordance with the authority given to him by *the person delivering it.*

Where an instrument may be construed either as a promissory note or bill of exchange, the holder may at his election treat it as either, and the instrument shall be thence forward treated as ordinarily. The cases in which an instrument may be treated as ambiguous are: Where in a bill the drawer and the drawee is a fictitiou person or a person not having capacity to contract. the holder may treat th instrument, at his option, either as a bill of exchange or as a promissory note. A addresses an instrument in the form of a promissory note to B who accepts it. The holder may at his option treat it as a note or bill. The reason is that in a promissory note there is no necessary of any. acceptance. The same will be the result in case of a fictitious bill in a "fictitious bill", the drawer, the drawee or the payee is a fictitious person. So also it may refer a non existing person or a pretended person. If the drawee is a fictitious person. the holder can treat the instrument either as a promissory note. or as a bill of exchange.

8.13.6. Instrument payable on demand : At sight, after sight and on presentment (sec.21) A promissory note or a bill of exchange, in which no time is fixed payment and a cheque, are always payable on demand (Sec.19). This section must be read with sec.21 the first sentence of which seems to form part of this Section. In a promissory note or a bill of exchange the expression 'at sight' and 'on presentment', mean 'on demand' .

A bill or note payable on demand becomes payable on the date on which it is drawn. Here on demand or presentment is necessary and the period of limitation commences from the date of execution. But if the defendant is ready and willing to make payment and actually pays into court the sum payable, the plaintiff may not be entitled to the costs of suit if it was filled without first demanding payment. The expression 'after sight' means in a promissory note, after presentment for sight and in a bill of exchange, after acceptance or noting for non-acceptance, or protest for non-acceptance. Every promissory note or bill of exchange which is expressed to be payable on demand at sight or on presentment becomes payable from the date of the bin or when it is "signed" or 'presented for payment'. In other cases, the bin or note becomes payable on the third day after the day on which it is expressed to be payable.

8.13.7. Bearer bills and order bills : A promissory note, bill of exchange or cheque is payable to bearer which is expressed to be so payable or on which the only or last endorsement is an endorsetmentt in blank (Sec.13 Expln (ii).

A promissory note, bill of exchange or cheque is payable to order which is expressed to be so payable or which is expressed to be a particular person and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable. A bill in form payable to "A" or order to "A" is an order bill. But a bill to pay "A only or A" personally is not an order bill (Sec. 13 Expln.(i).

Where the instrument is expressed to be payable to the order of the specified person and not to him or his order at his option (sec.13, Expln.ii). A bill payable "to the order of A" is payable either to A or to his order.

8.13.8. Lost Bill: If a bill of exchange is lost before it is over due, the holder may apply to the drawer, if required, to indemnify all persons whatever in case the bill alleged to have been lost shall be found again. If the drawer on request refuses to give such duplicate bill, he may be compelled to do so by a suit (sec.45-A). By sec.18 a lost bill or note is presumed to be duly stamped.

Usance: Instruments are sometimes drawn payable at one or more usances. An usance simply refers to the time fixed for payment of bills drawn in one country and made payable in another by the usage of the two countries. The period of the usance is not the same in all countries.

8.13.9. Hundis : A bill of exchange drawn in a vernacular language in accordance with the customs of native merchants in India is generally called a hundi. It may be sometimes in the nature of a promote. The drawer of a hundi is called a Shroff of Nanavaty, corresponding to a banker. The payee is called "Rakhya Dhani".

The following are some of the well recognised types of hundis; (a) Shah Jog hundi; (b) Jokhme hundi; (c) Nam Jog hundi; (d) Jawabee hundi; and (e) Zikri Chit. These types of hundis are sometimes bill of exchange and at other times promissory notes and are subject to local usages. These are unaffected by the provisions of the Indian Negotiable Instruments Act.

8.14. ESSENTIAL FEATURES OF NEGOTIABLE INSTRUMENTS

The essential elements of a negotiable instrument, no doubt have been already considered, but here we shall analyse the essential features of a negotiable instrument with reference to capacity of parties and consideration relating to negotiable instruments.

8.14.1. Capacity of Parties : Every person who is capable of contracting according to the law of contract can become a party to a negotiable instrument. He may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque (Sec.26).

As in the case of every other contract, in the case of a negotiable instrument also a minor, is not competent to bind himself by becoming a party to a negotiable instrument. Whether he is the drawer, maker, acceptor or endorser, he is not liable on the instrument. From this it is clear, that an instrument does not become void by reason merely of the fact that a minor is a party it will be binding upon all other parties. For sec.26 provides that a minor, may draw, endorse, deliver and negotiable instrument so as to bind all parties except himself. But the minor's rights under the instrument are not affected, if for example, he is the payee or endorsee or holder for the payment can be enforced by him or on his behalf. Minor can enforce his claim through a near friend. But a minor cannot be sued on a promissory note even if he has made a misrepresentation that he is major. (Leslie v. Sheill 1914, 3 K.B. 607). A minor cannot bind himself, by accepting a bill or making a note. Such instruments are not enforceable against the minor, but are enforceable against the other adult parties.

The position of lunatics, persons of unsound mind and drunkern persons is also the same as that of minors. They cannot be made liable on the instrument as a maker or acceptor or endorser. The contractual capacity of a company or corporation depends upon the provisions of its memorandum of association or charter of incorporation. If it is authorised, expressly or impliedly by the charter of its incorporation to do so, it may become a party to a negotiable instrument in any capacity, otherwise its contract shall be ultra vires.

8.14.2. Application of Agency: Every person capable of binding himself or of being bound, as mentioned in sec.26, may so bind himself or be bound, by a duly authorised agent acting in his name.

A general authority to transact business and to receive and discharge debts does not confer upon on agent the power of accepting or endorsing bills of exchange, so as to bind his principal. Further an authority to draw a bill of exchange does not by itself impose an authority to endorse (Sec.27).

No particular form as such is necessary for empowering the agent to put his signature. The agent may sign "per procuration" (or per pro) stating on the very face of the instrument that he signs as an agent. The words "Sans recourse" (without recourse) may also be used. These provisions of Sec. 27 clearly show that an agent can bind his principal by acting on his behalf only in the manner in which he is duly authorised to become a party to a negotiable instrument. There should be clearly expressed authority to sign and negotiate notes and bills. The best manner for an agent (X) to sign or endorse a negotiable instrument, where he wishes to make his principal (Y), liable, is to sign or endorse the same as follows: i) Y Principal, by his agent X. ii) X For Y iii) Y by X iv) X, agent for Y v) Y sans recourse vi) For Y - X vii) Per pro Y - X.

A mere signature 'X agent of Y' would not free him from personal liability and Y will be held liable based on the principles of law of agency. A guardian executing a promissory note as such not on behalf of a minor, but executing it in his own name, will be personally liable, even if the money was borrowed for the personal benefit of the minor, say for the purchase of necessaries, suited to his life. But where the note is signed by a guardian as guardian then for the discharge of the debt covered by the promissory note according to the general principles of Hindu law minor's estate would be liable. If this is not so done, he becomes personally liable.

It is general principle, that in the case of a trading partnership it may be easily presumed that every partner has the authority to bind his co-partners by drawing, accepting or negotiating an instrument. But in case of non-trading firms there is no implied authority to sign bills or notes on behalf of the partnership.

8.14.3. Liability of Agent Signing : An agent who signs his name to a promissory note., bill of exchange or cheque without indicating thereon that he signs as agent or that he does not intend there by to incur personal responsibility, is liable personally on the instrument, except to those who induced him to sign upon the belief that the principal only would be held liable (Sec.28).

Lord Ellenborough in Leadbitter v. Farrow (1816) 5M & S 345 says: "Is it not a universal rule that a man who puts his name to bill of exchange thereby makes himself personally liable unless, he states on the face of the bill that he subscribes for another or by procuration of another which are words of exclusion? Unless he says plainly "I am the mere scribe he becomes liable".

It is the essence of a claim upon a negotiable instrument that the person executing the document should disclose on the face of the document itself, that he is not personally liable and that he is executing the promissory note for some one else. So the doctrine of undisclosed principal is not applicable. It is not open either by way of claim or of defence nor is any evidence admissible to prove that the signatory executed it on behalf of an undisclosed principal: Pramod Kumar v. Domodar I.L.R. (1953) Cuttack 221.

8.14.4. Liability of legal representative signing (Sec. 29): A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is liable personally thereon unless be expressly limits his liability to the extent of assets received by him as such.

A legal representative may avoid personal liability on a bill or note signed or endorsed by him by adding to his signature such words a s "without recourse or without recourse to me personally". Unless the legal representative is signing a negotiable instrument expressly limits has liability to the extent of the assets received by him he win be held personally liable.

8.14.5. Consideration: Consideration as we know, is an essential element for giving enforceability to an agreement. We can cite sec.25 of Contract Act in support of this proposition with which provides than an agreement made without consideration is void. Bills of exchange promissory note and cheques are no exception to this main rule. There is a fundamental difference with regard to the essential elements of consideration in negotiable instrument and in other class of contracts. In the case of an ordinary contract the law does not presume consideration and the party seeking to enforce it must aver and prove that the contrary is proved. Every negotiable instrument is presumed to be made, drawn, accepted, endorsed, negotiated or transferred for a consideration. The presumption of consideration, however, may be rebutted. These principles are provided under sec. 118(a).

The effect of total or partial absence or failure of consideration in a negotiable instrument is dealt under Secs. 43, 44 and 45. A negotiable instrument made, drawn, accepted, endorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. On the face of the presumption of consideration the burden of proof lies on the party who alleges failure of consideration. The question of want of consideration or failure of consideration has to be judged with reference to the relation of the parties, between whom the question arises.

As noted above, negotiable, instrument made, drawn, accepted, endorsed or transferred without consideration creates no obligation between immediate persons. The explanation to sec.44 gives examples of parties standing in immediate relation. The drawer of a bill of exchange stands in immediate relation with the acceptor. The maker of a promissory note or bill of exchange or cheque stands in immediate relation with the payee and the endorser with his endorsee. Other signers may by agreement, stand in immediate relation with a holder. If consideration for a negotiable instrument paid at the time of making, drawing, accepting or endorsing it were to fail subsequently such subsequent failure has the same effect as its original total absence.

The consideration given for a negotiable instrument must be a lawful consideration. The consideration to support a bill may be either any consideration sufficient to support a simple contract or any antecedent debt or liability.

8.14.6. Liability under Accommodation Bills : Many bills are drawn, accepted and endorsed without any consideration, the various parties signing the bills for the purpose of lending their names to oblige their friends. Such bills are known as "*accommodation bills*" and the persons who draw accept and endorse them are called "accommodation parties". In other words, in an accommodation instrument which has been accepted. made or endorsed without consideration and for the help of a party. For example, X is in need of money. He draws a bill on Y which Y accepts to help X and without any consideration to Y. X can get the bill discounted and thus raise a sum of money to tide over his difficulties. Exception to sec.43

accordingly provides no party for whose accommodation a negotiable instrument has been made, drawn, accepted or endorsed can if he had paid the amount there of, recover thereon such amount from any person who became a party to such instrument for his accommodation.

The party accommodating is called the "accommodation party", and he puts his name without consideration for the purpose of accommodating some other party who is to use it, and is expected to pay when due. The party accommodated is called the accommodated party.

The liability of the accommodating party is the same to that of an ordinary party and he is liable to a holder for value of the instrument even though the holder was aware of the fact that the party was only an accommodation party. If the accommodation party has to pay he can recover the amount paid from the accommodated party to a suit. (Sec.43).

The accommodated party in turn undertakes to take up the bill on the due date. In the alternative he must provide the accommodation party with funds to meet the bill on the due date. If the accommodation party is forced to pay the bill, the other impliedly undertakes to compensate him to the extent of loss and damages suffered by him on the payment duly made by him in respect of the bill.

It is to be emphasised further that accommodation bill can be negotiated after maturity. By the proviso to sec. 59 "any person who in good faith and for consideration, becomes the holder after maturity, of a promissory note or bill of exchange made, drawn or accepted without consideration, for the purpose of enabling some party thereto raise money thereon, may recover the amount of the note or bill from any prior party". Further according to sec. 76 non-presentment of an accommodation bill to the drawee for payment does not discharge the drawer. In the case of an accommodation bill, failure to give prior notice of dishonour does not in any case discharge all parties to the bill.

8.14.7. Maturity: Secs. 22 to 25 provide rules for determining the time at which negotiable instruments fall due. The maturity of a promissory note or bill of exchange is the date on which it falls due (Sec. 22).

A promissory note or bill of exchange payable "on demand" is pay able on the date it bears. A note or "bill payable" at sight of "on presentment" is payable when "sighted" or "presented" for payment. These expressions mean on demand (Sec.21).

8.14.8. Days of Grace: 'Days of grace' are days of indulgence originally granted to the acceptor for the payment of his bill of exchange. It was originally a gratuitous favour, but the custom of merchants rendered it a matter of legal right. The instrument which are entitled to days of grace are all instruments other than hose expressed to be or in effect payable on demand. Therefore, the following are not entitled to days of grace - a cheque a bill or note payable "at sight" or "on presentment" or "on demand" or in which no time for payment is specified. But days of grace are allowed on all bills and notes that are expressed to be payable on a specified day, or at a certain period after date, or after sight or at a certain period, after the happening of a certain event.

Every promissory note or bill of exchange which is not expressed to be payable on demand, at sight or on presentment is at maturity on the third day after the day on which it is expressed to be payable (Sec.22). Then these three days allowed to these instruments after the day on which they are expressed to be payable are called days of grace. They are not particularly available in the case of cheques which are always payable on demand.

8.14.9. Calculating Maturity : 1. In calculating the date at which a promissory note or bill of exchange, made payable a stated number of months after date or after, sight or after a certain event is not maturity, the period stated shall be held to terminate on the day of the month which corresponds with the day on which the instrument is dated or presented for acceptance, or sight, or noted for non-acceptance, or protested for nor acceptance, or the event happen or, where the instrument is a bill of exchange made payable a stated number of months after sight and has been accepted for honour with the day on which it was so accepted. If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

Example : a) A negotiable instrument, dated 29th January is payable one month after date. The instrument is at maturity on the third day after 28th February (or 29th in a leap year).

b) A negotiable instrument, dated 30th August, is made payable three months after date. The instrument is at maturity on the 3rd December.

A promissory note or bill of exchange dated 31st August is made payable three months after date. The instrument is at maturity on the 3rd December.

2) In calculating the date at which a promissory note or bill of exchange made payable a certain number of days after date or after sight or after a certain event, is at maturity, the day of the date or of presentment for acceptance or sight, or of protest for non-acceptance, or on which the event happens, shall be excluded. The above rule is stated in sec.24.

3) When the day on which a promissory note or bill of exchange is at maturity is a public holiday, the instrument shall be deemed to be due on the next proceeding business day. The expression "Public holiday" includes Sundays and any other day declared by the Central Government by notification in the Official Gazette, to be a pubic holiday (Scc.25).

8.15. LIABILITIES OF PARTIES

8.15.1. Liability of Drawer : The acceptor is primarily liable to pay the amount of a bill that has been accepted. But the drawee may decline to accept a bill having accepted it may refuse or fail to pay at the stipulated time then under this section the drawer becomes liable to the holder. Hence the liability of the drawer is only secondary and the primary liability rests on the acceptor. His liability is conditional in the sense that it arises only when the bill is dishonoured by the drawee or acceptor. The dishonour of the bill referred to here may be either before or at maturity. Notice of dishonour is to be given to him as required by the Act. The nature of the liability is specified under sec. 30. According to this section, the drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to, or received by the drawer.

8.15.2. Criminal Liability of the Drawer of Cheque : Till 1989, drawer of a cheque, was subject to civil liability only in respect of the money due on a cheque, if it was dishonoured for reasons whatsoever. In 1988 Negotiable Instrument Laws (Amendment) Act, 1988 was passed which came into force on April 1, 1989. Now, dishonour of cheques, because of insufficiency of funds, is deemed as an offence for which the drawer may be punished with imprisonment for a term upto one year or with fine upto twice the amount of the cheque or with both. Such punishment, will be in addition to his liability in a civil suit. Sections 138 to 142 which have been inserted in the Negotiable Instrument Act, provide for such punishment, provided the following conditions are fulfilled :

(i) The cheque has been issued in discharge of debt or other liability in whole or in part. It implies that a cheque given in gift will not attract such punishment.

(ii) The cheque should be presented to the paying banker in time, i.e., within 6 months or its specific validity period, whichever is earlier. In case of a post-dated cheque, the period of six months is to be reckoned for the purpose of Section 138(a) from the date which is written on the cheque. Anil Kumar Sawhney vs. Gulshan Rai (1993(4) SCC. 424).

(iii) The dishonour of the cheque should be on account of insufficiency of funds only either the amount of money standing to the credit of the account is insufficient or that the amount of cheque exceeds the amount arranged to be paid from that account by an agreement with the bank.

(iv) The payee or holder in due course should give notice in writing to the drawer demanding payment, within 15 days of his receiving information of dishonour.

(v) The drawer can make payment within 15 days of the receipt of the notice. If he fails to do so prosecution can take place.

(vi) The complaint can be made only by the payee or holder in due course.

(vii) The complaint is to be made within one month of the cause of action arising (i.e., expiry of 15 days' time give to the drawer to make payment).

(viii) No court lower to that of Metropolitan Magistrate or Judicial Magistrate of 1st Class will try the offence.

Section 140 makes it quite dear that the drawer of the dishonoured cheque cannot defend himself on the ground that he had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentation, on account of insufficiency of funds.

It must be noted from the above that an offence under this section is committed only when the drawer of the cheque fails to make payment within fifteen days of receipt of notice, and not immediately on the dishonour of a cheque, because dishonour of cheque by itself does not give rise to a cause of action. Payment can still be made within 15 days of the receipt of notice of demand.

If the dishonoured cheque is drawn on behalf of a company, a firm or association of individuals every person who was incharge of and was responsible to the company or the firm for the conduct of its business, at the time the offence was committed, and also the company shall be deemed to be guilty of the offence. But if any such person proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such an offence, he will not be liable to punishment (Section 141).

8.15.3. Criminal Liability in case of Stop Payment of Cheque : The question whether dishonour of a cheque on stop payment instruction of the drawer to the drawee or the payee amounts to dishonour on account of in sufficiency of funds and entails criminal liability on the drawer has been examined in two recent cases by the Supreme Court.

In Electronics Trade and Technology Development Corporation Ltd. vs. Indian Technologists and Engineer Electronic Pvt Ltd 1996(2) SCC 739, the Supreme Court held, "Even if a cheque is dishonoured because of stop payment instruction to the bank, Section 138 would get attracted".

In Modi Cements Ltd vs. Kuchil Kumar Nandi (Criminal Appeal Nos. 244 – 46 of 1998) the Supreme Court observed :

"The objective of having penalties in case of dishonour of cheques for insufficiency of funds is to promote the efficiency of banking operations and to ensure creditability in transacting business through cheques".

The court further observed that "by giving instruction to the bank to stop payment immediately after issuing cheque against debt or liability, the drawer can easily get rid of the penal consequences not withstanding the fact that deemed offence was committed".

Liability of drawee of Cheque : Sec. 31 lays down "The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do so and in default of such payment must compensate the drawer for any loss or damage caused by such default". It is clear from this section, that the liability of the bank in the event of its dishonour is only to the drawer and not to the holder of the cheque for the simple reason that the contract, between a banker and customer is that if a debtor and creditor with additional obligation to honour the customer's cheque as far as funds permit. In order to make a banker liable under this section it is necessary that the cheque should be duly presented for payment and the banker will refuse payment when the cheque is not presented during the banking hours. The banker will be justified in dishonouring the cheques when the form of the cheques is of doubtful legality. The same will be the result when the customer has no sufficient funds with the bank permitting the payment of the cheque. The words "loss or damage" in the section include in addition to any pecuniary loss or damage the loss of credit or injured to reputation.

The drawee of a bill of exchange as has been stated already is under no obligation, contractual or otherwise, to the holder of the bill to accept it. He can avoid liability to the holder simply by refusing to accept the bill. Liability as such follows only when he accepts the bill and he becomes a party to the bill after his acceptance.

Liability of Acceptor of Bill and Maker of Note : In the absence of contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively. The acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand (Sec.32).

In default of such payment, the maker or acceptor is bound to compensate any party, to the note or bill for any loss or damage sustained by him and caused by such default.

As per the opening words of this section the liability of acceptor is subject to a contract to the contrary. The acceptor's liability upon a bill of exchange is primary and he is liable by reason of his acceptance. The expression "contract to the contrary" is used to cover mainly the position of accommodation bills and notes. It is again to be noted that on accommodation acceptor is not liable to compensate for failure to carry out his undertaking except to a holder in due course.

WHO CAN ACCEPT? Under see 33, persons who can accept a bill of exchange are : 1. *The drawee of a bill of exchange, that is, the person directed to* pay. 2. All or some of several drawees where the bill is addressed to more than one drawees where the bill is addressed to more than one drawee. 3. A drawee in case of need who is mentioned in the bill. 4. All acceptor for honour.

Where there are several drawees of a bill of exchange who are not partners, each of them can accept for himself, but none of them can accept it for himself, but none of them can accept it for another without his authority, (Sec. 34). Where a bill is addressed to two or more drawee, the bill should be accepted by all but if only some of them accept it, the acceptance is a qualified one and the holder may treat the bill as dishonoured, the acceptance of the drawee accepting it will be good and binding on them, for all of some or several drawees can accept.

8.16. ESTOPPEL :

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

8.17. ACCEPTOR BOUND ALTHOUGH INDORESMENT IS FORGED :

An acceptor of a bill of exchange already indorsed is not relieved from liability by reason that such the indorsement is forged, if he knows or had reason to believe the indorsement is forged, if he knows or had reason to believe the indorsement is forged when he accepted the bill (Sec. 41).

8.18. ACCEPTANCE OF BILL DRAWN IN FICTITIOUS NAME:

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

8.19. LIABILITY OF AN INDORSER :

In the absence of a contract to the contrary an indorser before maturity who has not excluded his liability, or made his liability conditional, is bound to every subsequent holder in case of dishonour by the drawee, acceptor, or maker to pay damages for any loss arising there from, provided due notice of dishonour, has been given to such indorser. Every indorser after dishonour; is liable as upon an instrument payable on demand (sec. 35).

Liabilities of other Parties ; Sec. 36 provides for the liability of parties to holder in due course. Every prior party to a negotiable instrument until the instrument is duly satisfied. The expression "prior party" in the section means the maker or drawee, the acceptor and all the intervening indorsees. Every prior party continues to be liable on the instrument is duly paid. The maker of a promissory note or cheque, the drawer of a bill of exchange until acceptance and the acceptor are, in the absence of a contract to the contrary, respectively liable thereon as principal debtor, and the other parties are liable thereon as sureties for the maker, drawer or acceptor as the case may be (Sec. 37). This general rule is subject to the following qualifications.

1. This ruling in sec. 37 is applied in the absence of a contract. Thus a drawer of a bill can make himself the principal debtor and the acceptor a surety for the drawer. In case the drawer pays the debt, he cannot call upon the accept or to

Check Your Progresse

1. Define negotiable instrument
2. What are the essential features of a Negotiable instrument?
3. Define Bill of Exchange and state its essential features
4. What are the differences between a cheque and Bill of Exchange?
5. Who is a holder in due course?
6. What is Inchoate Bill?
7. What is the days of grace?
8. Discuss the liability of drawer of a cheque

indemnify him. By reason of sec. 37 of the Act, the maker even in the case of an accommodation note, remains liable as principal and payee as surety only, from the point of view of the holder's rights in the absence of a contract to the contrary.

2. As between the parties so liable as sureties each, prior party is, in the absence of a contract to the contrary, also liable thereon as a principal debtor in respect of each subsequent party.

Examples : A draws a bill payable to his own order on B, who accepts. A afterwards indorese the bill to C and C to D and D to E. As between E and B, B is the principal debtor, and A, C and D are his sureties. As between E and A, A is the principal debtor, and C and D are his sureties. As between E and C, C is the principal debtor and D is his surety.

3. When the holder of an accepted bill of exchange enters into and contract with the acceptor which, under sec. 134 or 135 of the Indian Contract Act, 1872, would discharge the other parties the holder may expressly reserve his right to charge the other parties, arid in such case they are not discharged where the holder makes a composition with the acceptor or promises to give time or not to sue him.

8.19.1. Discharge of indorser's liability : When the holder of a negotiable instrument, without the consent of the indorser destroys or impairs the indorser's remedy against a prior party, the indorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity.

8.20 SUMMARY

In this unit have seen the definition of Negotiable Instrument, and various kinds of Negotiable Instruments, such as promissory note, Bill of Exchange and cheque and their features. The legal position of holder and holder in due course have been analysed in detail in the light of the provisions of the Negotiable Instruments Act. The essential requirements of a Negotiable instrument and the liabilities of parties to a Negotiable Instrument are well explained in this unit.

8.21 KEY WORDS

Endorsement	-	an act of endorsing
Ad infintum	-	any number of times

Discrepancy	-	differences between things
Forged	-	the action of forging banknote
Ambiguous	-	not clear

8.22 ANSWER CHECK YOUR PROGRESS

1. Refer 8.1
2. Refer 8.1
3 Refer 8.4 and 8.5
4. Refer 8.8
5. Refer 8.11
6. Refer 8.13.4
7. Refer 8.14.5
8. Refer 8.15.2

8.23 MODEL QUESTIONS

1. Define Negotiable instrument and state its essential characteristics.
2. Define Promissory note, distinguish between promissory note and bill of exchange.
3. Who is a holder in due course and what are the rights and privileges of holder in due courser?
4. Discuss the liability of drawer of a cheque.
5. Discuss the liability of an indorser.

UNIT - 9

LAW OF NEGOTIABLE INSTRUMENTS (CONTD...)

INTRODUCTION

One of the essential characteristic of a negotiable instrument is that it is freely transferable from are one person to another. This transfer may take place either (1) by negotiation or (2) by assignment. In this unit we are going to study the scope of negotiation, methods of transfer by negotiation and transfer by assignment. The other impotant topic is endorsement, its various kinds, and how endorsement could be offered. Next topic relates to presentments of negotiable instrument. Presentment is of two types. (1) Presentment foe acceptance and (2) Presentment for payment. All the principles relating to presentment have been discussed in detail in this unit. Then, discharge of parties from liability. The circumstances in which parties are discharged are explained. Next, dishonour of a negotiable instrument and protection given to paying banker and collecting banker have been analysed in this unit.

UNIT OBJECTIVES

- to study the scope of negotiation and assignment
- to analyse the rules relating to indorsement and its different kinds
- to study the importance of presentment of an instrument and when it is not necessary
- to know when the parties to a negotiable instruments is discharged
- to understand the rules relating to dishonour of a negotiable instrument
- to study the scope of protection given to paying banker and collecting banker.

UNIT STRUCTURE

9.1. NEGOTIATION AND ASSIGNMENT:

"When a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof the instrument is said to be negotiated" (section. 14). Such negotiation may take place in anyone of two ways.

(a) If the instrument is payable to bearer, it is negotiated by mere delivery of the instrument.

(b) If it is payable to bearer, negotiation can take place only by indorsement of the holder and delivery by him.

Negotiability can be differentiated from assignability. According to section 130 of the Transfer of Property Act, every actionable claim can be transferred by means of a seperate instrument in writing duly stamped and signed by the transfer or according to the rules laid down for transfer of actionable claims by the T. P. Act. Bills, notes and cheques, whether negotiable or not, are chooses in action or actionable claims and hence these instruments can be effected in addition to being negotiated by an indorsement under the Negotiable Instruments Act.

9.2. DIFFERENCE BETWEEN ASSIGNABILITY AND NEGOTIABILITY

1) In the case of transfer of negotiable instruments, consideration is presumed to have been given until the contrary is proved. There is no presumption in the case of assignment of ordinary chose in action.

2) In the case of negotiable instruments notice of transfer is not required, whereas in the case of assignment of chose in action notice of the transfer must be given by the transferee to the debtor.

3) Negotiation must be effected by simple delivery or indorsement and delivery, whereas assignment requires written document assigned by the transferor.

4) The assignee of a chose in action acquires no better title than what his transferor had. But he takes it subject to the defences and equities between the assignment in good faith and for value. But the transferee of a negotiable instrument, taking it bona fide and for value acquires a good title to it whatever might have been the defect in the title of the transferor.

9.3. INDORSEMENT:

When the maker of holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof, or on a slip of paper annexed thereto or so, signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to indorse the same and is called indorser. (Section. 15). The person to whom the instrument is indorsed is called the indorsee.

From the above section it is clear that no particular form is required for indorsement. But the signature must conform with the name mentioned in the bill. Further, the intention of the indorser to negotiate is essential. Indorsement may be made on the face of the bill or on the back of the instrument or on a slip of paper called an *"allonge"*. In case of indorsement as noted above, negotiation is important and where the instrument is delivered conditionally or for a special purpose only and not for tnansferring absolutely the property therein, it is called *"escrow"*.

Section 57 further provides the parties who are entitled to indorse and negotiate the instrument. They are, (i) maker, (ii) the drawer, (iii) the payee, or (iv) the indorsee.

But a payee or indorsee can indorse a negotiable instrument only if he is holder of the instrument. It is to be noted again that when there are more than one, all of them must join in making, drawing and indorsing the instrument.

9.4. INDORSEMENT IN BLANK AND INDORSEMENT IN FULL

(I) If the indorser signs his name only, the indorsement is said to be "in blank" and if he adds a direction to pay the amount mentioned in the instrument it is said to be "in full" and the person so specified is called the "indorsee" of the instrument (Sec. 16). The latter type of indorsement may also be called a "special indorsement".

(2) An instrument may further be classified into (i) restrictive or (ii) conditional. When the express words, the instrument may either restrict or exclude the indorsee's right to further negotiate the instrument or to receive the the contents for the indorser or another specified person. This type of instrument is called "restrictive instrument".

Illustration: A singns the following indorsement on different negotiable instruments payable to bearer.

(i) "pay the contents to B only:" : (ii) "pay B for my use";

(iii) "pay B or order for the account of A"; (IV) "The within must be credited to B".

These indorsements exclude or restrict the right for the further negotiation by B.

Therefore, an instruments which is negotiable in its origin continues to be negotiable until it has been restrictively indorsed or payment or satisfaction thereof is made at or after maturity but not afterwards.

The general rule may be referred to here. The indorsement of a negotiable instrument followed by delivery transfer to the indorse the property therein, with the right of further negotiation But the resultant effect of a restricive indrosement precluding further negotiation is contrary to the general rule. But crossing of a cheque with the words, "account payee" and mentioning a bank has been held not a restrictive indorsement.

9.5. CONDITIONAL INDORSEMENT:

The indorser of a negotiable instrument may, by express words in the instrument, exclude his own liability thereon, or make such liability or the right of the indorsee to receive the amount due thereon depend upon the happening of a specified event, although such an event may never happen. Where an indorser so excludes his liability and afterwards becomes the holder of the instrument. all inter-mediate indorsers are liable to him (sec. 52). A conditional indorsement never affects negotiability of the instrument. It only qualifies the duties and obligations of the indorser. Therefore such as instrument may also be called a qualified indorsement.

Examples of a conditional indorsement are ; (i) "Pay A or order without recourse to me" or (ii) "Pay A order sans recourse" (iii) "Pay A or order at his own risk".

It can be further made by making the indorser's liability depend upon the happening of a specified event which or may not happen e.g. the arrival of a ship, indorsee's marriage with another specified person, etc. An indorser is therefore entitled to exclude his own liability or make it conditional.

9.6. EFFECT OF INDORSEMENT:

The indorsement followed by delivery transfers to the indorsee the right of further negotiation. This is called absolute indorsement and it differs from restrictive or conditional indorsement.

9.7. CONVERSION OF BLANK INDORSEMENT INTO INDORSEMENT IN FULL:

The holder of a negotiable instrument indorsed in blank may without signing his own name. By writing above the indorser's signature a direction to pay to any other person as indorsee convert the indorsement in blank into an indorsement in full. The holder hereby not incur responsibility of an indorser. (sec. 49)

Examples: Y is the holder of a bill indorsed by X, in blank. Y writes over X's signature the words "pay to Z or order" Y is not liable as indorser but the writing operates as an indorsement in full from X to Z. The advantage of this procedure is that the holder, through transfers the instrument does not incur the responsibility of an indorser.

According to sec. 60 a negotiable instrument may be negotiated except by the maker, drawer or acceptor after maturity until payment or satisfaction there of by the maker, drawer or acceptor at or after maturity but not after such payment or satisfaction: The general rule is that a bill of exchange is negotiable ad infinitum until it has been paid by or discharged on behalf of the acceptor.

9.8. NEGOTIATION OF DISHONOURED AND OVER DUE INSTRUMENTS:

As general rule a bonafide holder for value of a negotiable instrument is not affected by any defects in the title of his transferor. This rule is however, subject to two limitations: (1) when a holder acquires it with notice of dishonour and (2) when he acquires it after maturity, sec. 59 provides for exceptional cases following the negotiation of (i) dishonoured instruments and (ii) overdue instruments.

(i) The holder of negotiable instrument, who has acquired it after dishonour, whether by non-acceptance or non-payment with notice thereof, after maturity has only as against the other parties, the right thereon of his transferor. The transferee of a dishonoured instrument, who takes it with notice of dishonour cannot acquire a better title to it than that which his transferor had. Such a transferee is not a holder in due course for by sec. 9 of the Act, he must acquire the instrument before it became payable and without having sufficient cause to believe that any effect existed in the title of the person from whom he derived his title.

(ii) The transferee of an overdue instrument as in the case of a person acquiring dishonoured bill cannot acquire a better title to it than the transferor had. A bill or note is deemed to be overdue on the expiry of the day on which it falls due, and where days of grace are allowed it is only after the termination of the last days of grace that the instrument becomes overdue. An overdue instrument though can be transferred is not entitled to get the essential attribute of negotiability. A person who takes an over due instrument can not be a holder in due course because section 9 of the Act requires that a holder in due course should acquire the instrument has been dishonoured or has become overdue, it can be negotiated subject to all equities with which it may be encumbered.

The proviso to section 59 with regard to accommodation notes and bills forms an exception to the rule regarding the negotiation of an over-due bill. Proviso to section 57 provides "that any person who, in good faith and for consideration, becomes the holder, after maturity, of a promisory note or bill of exchange made, drawn, or accepted without consideration for the purpose of enabling some party thereto raise money thereon may recover the amount from any prior party"

9.9. FURTHER RULES REGARDING NEGOTIATION:

(a) Holder deriving title from holder in due course: A holder of a negotiable instrument who derives title from a holder in due course has the rights thereon of that holder in due course (Section 58). But the holder should not be party to any fraud or illegality affecting the instrument.

(b) Instrument indorsed in blank: Subject to the provisions herein after contained as to crossed cheques, a negotiable instrument indorsed in blank is payable to the bearer thereof eventhough originally payable to order (Section.54) Section 13 Explanation (ii) also provides the same rule; A note or bill or cheque is payable to bearer which is expressed to be so payable or on which the only or last indorsed is an indorsement in blank.

(c) Partial indorsement: A partial indorsement i.e. an indorsement which purports to transfer to the indorsee a part only of the amount does not operate as a negotiation of the instrument. But where the instrument has been partly paid a note to that effect may be indorsed on the instrument, which may then be negotiated for the balance (sec. 56).

(d) Indorsement by legal representative: The legal representative of a deceased person cannot negotiate by delivery only, a note, bill or cheque payable to order and indorsed by the deceased but not delivered.

9.10. PRESENTMENT FOR ACCEPTANCE:

There are two kinds of presentment for acceptance and presentment for payment. It is not in all cases necessary to present a bill of exchange for acceptance before presenting it for payment e.g. bills payable on a certain number of days after date and bills payable on a certain day need not be presented for acceptance before presenting them for payment. In these cases presentment for acceptance is not compulsory. But where a bill of exchange is payable after sight or is so expressed that it shall be presented for acceptance or that it is payable elsewhere than at the place of residence or business of the drawee, presentment for acceptance is necessary to fix the maturity of the instrument.

If no time or place is specified therein for presentment, it must be made within a reasonable time after the instrument is drawn and in the business hours on a business day. If the bill is directed to the drawee at a particular place, it must be presented at that place, where authorised by agreement. or usage, a presentment by through the post office by means of registered instrument is sufficient. The bill must be presented by a person . entitled to demand acceptance. The bill must be presented to the drawee or his authorised agent if he can be found after reasonable search. If he cannot be found after reasonable search the bill is dishonoured.

Presentment can be made to the duly authorised agent of the drawee; or maker of acceptor. Where the drawee is dead, presentment may be made to his legal representative. Where the drawee is bankrupt presentment may be made to the Official Assignee or Official Receive as the case may be.

According to sec. 63, the holder must allow the drawee fortyeight hours (exclusive of holidays), if so required by the drawee to consider whether he will accept it.

In default of presentment for acceptance when it is necessary party to the instrument is liable on the instrument to the person making such default. The drawer and all the indorsers are discharged from liability to the holder making such default.

9.11. PRESENTMENT FOR PAYMENT:

Promissory note, bill of exchange and cheques have to be presented for payment to the maker, acceptor or drawee by or on behalf of the instrument.

Presentment for payment must be made during the usual hours of business, and in the case of promissory note or bill of exchange payable after specified period, presentment must be made at maturity if the amount due under a promissory note is to be paid in instalments, it should be presented on the third day after the date fixed for the payment of each instalment. If a promissory note, bill of exchange or cheque is made drawn, or accepted payable at a specified place and not elsewhere, it must be presented for payment at that place; otherwise all the parties there to will be discharged from liability. If a promissory note or bill of exchange is expressed to be payable at a specified place simply, must be presented for payment of that place. Otherwise, only the maker or drawer of the instrument will be discbanged from liability, and not the other parties. A promissory note or bill of exchange not expressed to be payable at a particular place has to be presented for payment at the place of business if any, or the usual residence, of the maker, drawer or acceptor, has no regular place of business if any, or the usual residence, of the fixed residence, it may be presented to him in person wherever found. A negotiable instrument payable on demand must be presented for payment within a reasonable time after it is received by the holder.

Presentment for payment by the holder is not necessary to charge the maker of a note or the acceptor of the bill , for they are the principal debtor on these instruments. The reason for the rule is that by common law a debtor is bound to seek out his creditor and pay him. But in order to charge other parties presentment is essential except in cases when presentment for payment is legal by excused. In default of presentment the other parties i.e., the drawers and indorsers in case of bills and cheques and the indorsers in the case of promissory notes, are discharged from liability on the instrument to the holder making default.

Sec. 64 expressly provides an exception. When a promissory note is payable on demand and is not payable at a specified place, no presentment is necessary in order to charge the maker of such instrument.

9.12. WHEN PRESENTMENT FOR PAYMENT UNNECESSARY:

Sec.76 specifies the case in which presentment, is dispensed with and thus contains exceptions to the rule stated in Sec. 64. An instrument need not be presented for payment, and can be treated as dishonoured in the following cases:- i) If the maker, drawer or acceptor intentionally presents the presentment. or (ii) If the instrument is made payable at his place of business and he close it on a business day during business hours, or (iii) If the instrument is payable at some other specified place and neither he nor his agent attends that place during the usual business hours, or (iv) If the instrument is not payable at any particular place and he cannot after due search be found, or v) If the party, who is sought to be charged, has engaged to pay not withstanding not presentment, or (vi) If the party, sought to be charged, with the knowledge that presentment for payment has not been made, makes a part payment of thereon in whole or waives his right to take advantage of the default in presentment for payment, or (vii) If the drawer is sought to be made liable, and he could not suffer any damage from want of presentment.

9.13. DISCHARGE FROM LIABILITY ON NOTES, BILLS AND CHEQUES:

The marker, acceptor or indorser respectively of a negotiable instrument may be discharged from liability in the following ways.

9.13.1. Discharge by cancellation etc,: The maker, acceptor or indorser respectively, of a negotiable instrument is discharged from liability thereon. (a) by cancellation : to a holder thereof who cancels such acceptor's or indorser's name with intent to discharge him and to all parties claiming under such holder. (b) by release : to a holder thereof who otherwise discharge such maker, acceptor or indorser and to all parties deriving title under such holder, after notice of such discharge. (c) by payment : to all parties thereon, if the instrument is payable to bearer or has been indorsed in blank and such maker, acceptor on indorser makes payment in due course of the amount due thereon.

9.13.2. Discharge by allowing drawee more than forty-eight hours to accept: If the holder allows the drawee more than forty eight hours exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder.

9.13.3. Failure to present cheque in time: Where a cheque is not presented within a reasonable time of its issue, and the drawer had sufficient funds with tne bankers at that time when the presentment ought to have been made entitling him to have the cheque honoured but on account of the delay in presentment by the holder, the bank fails meanwhile, and the drawer suffers by him. What is reasonable time for presentment for payment, is a question of fact depending on the nature of the instrument, usage of trade, etc. The holder of a cheque loses his remedy against the drawer but will be entitled to recover the amount to the extent of such discharge from the banker.

9.13.4. When acceptance is qualified or limited: If a holder of a bill of exchange acquiesces in a qualified acceptance or one limited to part of the sum mentioned in the bill, which substitutes a different place or time for payment, or where the drawers are not partners, is not signed by all the drawees who are not partners, all previous parties whose consent is not obtained to such acceptance are discharged against the holder, and those claiming under him, unless on notice given by the holder they assent to such acceptance.

9.13.5. Material alteration: Material alteration of the instrument renders the instrument void as against any one who is party to the instrument at the time of making such alteration and does not consent to such alteration. But if the alteration is made with the consent of parties or to carry out the common intention of the original parties then the instrument is not rendered void against them. The fact that such an alteration is made by an indorsee, discharges the endorser from all liability to him even in respect of the consideration. According to section 87 filling up of blanks in case inchoate instrument, or qualified acceptance, or crossing of cheques are not material alterations.

But if a material alteration is made accidentally the instrument is not rendered void – in *Hong Kong and Shangai Bank v Lo Lee Shi.* (1928 A.C. 181) a bank note was accidentally mutilated and effected by wash and ironing of the garment in which it was left. The material portions of it were not lost but the number could not be recovered. Held the instrument was not rendered void.

9.13.6. Instances of material alteration: If alterations are made in regard to any of the following they are material alteration: (a) date: (b) time of drawing; (c) place of payment; (d) sum payable; (e) medium of payment; (f) rate of interest; (g) number of parties; (h) the relation of parties; (i) the legal character.

It is an established rule that in the case of a material alteration a party guilty of the same cannot sue on the instrument. As noted above, if such alteration is made by the indorsee he cannot sue his indorser even on the original consideration. The section is silent, and does not say whether he can sue on the original consideration if the payee or drawee is guilty of a material alteration. When the alteration is not fraudulent but innocent, the payee or drawee would be permitted to use on the original consideration though the instrument is void.

Section 88 expressly provides that an acceptor or indorser is bound by his acceptance or indorsement notwithstanding any previous alteration of the instrument. Where the material alteration is not apparent and the payment had been made according to the apparent tenor of the instrument and in due in course by a person liable to pay, it shall discharge such a person from all liability thereon (section 89). *When bill comes into the acceptors hands at or after maturity* - If a bill of exchange which has been negotiated at or after maturity held by the acceptor in his own rights, all rights of action thereon are extinguished.

9.14. PROTECTION OF BANKERS:

Section 84 provides sufficient protection to a banker making a payment in due course of an order cheque or a bearer cheque subsequently indored in full or in blank - Sec.85. A extends the protection further to drafts drawn by one branch of a bank on another payable to order.

To the well known general rule that "forgery conveys no title" and even a holder in de course will not be protected against forgery; there are two exceptions to be found in sections 85 and 85A. Further it should be noted that a banker is protected only if the payment is made in due course i.e. in good faith and without negligence under circumstances not affording reasonable ground for believing that the holder is not entitled to receive the payment.

9.15. CUSTOMER'S DUTY TOWARDS BANK:

The customer owes a duty to the bank to draw up his cheques as not to invite or faciliate forgery or fraudulent alteration. Again it is well settled that a customer is bound to exercise proper and reasonable care not to misled the bank, and in breach of such duty if he draws a cheque in a manner enabling the committing of fraud, customer is responsible for the loss as a natural and direct consequences of his act-*London Joint Stock Bank v Macmilan* (1918 A.C. 777). If the customer misleads the bank by want of proper caution in the mode of drawing the cheque, so as to admit of interpolation as an additional word or figure he would have to bear the loss if the bank makes a bonafide payment. If the customer by his negligence or default induced the banker to make the payment it is the customer, not the banker who must bear the loss (Young v. Grote 1827 4. Bing 263) but beyond taking reasonable care in the transaction itself, the customer is not to take precautions in the general course of carrying out of his business to prevent forgeries on the part of his servants. The following passage given by Baron Parke is highly appreciated in this context. "If a man should lose his cheque book or neglect to lock the desk in which it is kept and a servant or stranger should take it up, it is impossible in our opinion to contend that a banker paying his forged cheque would be entitled to charge his customer with that payment" *Bank of Ireland v. Even Trustees (1885-5 H.L.C. 385).*

9.16. LAW RELATING TO DISHONOUR OF NEGOTIABLE INSTRUMENTS

9.16.1. Dishonour: The party bound to pay the amount in an instrument may honour the same by accepting it for payment or by payment straight away. This dishonour arises in two ways: (1) by non-acceptance or (2) by non-payment, after having undertaken to pay the same. Section 91 deals with dishonour by non-acceptance. Dishnonour by non a acceptance arises when the drawee, or one of the several drawees (not being partners) makes default in acceptance upon being duly required to accept the bill, or where presentment is excused and the bill is not accepted. Where the drawee is incompetent to contract, or the acceptance is qualified, the bill is deemed to be dishonoured.

9.16.2. Notice of Dishonour: Notice of dishonour is dealt with in section 93. When an instrument is dishonoured, the holder informs the parties in the instrument if he wants them liable on it. One receipt of such notice of dishonour such party must give the notice of the same to all other prior parties whom he wants to hold liable. But the maker of a dishonoured promissory note, or drawee or acceptor of a dishnonoured bill of exchange or cheque need not be notified of such dishnonour. So also persons jointly liable need out notified individually.

The mode of giving notice of dishonour is dealt within section 94. It may be given orally or in writing. It must be given within a reasonable time from the date of dishnonour and the notice must be delivered at the place of business or at the residence, if the party has no place of business. A notice sent by post does not become invalid because of miscarriage. If the person giving notice is sent, such notice is a valid notice.

9.16.3. Notice of dishnonour is unnecessary (Sec. 98): In certain cases notice of dishonour is unnecessary and they are dealt with in section 98.

1. When it is dispensed with by the party entitled to such notice
2. The drawer need not be notified when he countermanded payment.

   When the party charged could not suffer damage for want of notice

4. When the party entitled to notice cannot be found after due search; or the party had to give notice.

5. To charge the drawers when the acceptor is also a drawer.

6. In the case of a promissory note which is not negotiable notice is unnecessary.

7. When the party entitled to notice unconditionally undertakes to pay the amount due on the instrument.

9.17. NOTARY PUBLIC – NOTING AND PRETEST:

Notary Public is an officer appointed by the Government to attest documents mainly in the mercantile practice, entered into in a foreign country. (See Notaries Act, 1952 for details). His functions relating to negotiable instruments are dealt within section 99 and 100.

9.18. NOTING (SEC.99):

Noting simply means the fact of dishondur of the instrument being noted by the Notary Public in the instrument, or if there is no sufficient space, in a paper attached to the instrument. When a promisory note or a bill has been dishonoured by non-acceptance or non payment the holder may cause such dishonour to be noted by the Notary Public.

Noting will contain the following particulars: 1. Date of dishonour 2. Reason for dishonour. 3. If not expressly dishonoured, the reason why the holder takes it as dishnonoured, and 4. The notary charges. Noting is not compulsory in case of inland bill or note.

9.19. PROTEST (SEC.100):

"Protest" is the certificate issued by Notary Public for having noted within a reasonable time, the fact of dishnonour of the instrument (Sec.100).

The object of noting and protest is to obtain unimpeachable evidence of the fact of dishonour. On proof of protest the fact of dishonour is presumed unless disproved. Bills drawn out of India must be protested.

Protest for better security (Sec.100): This is dealt with in section 100. According to this section the holder of a bill of exchange may require a Notary Public to demand better security from the acceptor. When the acceptor has become insolvent, or his credit has been publicly impeached before the maturity of the bill. Demand for better security must be made within a reasonable time. (What is reasonable time is dealt-within sections 105 to 107). If the demand for better security is satisfied such facts may be noted and certified by notary public. Such certificate is called "a protest for better security".

9.20. CONTENTS OF PROTEST (SEC.100):

Sections 101 deals with the contents of a protest. It must contain the following particulars.

1. Either the instrument itself or a literal transcript of the instrument and everything written or printed on it.
2. Name of the person for and against whom the instrument is protested.
3. A statement that payment or acceptance, or better security as the case may be, has been demanded; the terms of answer, if any
4. The place and time of dishonour of the bill or note. If better security has been demanded the place and time of refusal.
5. The signature of the Notary Public.
6. In the event of acceptance for honour or payment for honour, the name of the person by whom, or the person for whom and the matter in which such acceptance, or payment was offered and effected.

9.21. ACCEPTANCE FOR HONOUR (SEC.108) AND PAYMENT FOR HONOUR (SEC.113):

When a bill of exchange has been dishonoured by the drawer and noted or protested for non-acceptance, or for better security with the consent of the holder, any person (not being a party already liable) may by writing on the bill accept the same for the honour of any party thereto.

Sections 111 and 112 deal with the liability of acceptor for honour. He takes the place of the person for whose honour he accepted to lend his credit, with regard to all his against prior parties and his liabilities to subsequent parties. The acceptor for honour is entitled to be indemnified by the party to whom he lent his credit.

Payment for honour (Sec.113): When a bill has been noted or protested for non-payment, any person may pay it for the honour of any party liable on the bill. The person desires to pay should have declared the same before a notary public and he should have recorded the same.

Section 114 deals with the effect of payment for honour: A payer for honour on paying a bill acquires all right of the holder whom he pays. He is entitled to recover all sums paid by him with interest and expense properly incurred.

9.22. CROSSING OF CHEQUE:

Cheques which are paid over the counter are called open cheques and crossed cheques are paid only through a bank to avoid loss or fraud what is not paid over the counter the party getting payment can be easily traced. Crossing may be "general" or "special".

General Crossing: It is dealt within section 123 where a cheque bears across its face an addition of the words "and Company" (or any abbreviation thereof) between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words not negotiable it is called a cheque crossed generally. The practice of writing "account payee" is an instruction to the receiving bank to pay the particular cheque into the bank which keeps the account of the payee.

Thus when a cheque is crossed generally, payment shall be made only through a bank and when it is specially crossed, it can be encashed only through the bank specified therein.

"Not negotiable" crossing : It must be home in mind that the words "not negotiable" do not render the cheque non-transferable, but only deprives the incidence of negotiability. That is to say if the holder has good title he can transfer it but in case he has only a defective title the transfere gets only that defective title. (Section 130).

Marking of cheque: It must be clearly understood that marking of a cheque for payment is not acceptance thereof. It does not create any liability to payment on the basis of such marking. This point was made clear by the Privy Council in The Punjab National Bank Ltd. V. The Bank of Baroda Ltd (1949) A.C. 176. One G gave a post-dated cheque to M on the Bank of Baroda for Rs.2,75,000 in satisfaction of his debt. The cheque was marked by B Bank as good for payment on 20.6.39. M discounted this cheque with the Punjab National Bank and obtained Rs.2,40,000 immediately. On 20-6-39 the Punjab National Bank presented the cheque on the counter of the Bank of Baroda. It was found that a credit of 7 annas 3 pies only in G's account. Hence payment was refused. The Punjab National Bank sued the Bank of Baroda to secure the payment of the cheque. They contended by marking the cheque as good for payment, the Bank of Baroda had accepted the cheque and therefore should be held liable as acceptor. Rejecting their contention, the court held "No case is reported in England or in India of a banker being held liable or even sued, as an acceptor of a cheque drawn upon him".

Payment of Crossed Cheques (Sec. 126 to 130): Where a cheque is generally crossed, a banker shall pay it only through banker and when it is specially crossed the banker must pay to the bank it is crossed, or his agent for collection. Banker will be protected only if his payment is in due course.

9.23. PROTECTION FOR BANKERS

1. **Bearer cheques:** A banker is discharged when he makes the payment in due course to a bearer cheque. In other words a banker is protected only of payment is made in due course. The rule that "once a bearer, always a bearer", now contained in section. 85(2)

2. **Order Cheques:** If payment is made in due course a bank will be protected even if the indorsement of the payee is forged. But the banker is expected to be familiar with the customer's signature and the forgery of his signature is within the protection by payment in due course (Sec.85 cl. [1]). The protection given by this section is available also to bank drafts.

9.24. COLLECTING BANK:

The protection given to drawee bank is extended to the collecting bank also. Accordingly, a collecting bank is protected only if the following conditions are fulfilled (Sec.131).

1. The cheque must be a crossed one and that such crossing must have been made before it reached the banker.

2. The collecting banker must be receiving payment for a customer.

3. The collecting banker must have acted as an agent for the purpose of collecting the amount for the customer. That is, if the banker is himself the holder the protection is not available.

4. The collecting banker must have acted in good faith and without negligence. The bank will be guilty of negligence if it failed to notice difference between the name of the payee as appearing on the cheque and as given in the indorsement. So also if the banker ignores the directions. (e.g. account payee) on the cheque he will be guilty of negligence. Sec 131 A extends the same protection to any crossed draft as if it were a cheque.

In, Indian Bank v. Catholic Syrian Bank Ltd (1980 T.N.L.J.P.23) one Mr. Dessai from Indore opened a current account with the Indian Bank at Salem. On 12th June 1960 one Mr. Mohamed Hussian obtained a demand draft for Rs.20 from the Singanallur Branch of the Catholic Syrian Bank Ltd. The draft was drawn on the respondent's branch office at Cochin in favour of M/s Dessai & Co. This draft was altered by clever forgery so as to respondent bank in favour of Mr. Desai. The forged draft was collected by Mr. Dessai through his account with the appellant bank on 13th June 1969. The appellant received payment of the same from the respondent bank at Salem. On 14th June 1969, the Salem branch of the respondent came to know on its reference to Singanallur branch that the latter had issued a draft only for a sum of Rs.20 and that too drawn in favour of M/s. Dessai & Co and payable at Cochin branch office and the draft for Rs.20,000 had been issued. Mr.Dessai in the meanwhile had withdrawn the proceeds of the draft collected by the appellant. The respondent filed a suit for Rs.29,000 against the appellant on the ground that the appellant had been negligent while opening a current account in the name of Mr.Dessai by reason of this negligence and want of good faith the forged draft had come to be wrongly converted.

The trial court passed a decree in favour of the respondent for Rs.25,000 and disallowed only a sum of Rs.4,000 on the ground of contributory negligence on the part of the respondent in having paid the draft without receipt from its Singanallur branch. On appeal by Indian Bank, the Madras High Court held that the appellant bank had not acted without negligence. The Agent of Indian Bank should have independently questioned Dessai about his business and his credit worthiness before allowing him to open an account. When opening the courrent accout. Dessai had given the address of a well known coustomer of the bank, by whom he had been introduced. Further, the draft was put into account so shortly after the opening of the account as to lead to an interference that it formed a part of the opening of the account as to lead to an interference that it formed a part of the opening the account had to be treated as negligence in the matter of opening the account had to be treated as negligence in the matter of opening the account had to be treated as negligence in the matter of realisation. There is no contributory negligence on the part of respondent in not waiting for the advice from its Singanallur Branch before making payment. Appeal was dismissed and the entire sum of Rs.29,000 was decreed against Indian Bank as it was not entitled to protection afforded by Sec.131 and 131-A of the Negotiable Instrument Act.

9.25. PRESUMPTION ATTACHED TO PROMISSORY NOTES (SECS. 118 & 119):

There are certain presumptions attached to negotiable instruments which need not be proved; but they are rebuttable by evidence to the contrary. Such presumptions are as follows:

1. Every negotiable instrument was made, drawn, accepted negotiated and transferred for consideration.
2. The date on the instrument is the date on which it was drawn.
3. Every bill of exchange was accepted in a reasonable time before maturity.
4. Every transfer is made before maturity

5. Endorsement are made in the order in which it is found in the instrument.

6. A lost promissory note was properly stamped.

7. The holder of an instrument is a holder in the due course.

8. In a suit upon a dishonoured instrument on proof of the protest, the fact of dishonour is presumed.

9.26. ESTOPPEL : (SEC. 120 & 122):

The following estoppels apply to suits.

1. Maker of a promissory note, drawer of exchange or cheque and the acceptor of a bill for the honour of a drawer are estopped from denying the validity of the instrument as originally made or drawn.

2. The maker of a promissory note and an acceptor of a bill payable to order are estopped from denying the payee's at the date of the note or bill to endorse the same.

3. An indorser of a negotiable instrument is estopped from denying the signature, or capacity to contract of any prior party to the instrument.

Check Your Progresse

1 Define negotiation
2 Define indorsement
3 What is meant by conditional indorsement?
4 When presentment for payment is necessary?
5 What is material alteration ?
6 What are the instance of material alteration ?
7 When notice dishonour is not necessary ?
8 Define Noting and protest
9 Acceptance for honour –Explain
10. Crossing of cheque – write a note

9.27. INTERNATIONAL LAW (SECS. 134 TO 137):

1. The liability of the maker or drawer of a foreign instrument is decided according to the law of the place where he made the instrument, indorsers are regulated by the law of the place where the instrument is made payable.

2. Where the instrument is made payable in a different place from that which it is made or indorsed, the law of the place where it is made payable determines liability.

3. If a negotiable instrument is made, drawn, accepted or indors out of India, but in accordance with the law of India, subsequent acceptance or indorsement and thereon in India, will not be regarded as invalid because the agreement evidenced by such an instrument is invalid according to law of such foreign country.

4. The law of any foreign country, regarding promissory note bill or cheque is presumed to be same as that of Indian unless the contrary is proved.

9.28. SUMMARY

In this unit we have discussed the rules relating to negotiation and assignment and analysed differences between assign ability and negotiability. The definition of indorsement

Various kinds and its effect has been explained. The other topic presentment for acceptance and presentment for payment, when presentment for payment not. Necessary has been analysed. How the parties to a negotiable instrument are discharged and various instances are well discussed. Protection available to a paying banker and collecting banker has been discussed in detail.

9.29. KEY WORDS

indorsement	-	an act of endorsing
ad infinitum	-	endlessly, forever
encumbered	-	burden or hindrance
inchoate	-	not fully developed
counter manded	-	cancelled

9.30. ANSWER TO CHECK YOUR PROGRESS

1. Refer to 9.1
2. Refer to 9.3
3. Refer to 9.5
4. Refer to 9.12
5. Refer to 9.13.5
6. Refer to 9.13.6
7. Refer to 9.16.3
8. Refer 9.18 and 9.19
9. Refer 9.21
10. Refer 9.22

9.31. MODEL QUESTIONS

1. Define negotiation Distinguish between negotiability and assignability.
2. Define indorsement What are the various types of indorsement and its impact ?
3. What is presentment for payment and presentment for acceptance ?
4. When parties to a Negotiable instrument are discharged from liability.
5. To what extent a banker is protected when it collects a cheque on behalf of a person who is not its customer?

UNIT - 10

FORMATION OF A COMPANY

INTRODUCTION

A company in common parlance, means a group of persons associated together for the attainment of a common end, social or economic. We are mostly concerned with registered or incorporated companies. The term registered company means a company incorporated, under the Companies Act, 1956. A company is in law regarded as an entity separate from its members. A company may be a company limited by shares or a company limited guarantee. A company is a juristic person with a perpetual succession. The capital of a company is divided into parts called shares. A company can sue and be sued in its corporate name. These are the characteristic of a company.

Before a company is formed, certain preliminary steps are necessary. All these steps are taken by certain persons known as promoters. They do all the necessary preliminary work incidental to the formation of a company. In this unit we are going to study the various stages in the formation of a company, what are the documents to be filed to before the Registrar of companies and the importance of prospectus in mobilizing the capital of a company.

OBJECTIVES

- to study the various stages involved in the formation of a company.
- to know the procedure for Registration of a company.
- to study the procedure or commencement of business
- to understand the role of promoters
- to analyse the importance of documents like memorandum of Association, Articles of Association and prospectus.

UNIT STRUCTURE

10.3. Registration
10.4. Commencement of Business
10.5. Promoters
10.6. Minimum subscription
10.7. Memorandum of Association
10.8. Contents of the Memorandum
10.9. Alteration of Memorandum
10.10. Doctrine of ultra vires
10.11. Exception to the doctrine of vires
10.12. Personal liability of directors
10.13. Articles of Association
10.14. Contents of Articles
10.15. Alteration of Articles
10.16. Binding force of Memorandum and Articles
10.17. Constructive notice of Memorandum and Articles
10.18. Doctrine of Indoor Management
10.19. Exceptions to the doctrine
10.20. Distinction between Memorandum and Articles of Association
10.21. Prospectus
10.22. Definition of prospectus
10.23. Statement in lieu of prospectus
10.24. Contents of prospectus
10.25. Reports to be set out in part II
10.26. Mis-statement in prospectus
10.27. Effects of mis-statement
10.28. Liability of Company
10.29. Liability of Directors, Promoters.
10.30. Underwriting
10.31. Importance of Underwriting
10.32. Summary
10.33. Key words
10.34. Answer to check your progress
10.35. Model questions

10.1 FORMATION OF COMPANY - PROMOTION

There are three distinct stages in the formation of a company viz., (1) Promotion (2) Incorporation and (3) Commencement of business.

Promotion is the first step in the formation of a joint stock company. In common parlance promotion refers to the process by which a company is brought into existence. Gerstenberg defines it as "discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits therefrom". The person, association, syndicate or partnership firm engaged in the promotion of a Company is known "Promoter". It is the promoter who conceives the business idea, studies critically and carefully the prospects of converting it into a business proposition and brings together the minimum number of men, machinery and materials to demonstrate its feasibility.

10.1.1. Discovery of Business Opportunities : The work of promoter starts when an idea strikes him regarding some business venture which can be profitably undertaken by a company. The idea may be-

(a) to start a new company to exploit an invention of a technological improvement in a particular field.

(b) to take over an already existing unit and expand it to have the economics of large-scale operation or to make best use of existing business opportunities, or

(c) to amalgamate together two or more existing concerns to eliminate cut-throat competition and reduce the cost of operation.

10.1.2. Investigation : The second step in promotion is to carry out a thorough and detailed investigation of the business idea. The purpose of the investigation is to determine whether the proposed product or service can be put in the market, in quantities that will justify the new enterprise and at cost that will leave a sufficient margin of profit.

(a) Technical feasibility of the proposed venture.

(b) Availability of physical facilities, like raw-materials, transport facilities, power supply, skilled labour, etc.

(c) Extent and intensity of the market for the product or service and the magnitude of competition, actual or potential, that the concern has to face.

(d) Financial requirements of the venture, and

(e) Profit possibilities based on probable operating costs and revenue at different levels of operation.

Surveys and estimates of the aforesaid factors call for an expert study especially in an expert study especially in an economy of inflation like ours. Further the results of the investigation should also be verified by an independent agency. In industrially advanced countries like U.S.A and U.K. there are specialised institutions to take up this job of investigation and verification. In less developed countries like ours, where there are no such specialised institutions the promoter has to utilise the service of experts in various field to carry out this investigation and verification work efficiently.

10.1.3. Assembly : If the promoter is satisfied with the feasibility and profitability of the business idea, the next step is to assemble the proposition. It covers a wide range of activities for instance, selection of a site and taking it for lease or purchase, arranging for the construction of the plant and the purchase of the equipment, securing of patents, making tentative commitments for personnel etc. Briefly speaking it results in an assembly of original idea properly and managerial ability.

10.1.4. Financing : When these three stages are over, the promoter is said to posses the proposition. This proposition should be presented to the public and the necessary funds raised to launch the enterprise as a going concern, with title to the necessary property and with sufficient cash to meet the working capital requirements and contingencies.

10.2. INCORPORATION

A company is said to be incorporated when it is registered with the Registrar of Joint Stock Companies under the Companies Act, 1956. But before registration of a company, the promoters have to do the following:

10.2.1. Name of the Company : The promoters must first decide upon the form of the proposed company -- whether it should be a private company or a public company. Next the promoters must select a few names for the proposed company in the order of preference and make an application to the Registrar of Joint Stock Companies for approval of one of them. When the name is approved, the Registrar usually keeps it pending for a period of three months. If the company is not registered by that name within this period, a fresh application will have to be made.

10.2.2. Sanction for capital issue : If the capital proposed to be raised by the company exceeds Rs.50 lakhs, the promoters should obtain the prior sanction of the Central Government under the capital issue (Control) Act, 1974.

10.2.3. Industrial Licence : If the company to be formed intends to start an industrial undertaking included in the Schedule annexed to the Industrial (Development and Regulation) Act, 1951 a licence must be obtained under that Act. Thereafter steps must be taken to register the company.

10.3 REGISTRATION:

For the registration of a company, the following document together with the necessary fee, must be submitted to the Registrar of company of the State in which the registered office of the company is to be situated :

1) The Memorandum of Association, prepared in accordance with the provisions of the companies Act, and signed by at least 7 persons in case of a public company and 2 persons in the case of a private company.

2) The Articles of Association (except where Table Attached to the companies Act has been adopted as the Company's articles)

3) In the case of public company having a share capital (i) a list of persons who have consented to act as directors. (ii) a written consent

of the directors to act in that capacity, and (iii) an undertaking by the directors to take up and pay for their qualification shares. (Note: This is not necessary in the case of (a) a private company (b) a company not having any share capital and (c) a company which was a private company, before becoming a public company).

4) A statutory declaration by an advocate, an attorney or a pleader, a chartered accountant, or a person named in the articles as director manager or secretary of the company that all the requirements of the Act and Rules there under in respect of registration have been complied with.

5) Sanction of Controller of Capital Issues under the Capital Issues (control) Act, 1947, if the capital proposed to be raised exceeds Rs. 50 lakhs.

6) Licence obtained under the Industries (Development and Regulation) Act, 195]. if the company is to participate in an industry which is included in the Schedule annexed to that Act.

The Registrar of companies, on receipt of the above documents with necessary fee for registration, examines and verifies them. If he is satisfied with the requirements of the Companies Act he will register the company and issue the Certificate of incorporation. The legal existence of the company begins from the date of the certificate of incorporation. The certificate is conclusive proof that the company has come into existence as a separate legal entity. Once the certificate is issued, the in Corporation cannot be challenged even though there were irregularities prior to registration.

10.4. COMMENCEMENT OF BUSINESS

A private company can commence business immediately on its incorporation. But a public company cannot do so. A public company has to comply with certain additional formalities and obtain a second certificate known as certificate of commencement of Business before it can commence business.

The Certificate of commencement of business will be issued be the Registrar, only if the public company fulfils the following conditions :

(a) if the public company has issued a prospectus:

(i) The shares payable wholly in cash have been allotted at least to the extent of the minimum subscription.

(ii) Every director has paid in respect of shares held by them the application and allotment money in the same proportion as others.

(iii) No money is, or may become, liable to be repaid to the applications for shares or debentures offered for public subscription by reason of any failure to apply for or to obtain permission for the shares or debentures to be dealt in on a recognised stock exchange.

(iv) A duly verified declaration by the secretary or one of the directors that the above three conditions have been complied with, has been filed with the Registrar.

(b) If the public Company has not issued a prospectus :

(i) A Statement in Lieu of Prospectus has been field with the Registrar.

(ii) Every director has paid in respect of shares held by him for the application and allotment money in the same proportion as others.

(iii) A duly verified declaration by the secretary or one of the directors that the application and allotment money have been paid by the directors in the same proportion as others, has been filed with the Registrar.

If the Registrar, is satisfied that the above provision, as applicable have been complied with, be will issue the Certificate of Commencement of Business. Such a certificate shall be a conclusive evidence that the company is entitled to commence business. A public, company should obtain this certificate with in one year after the date of incorporation. Otherwise it is liable to be wound up. Any contract made by the company before obtaining this certificate is provisional only and not binding on the company till such a certificate is obtained.

10.5. PROMOTERS

Definition :

The term promoter has not been defined in the companies Act. As Bowen L.J. has rightly pointed out ("the term promoter is not a term of law, but of business usefully summing up in a single word, a number of business operations familiar to the commercial world by which a company a company is generally brought into existence").

In short, the persons who initially plan the formation of a company and bring it into existence are called promoters. It is the promoter who conceives the idea, studies critically the proposed of converting it into a business proposition, and brings together the minimum number of men, machinery and materials to demonstrate its workability.

The promoter may be an individual, a group of individuals, a firm, a joint stock company or a syndicate formed for the purpose. It is a question of fact whether a person is a promoter it must be made clear that the term promoter does not include a person who has acted in a professional capacity such as counsel, solicitor, accountant or auditor.

His journey begins when he conceives a business idea: In many instances, he is not only an, "Individual but he is distinctly individualistic". Indeed he frequently "travels alone : for a considerable time because of his ideas : yet he continues his travel. He becomes a successful promoter when he reaches his destination namely the point at which business begins operations as a going concern.

The American economic history unfolds the romance of spectacular promotions. John D. Rockfeller in the field of petroleum Industry and J.H. Moore and W.H. Moore his contemporaries : J.P. Morgan in the field of banking; and stone and Webster in the field of engineering firms. The activities of some of them provide more fascination for reading than most purely fictional literature. Our Indian industrial history also reveals the most outstanding personalities in the promotion of industries. They are J.N. Tata in the field of iron and steel and J.R.D.

Tata and G.D. Birla in the second generation; Ramakrishna Dalmia the field of cement production : and Raj Bahadur Seth Gujarmal Modi in the field of textiles.

A successful promoter is a creator of weal and he is an economic prophet. For which he is able to visualize what does not yet exist and organise business enterprises to make products available to the public. In short, he transforms the pins hopes into a big reality.

His functions are of great economic and social value. He may create a new service or product, or he may introduce new methods for producing goods and services at cheaper costs. By effecting consolidation as may eliminate the wastes of competition improve the tone of industrial and thereby, ensures stability in the economic system. This is more so in the case of capitalistic countries. Ultimately, the promoter increase the total employment for his society and enhances the per capital income by utilising the human and material resources. Thus, he renders yeoman services to the society as a whole. His indispensable functions of assembling the men, money and materials into a going concern makes the wealth of nations of ascend heights.

Sometimes, the promoter is regarded as an unscrupulous sort of person endeavouring to first worthless corporate securities upon a gullible public.

10.5.1. Legal Implications : A promoter must act in a fiduciary capacity. He should not secure for himself secret profit. Although his acts are in the nature of agency, he is not an agent in the of law Because before the organisation is incorporated, no principal can be created. But he may be the agent of individuals for whom he is acting in the organisation of a corporation. Or well. he may be acting for himself using own financial resources. All his preliminary arrangements and contracts are almost always contingent upon the successful organisation of the corporation and upon its assumption of the obligations created by the promotion.

But it is bound to assume pre-incorporation obligation of any kind. The time, energy and money that a promoter invest in pre-incorporation activities may be sacrificed in case he is not able to satisfy the persons interested order to get over this difficulty the usual practice now is not to make any contract before the registration of the company but to draft a 'draft agreement' to be entered into by the vendor or promoter and the corporation after incorporation. This 'draft agreement' is referred to in the memorandum in the objects clause (generally as the first clause) and also in the articles. The draft agreements is initiated is initiated by one or more of the names directors or by a lawyer, solicitor or accountant of the corporation. The agreement then comes up before the board of director after the corporation after the corporation is registered and it is entitled to commence business. In the meeting of the board of directors the agreement is adopted signed and sealed after due consideration.

10.5.2. Qualifications : The concept of promotion usually involves something new. It will exist at the outset in the mind of the promoter only. Hence, the outstanding qualification of a promoter is the possession of fertile imagination. In order to be successful, it must be a practical one. It must lead to a product that is necessary. Is it enough? No. He must be able to induce the acceptance of his products by those who are expected to buy them. This implies that he is a good salesman. In fact he must be a super salesman. Because, before he markets his products he must market his ideas in order to enlist the financial and other support needed to get his enterprise started. A suitable blending of these two characteristics viz, fertile imagination and its practical turn will make him a successful promoter. But the line between the so called "Pure imagination" and practical ideas cannot always be easily drawn.

Any newly promoted project involves new trials which are being blazed through the economic wilderness. In this process the promoter should exercise a great sense of judgment and balance the opposing forces. These concepts seem to be in conflict with qualities of imagination, initiative and enthusiasm. That is why a truly successful promoter is so rare.

He must have the courage of his convictions and must be persistent in pressing his claims, even expected criticism and open opposition. He must be in a position to inspire confidence. The business honesty and integrity in him should not only remain a matter of faith for him but he should be able to transform that faith into action also.

10.5.3. Compensation or Remuneration : As the activities of a promoter rotate to the future, the risks are of great. In the development of new enterprise, risk in the cardinal factor to be faced by the promoter. He should be compensated for his efforts and sometimes for his cash contributions as well for his pre-incorporation activities. He may be paid in cash for his out of pocket expense and in equity shares for the risks taken and intangible service rendered by him. But in practice, the modes of compensating the promoter vary from company to company. They take one or more of the following forms :

a) Commission : Commission may be paid to be promoter or the purchase price of the property or business acquired by the corporation or company through him.

b) Profit : The promoter may purchase a business or other property and may be allowed to sell his business to the corporation or company at a higher price, or he may sell his business to the corporation or company at à profit.

c) Lump Sum : The promoter may get a certain lump sum compensation for his services.

d) Managing Director : In India, promoters were generally appointed as the managing agents of the company or corporation. Following the abolition of the managing agency system at present they are appointed, in general as Managing Director or Manager or General Manager.

e) Cash or share or debenture : The compensation or remuneration payable to promoters may be paid in cash or by allotment of shares or debentures, or partly in one and partly in the other.

10.5.4. Types of Promoters : There is no specific training school for promoters. But we can attribute that their own exclusive quality, sometimes called "Business sense" and their own experience in the world of Business as their twin schools of training. Promoters can be divided into various types as discussed below:

1. Accidental Promoters : This group includes the large number of organisers of small business enterprises who see commercial possibility in some idea or other. Most of them buy commercial and industrial tombstones with their capital, their enthusiasm, and their energy. They happily confine to their localities in which they live. Hence, their failure are not much of importance.

2. **Professional Promoters :** Some local business magnates, bankers end lawyers and ever on the look out for promotion opportunities. They initiate new enterprises, incorporate and expand old ones and at times, effect combinations of local enterprises thus the invitation for promotion is laid at the feet of the local professional promoters.

3. **Engineering firms and manufacturing corporations :** A few outstanding engineering firms or manufacturing corporations undertake promotion as a side issue. In many cases it has proved to be lucrative and come to stay as their main interest. Manufacturing corporations, sometimes promote new enterprises as an outled for their products. Thus, paves the way for success.

4. **Financial Promoters :** Financial institutions like investment houses sometimes act as promoters: When the stock exchange possesses a favourable climate for floating securities, the financial profit from such issue induces financial institutions to seek opportunities for sale of new issues or bonds or birth.

5. **Managing Agents :** There is common feature between the professional promoters (discussed above) and the managing agent. Both are always on the look out for business opportunities. But they differ from the professional promoters found in industrially advanced countries as regards the maintenance of contact with the promoted concern after promotion. The latter (professional promoters) have nothing to do with their promoted enterprises after their incorporation while the former (managing agents) were closely associated with their promoted enterprises even after their incorporation.

6. **Specialised Institutions :** In the post independence era of India, the concept of planned Industrial development has gained momentum. It has given rise to the growth of industrial Finance Investment Corpora lions at the State level are the Industrial Development Bank of India at the national level are examples in this direction. These specialise organisations are intended to analyse the prospects of a particular enterprise in a particular region and thus bring new enterprise into life and ensure their success.

7. **Government :** The State is also emerging as an entrepreneur in a big way in the promotion of industries with the advert of planned economy. Following

the principles enunciated in the Industrial Policy Resolutions the State has made substantial progress in various industries especially, in heavy industries.

10.6. MINIMUM SUBSCRIPTION:

The law is anxious in protecting the interests of the general public.

In order that a company may have the necessary minimum capital to start with and to carry on operations without difficult the Act Jays down a 'minimum subscription'. The amount must be shown in the prospectus for the information of the prospective buyers.

The application money on each share shall not be less than 5 percent off its nominal value. While calculating the amount of minimum subscription the prospectus must show the minimum amount required for each of the following purposes separately :

i) The purchase of any property bought or to be bought out of the proceeds of the issue of shares.

ii) Preliminary expenses and commissions on shares payable by the company.

iii) Repayment of loans made for these two requirements mentioned above.

iv) Working capital

v) Any other expenditure stating the nature and purpose and estimated amount in each case.

If the minimum subscription amount is not fixed and stated in the prospectus, the whole amount of the share capital issued to the public shall be deemed to be the minimum subscription.

This restriction apparently does not apply to a private company. According to Sec. 69 of the Act, if a company has not received the amount of minimum subscription when 120 days after the issue of the prospectus, all moneys received with share application should be repaid within the next few days without interest.

Otherwise the directors will be liable jointly and severally to repay the amount with interest at the rate of 5 per cent per annum.

10.7. MEMORANDUM OF ASSOCIATION

As we have already seen, Memorandum of Association is one of the most important documents to be filed with the Registrar of joint stock companies to obtain the Certificate of incorporation. It is the primary documents of a company which sets out the constitution of the company and which, as such, forms the foundation on which the superstructure of tile company is based. It is as it were the Charter of the company. The purpose of the memorandum is to enable the shareholders, creditors and those who deal with the company to know what is its permitted range of enterprise. It defines the relation of the company with the members of the public. It is a public document and can be inspected by anybody.

The Companies Act requires that the memorandum shall be printed, be divided into paragraphs, numbered consecutively and signed by each subscriber who shall add his address and description in the presence of atleast one witness who shall attest that signature.

10.8. CONTENTS OF MEMORANDUM OF ASSOCIATION:

According to Sec. 13 of the Companies Act. 1956, the Memorandum of Association of every Company shall contain the following particulars.

1. The name of the company with the word "limited" at the end of the name of a public company and the words 'private limited' at the end of the name of a private company. (Name clause).
2. The name of the State in which the registered office of the company is to be situated (Situation clause);
3. The objects of the company (Object clause)
4. The nature of liability of members i.e., whether limited by shares or guarantee or unlimited (Liability clause)
5. Details of share capital of the company (Capital clause)
6. Subscription of Association clause.

The Memorandum of Association drafted should be in accordance with the prescribed form or as near thereto circumstances admit. But there must be nothing contrary to the provisions of the Act.

10.8.1. Statutory Provisions Relating to the contents of the Memorandum :

1) Name Clause : A company may choose any name it likes; but

(a) the name **should not** be identical with or closely resemble the name of, an already existing **company** and

(b) **the name should** not be considered undesirable by the Central Government.

Under the Emblems Names Prevention of Improper use Act, 1950 the Government has power to declare what names and emblems are not to be used by companies and in trade and patterns. Subject to the above rules a company can adopt any name it likes.

The central Government may, by licence, permit the omission of the words "limited" or 'private limited' in the case of companies which are formed for promoting commerce, art, science, religion, charity or my other useful object and which are non-profit and non-dividend paying organisations.

10.8.2. Situation Clause : The memorandum should mention the place of the registered office of the company to which all communications and notice may be addressed. If the situation of the registered office is changed from one place to another within the same town or village, no alternation of the memorandum is required but notice must be given to the registrar within 30 days.

If the registered office is changed from one city, town or village to another within the same state a special resolution must be passed and notice must be given to the Registrar.

To change the registered office from one state to another, it is necessary to amend the memorandum.

10.8.3. Object clause : This is the most important clause in the memorandum. This clause defines the limits and extent of the activities of the company. It states

a) the main objects to be pursued by the company on its incorporation.

b) the objects incidental or ancillary to the attainment of the main objects; and

c) other objects of the company.

In case of companies (other than trading corporations) with objects not confining to one state, the memorandum shall state the States to whose territories the objects extend.

This clause enables the subscribers to the shares and loan capital of the company.

(i) to be fully aware of the objects to which their money can be employed and

(ii) to protect the creditors by ensuring that the company's funds to which they must look for payment are no dissipated in unauthorized.

10.8.4. Liability clause : This clause should be included in the memorandum of every limited Company indicating that the liability of members is limited and whether the liability is limited by share or by guarantee should be clearly mentioned.

10:8.5. Capital Clause : This clause in the memorandum states the nominal or authorised capital of the company, the value of each share, the way in which the capital is divided into various classes of shares and the rights and privileges attached to each class of shares.

In the case of companies limited by guarantee, the amount promised each member to the contributed by them in case of the winding up of the company is be mentioned.

10.8.6. Subscription or Association Clause : In this clause it is stated that the signatories or the memorandum are desirous of forming themselves into an association to carry out objects set out in memorandum . Each subscriber to the memorandum must at least take one share each and should write opposite to his name the number of shares takes. As we have pointed already, in the case of private company atleast 2 persons and in the of a public company at least 7 persons should subscribe to the memorandum. The signature of the subscribers shall be attested by at least one witness.

10.9. ALTERATION OF MEMORANDUM :

The memorandum can be altered only in the manner and to the extent, for which express provisions has been made in the Companies Act.

1. Change of Name :

A company is permitted to change its name. This can be done by passing a special resolution and getting the approval of the central government in writing. Government approval is not necessary if the change of name involves only the addition or deletion of the word "private" on conversion of a public company into a private one or vice versa.

However, if the change of name is necessitated by the fact that a company was registered through inadvertence or otherwise with a name which, in the opinion of the Central Government, is identical with or too nearly resembles that of an already existing company, then, the name may be altered by passing on ordinary resolution and getting the written approval of the Central Government.

In both these cases the change of name will be effective only after the Registrar issues a fresh certificate of incorporation altering the name of the company. The change of name should be carried out in all copies of the memorandum and articles issued after the date of alteration.

2. Change of Registered Office :

Alteration of the memorandum is necessary only if the registered office is changed from one state to another. The procedure is to, -

a) pass a special resolution and

b) get the resolution confirmed by the Company Law Board.

The change will be permitted only if it is sought for some purpose for which an alteration of objects permissible under the Companies Act. Sufficient notice must to given to every person whose interest will be affected by the alteration. Consent of the creditors to the alteration, is to be obtained to their debt or claim is to be discharged or secured. The Registrar must be given a reasonable opportunity to appear before the Company Law Board and state his objections and suggestions. If any, with respect to the confirmation of the alteration. After the Company Law Board has confirmed the alteration, the special resolution and a certified copy of the confirmation order must be filed with the Registrar of both the states within 3 months from the date of the order. The Registrar of state where the registered office was originally situated will then transfer all the documents of the company to the Registrar of the other State.

3. Alteration of Object Clause:

Alteration of the object clause is permitted only one of the following grounds.

(i) to enable the company to carry on business more economically and efficiently;

(ii) to attain its main purpose by new or improved means;

(iii) to enlarge or change the local area of its operations;

(iv) to carry on some business which under existing circumstance may conveniently or advantageously be combined with the business of the company;

(v) to restrict or abandon any of the objects specified in memorandum;

(vi) to sell or dispose of tile whole or any part of the undertaking of the company; or

(vii) to amalgamate with any other company or body of persons. The Procedure is to

(a) pass a special resolution and

(b) get the resolution confirmed by the company Law Board.

The Company Law Board may confirm .only after it is satisfied (i) that notice of alteration has been given to the debenture-holders creditors and others whose interests will, in the opinion of the Company Law Board, be affected by such an alteration and (ii) that every creditor who is entitled to object has either consented to the alteration, or that his claim has been discharged, determined or secured to the satisfaction of the Company Law Board.

The 'alteration of the objects' does not mean the introduction of an entirely new object. The Company Law Board may make an order confirming the alteration either wholly or in part wholly or in part and on such terms and conditions if any as it things fit.

4. Change of Liability Clause:

The liability of the members cannot be altered so as to increase the liability of the members, or prejudice their interests. No member will be bound by such an alteration. The alteration can be effected only with the consent of the members in writing either before or after the particular alteration is made.

5. Alteration or Capital Clause:

A company limited by shares, if allowed by its articles, can by an ordinary resolution alter its share capital so as to.

a) increase it by the issue of new shares.

b) consolidate and divide its capital into shares of large amount.

c) sub-divide to shares into the shares of smaller amount.

d) convert its fully paid-up shares into stock or reconvert stock into fully paid up shares.

e) cancel shares which have not been taken or promised to be taken at the time of the resolution.

If the articles authorize, a company by a special resolution confirmed by the court may reduce its share capital in any way and in particular by,

a) reducing or extinguishing the liability of members for uncalled capital.

b) write off or for cancelling paid-up capital which is lost or unrepresented by available asets.

c) paying of capital which is in excess of the company's requirement.

10.10. DOCTRINE OF "ULTRA VIRES"

A company cannot depart from the objects ad laid down in the memorandum. A company has the power to do only such things which are essential to the attainment of its objects specified. In the memorandum, if a transaction is outside the scope of the company's objects and powers. It is wholly void is known as ultra vires the company in other words an act done by the company beyond the object clause of the memorandum of the company is called ultra vires. "Ultra" means "beyond", "vires" means "powers". The term "ultra vires" means beyond the power and authority of the company in other words, if a transaction is outside the scope of the company's objects, it is void and will not be binding on the company. The leading case on the points is Ashbury Railway Co .V. Ritchie. The company was authorised to manufacture railway wagons whereas it purchased a license to lay railway line. Held ultra vires.

In London County Council .V. Attorney General, the main object of the company was to run tram cars. But the company was actually running omni-bus. It was held by the court that running omni-bus was in no way connected with the major object namely, running term cars and hence it was an ultra vires act.

In A. Lakhmanaswami Mudaliar .V. Life Insurance Corporation of India, the directors of a company were authorised payments towards any charitable or any benevolent object. In accordance with the shareholders resolution, the directors paid two lakhs of rupees to a trust formed for the purpose of promoting technical and business knowledge.

The payment was held to be ultra vires. The supreme court held that the director could not spend the company's money on any charitable object which they might choose. They could spend money for the promotion of any such charitable object, which the company exceeds its authority, the act is good to the extent of its authority and bad as to the excess. But if the excess is inseparable from the authority conferred on the company by the memorandum the whole transaction would be void on the basis of the doctrine of ultra vires.

If an act is ultra the company (beyond the scope of the powers of company) it cannot be ratified even by the whole body of its shareholders.

10.11. EXCEPTION TO THE DOCTRINE OF ULTRA VIRES:

1. If an acts ultra the directors (beyond the scope of to the powers of the directors) but not ultra vires the company, it can be ratified by the whole body of its share holders.
2. If an act ultra vires the articles (beyond the scope of the articles of association) it can ratified by altering the articles by a special resolution at the general body meeting.
3. If a person borrows money from the company under a contract which is ultra vires the company, the company can sue him for the recovery of the money and,
4. The properties acquired by ultra expenditure can be protected by the company.

10.12. PERSONAL LIABILITY OF DIRECTORS :

It is the duty of the directors to see that the funds of the company are used only for legitimate business of the company. If the funds of the company are used for a purpose other than mentioned in its memorandum the directors will be personally liable to restore to the company the funds used for such purpose.

10.13. ARTICLES OF ASSOCIATION

This is the second important document of the company. The articles of association is a document which contains rules and regulations and byelaws for internal management of the company. They are the rules regarding the mode and the form in which the business of the company is to be carried on. They are internal regulation of the company governing its management and embodying the powers of the directors and officers of the company as well as the powers of shareholders.

Articles of association are subordinate to the memorandum of association and the articles which are at variance with the memorandum is, to that extent, inoperative. In case of conflict between memorandum and articles of association memorandum prevails.

The articles must be printed and signed by each subscribers of the memorandum in the presence of at least one witness, who must attest the signature.

In the case of a company limited by guarantee, a private company limited by shares and an unlimited company, the articles must be registered along with the memorandum. But it is not compulsory in the case of public company limited by shares.

If all public company limited by shares does not register a special set of articles of association of its own, the regulations laid down in Table A (which is model set of articles) in the First Schedule to the Act will apply. Even if such a Company has registered a special set of articles but the articles are silent on some point, the regulations contain in Table A will apply to the same extent as if they were embodied in its own articles, unless the articles exclude or modify Table A.

10.15. CONTENTS OF ARTICLES

Generally the articles contain provisions relating to the following.

a) Share capital share certificates, rights of share holders.

b) Number and value of shares.

c) Rules as to share certificates

d) Rules as to calls on shares

e) Rules as to transfer, transmission and forfeiture of shares

f) Rules as to alteration of capital

g) Rules as to general meeting

h) Rules as to directors, their remuneration etc.

i) Rules as to dividends and reserves

j) Rules as to accounts and audit and

k) Rules as to winding up

l) Rules as to share warrant and stock

10.15. ALTERATION OF ARTICLES:

A company has wide as well as inherent powers to its articles. The power to alter articles cannot be taken away by a special resolution only and not by an ordinary resolution. A copy of every special resolution altering the articles must be filed with the Registrar within 30 days of its passing and be attached to every copy of the articles issued thereafter. But there are certain limitations for alterations. They are as follows:

1. The articles must be altered in good faith and not so as to give an unfair advantage to a majority of the shareholders.
2. It should not be in conflict with the memorandum or violate any statutory provisions or principles of law.
3. The alteration must be made for the benefit of the company as a whole.
4. The alteration must not enable the company to commit any breach of contract with any outsider.
5. The alteration must not contain anything illegal or be against public policy, and
6. The alteration must not in any way increase the liability of the existing members to contribute to the share capital of the company unless they agree in writing before the alteration is made.

10.17. EFFECT OR MEMORANDUM AND ARTICLES OF ASSOCIATION OR BINDING FORCE OF MEMORANDUM AND ARTICLES

Section 36 of the Companies Act provides that memorandum and articles when registered shall bind the company and the members thereof to the same extent as if they had been signed by the company and each member. The effect of the provisions of memorandum and the article is to constitute a contract between each member and the company.

It would be easy to appreciate the effect and implications of both these documents by considering how far the memorandum and the articles is to constitute a contract between each member and the company.

It would be easy to appreciate the effect and implications of both these documents by considering how far the memorandum and articles bind:

a) the members to the company.

b) the members interse,

c) the company to the outsiders; and

d) the company to the members.

10.17.1. Binding the members to the company : As between the members and the company each member is bound to the company by statutory convenient to follow the provisions of the memorandum and articles. The effect is that each member is bound to the company to conform to these documents even if a member has not actually signed the same. If a member commits a breach of any of the terms laid down in these documents, the company can sue him. On the same analogy a member can sue the company.

But any alteration of the memorandum or articles regarding the increase of liability of the members is not binding on a member unless the member agrees in writing before or after the alteration.

10.17.2. As between the members interse, each member of the company is bound by the articles. If a member has committed a breach of the article another member has no right to sue him. Such a contract can be enforced another member only through the company. In other words it is only the company which can sue such a defaulting member.

10.17.3. Binding the company to outsiders : As between outsiders and the company, neither the memorandum nor the articles give any right to outsiders against the company. They do not constitute a contract between the company and third persons. In other words an outsider is a stranger to the contract and therefore these documents do not given him any right against the company.

10.17.4. Binding the company to members : Since both the documents constitute a contract between the company and the members, a company is also bound to the members in the same manner as the members are bound to the company. An individual member is entitled to institute a suit against the company to enforce his individual rights such as his right to vote or his right to stand as a candidate for election as director of the company etc. For instance the dividend will be paid out of profit, if the directors propose to pay dividend out of capital, a member has right to file a case against the company in the court restraining it from doing so.

10.18. CONSTRUCTIVE NOTICE OF MEMORANDUM AND ARTICLES OF ASSOCIATION

When the memorandum and articles of the company have been duly registered, they assume the character of public documents. They are open to inspection by the public at the office of the Register on payment of small fees. It is therefore the duty of every person dealing with a company to inspect its public documents and make sure that his contract is in conformity with their provisions. Hence, every person dealing with the company is deemed to have notice of the memorandum and articles of association. This is known as constructive notice of the memorandum and articles of association.

Everybody dealing with a registered company is deemed to have constructive notice of the contents of the memorandum and articles of association. He will be deemed in law to have notice of not only the company's powers but also of the directors powers and of the limitations and restrictions impose by the articles and other regulations. Thus, a person dealing with the registered company is presumed not only to have read the public documents like memorandum and articles, but also to have understood them according to their proper meaning. Whether he has read these documents or not, be is presumed to have notice of their contents. If a person, dealing with a company enters into a contract, which is beyond the powers of the company as set out in those documents, he must face the consequences in respect of such dealing or transaction.

For example:

The articles provide that a bill of exchange must be signed by two directors. But a Particular bill is signed by only one director, the holder of the bill cannot claim payment upon such a bill.

In Venkatasamy vs. Ramamurthi, the articles of association of a company required that all deeds on behalf of the company should be signed by the managing director, the secretary and a working director, one Mr. V. accepted and deed of mortgage executed only by the secretary and working director. The question also whether Mr. V. could claim against the company under this deed. The court observed that if Mr. V. had referred to the articles before entering into a contract with the company he would have discovered that a deed should be executed by three specified officers of the company and he would refrained from accepting a deed inadequately signed. Hence it was held by the court that the deed was invalid and Mr. V. could not claim any amount under this deed.

So it is very clear that whether a person actually reads both these documents or nor, he is considered to be in the same position as if he had read them. He will be presumed to know the contents of these documents.

10.19. DOCTRINE OF "INDOOR MANAGEMENT" (EXCEPTION TO THE DOCTRINE OF CONSTRUCTIVE NOTICE)

There is however one exception to the doctrine of construction notice, namely that so far as the internal proceedings of the company are concerned outsiders dealing with the company are entitled to assume that everything has been regularly done. The doctrine is generally known as the doctrine "indoor management". Ordinarily all questions relating to the constitution of the board, quorum voting, Internal resolutions and regulations are regarded as parts of indoors management. A person can be presumed to know the constitution of the company, but not what may or may not have taken place within indoors that are closed to him. For instance, a person dealing with the company must see that the delegation of authority is provided by the articles, but he need not enquire whether the proper procedure has been followed for the delegation of such authority to the person with whom the outsider is dealing. The leading case on this point is as follows:

Royal British Bank Vs. Turquand

The directors of the bank borrowed a particular amount of money from Mr. T. The directors of the company provided that the directors might borrow on bonds only when they are authorised by a resolution passed at a general meeting of the company. Actually no resolution was passed. So the shareholders represented that there had been no such resolution authorizing the loan and therefore it was taken without authority. The court held that passing a resolution was the internal proceedings of the company and hence Mr. T. had the right to infer that the necessary resolution must have been passed. It was decided by the court, that the company was liable to pay the loan.

Thus the doctrine of constructive notice does not extend to internal proceedings of the company. The principle of the constructive notice protects the company against outsiders and the doctrine of indoor management protects the outsiders against the company.

10.20. EXCEPTION TO THE DOCTRINE OF INDOOR MANAGEMENT

1. The doctrine of "indoor management" will not, however apply where the person dealing with the company has notice of the irregularity and

2. Where the acts done in the name of the company are void abinitio, the doctrine of indoor management is not applicable.

Distinction between memorandum and articles of association

The memorandum and articles of association are the two important sets of documents which determine the constitution and the scope of the function of a limited company. They both supplement each other. But there are some distinctions between them.

	Memorandum of association	Articles of association
1.	Memorandum of association is the charter of the company. It defines the fundamental conditions of the company's incorporation including the objects. In short, it lays down what is to be done.	The articles merely lay down various ways and means to fulfill those conditions and for achieving those objects. In short; the articles state how things are to be done.
2.	Memorandum cannot be easily altered, it can be altered only on the permission of the Central Government. In some cases sanction of the Company Law Board is required.	Articles can be altered by passing a special resolution Permission of the could of the Government is non declared.
3.	The memorandum defines the object beyond which the company cannot go.	The articles simply prescribed regulations for the internal management of the company.
4.	Memorandum defines the object beyond which the company cannot go.	Articles regulate the relative between the company and the member or members interest.
5.	Any act done beyond the powers given the memorandum is ultra vires and wholly void and cannot be ratified even by all the share holders.	Any act done beyond the articles are simply irregular and not void and can be ratified subsequently by the shareholders.
6.	Memorandum of association being the charter of the company is the supreme document.	The articles are subordinated to the memorandum of association. If there is any conflict between the articles and memorandum. the latter prevails.

10.21. PROSPECTUS

In order to function properly and efficiently a company requires capital. A public company may raise capital from the general public by issuing shares. Members of the public are invited to subscribe for its shares and investigation is sent to the public in the form of prospectus inviting offers for shares. The central theme of the prospectus is that is sets out the prosecutes of the company and the purpose for which the capital is required. The issue of a prospectus has been regarded as perhaps the most practical and important matter connected with the formation of a company, because it is the means by which the necessary capital for the company is acquired. The prospectus is the basis on which the prospective shareholders from their opinion and take decisions as to the worth prospectus of the company.

10.22. DEFINITION OF PROSPECTUS

Section 2 (36) of the companies Act defines a prospectus as follows:

"Prospectus meant by document described or issued as a prospectus and includes, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any shares on or debentures of a body corporate".

In short, any document inviting offers from the public for the subscription of shares or debentures in a company is prospectus. In other words, a document is not a prospectus unless it invites the public to subscribe for shares in the company. Thus a prospectus may be understood as a circular, which is issued by or on behalf of a company to induce the public to subscribe for the shares or debentures of the company.

10.23. STATEMENTS OF LIEU OF PROSPECTUS

A private company need not issue a prospectus. It is prohibited from inviting the public to subscribe for any shares in the company. It is also not obligatory for a public company to issue prospectus. It is does not issue a prospects it must submit to the Registrar statement called statement in lieu of prospectus. The statement must be signed by very person who is named therein as a director or proposed director or by his agent duly authorised in writing. It must contain most of the information which would be required in the prospectus.

10.24. IMPORTANT CONTENTS OF PROSPECTUS

Prospectus is the window through which an investor can took into the soundless of a company's venture. Hence it must disclose all materials and essential particulars of the company.

Section 56 of the Companies Act says that every prospectus shall state the matters specified in part I of Schedule II and set out the reports specified in part II of the schedule of the Act. Some of the important contents of prospectus are as follows:

1. The main object of the company with the names, address, description, and occupations of the signatories of the memorandum and the number of shares subscribed for by them.
2. The number and the classes of shares, if any and the nature and extent of the interests of the holders in the property and profits of the company.
3. The number of shares, if any fixed by the articles as the qualification shares of a director and any provision in the articles as to the remuneration of the directors.
4. The names, occupations and addresses of the directors, managing director or manager.
5. Where shares are offered to the public for subscription particulars as to the minimum amount which must be raised by the issue of the shares.
6. the time of the opening of the subscription list.
7. The amount payable on application and on allotment of each share.
8. The substance of any contract or arrangement or proposed contract or arrangement.
9. The amount paid or payable by way of premium for each shares which had been issued within two years proceeding the date of the prospectus
10. The essential amount of preliminary expenses.

11. The names and address of the auditors, if any, of the company

12. The right of voting at meeting of the company and the restrictions, if any and

13. A reasonable time and place at which copies of all balance sheets and profit and loss accounts may be inspected.

10.25. REPORTS TO BE SET-OUT IN PART II:

1. A report of the auditors as to the profits of the company and rates of divided paid during the last five financial year.

2. A report by the named accountants as to the profit of any business to be acquired for the same period.

The prospectus issued by or an behalf of a company must be dated and signed by every person named therein as a directors and filed with the Registrar on or before the date of its publication. The copy filed with the Registrar must be accompanied by the consent in writing of the person, if any, named therein as the auditor, legal adviser, solicitor, banker of the company, to act in that capacity.

10.26. MIS-STATEMENT IN PROSPECTUS AND THEIR EFFECTS:

A prospectus is requires to give as full accurate and fair picture of the state and prospectus of the company to the persons who purchase shares. Because, a contract made with the company to purchase share in an uberrima fiedi (utmost goodfaith) contract. Hence there must be full frank and honest disclosure of all materials facts pertaining to the company. The intending purchasers of shares are entitled to know true and correct disclosers of all the facts regarding the company in the prospectus, the person who purchased shares can rescind the contract and claim damages.

Section 65 of the Companies act, envisages two kinds of untrue statement which may be included in a prospectus viz

a) The commission to state a material fact which mislead the investor

b) The inclusion of a statement which is misleading

10.27. EFFECTS OF MIS-STATEMENT

If the prospectus contains a mis-statement or omits to disclose a material fact, the following persons are liable :

a) Company Director of the company of the time of the issue of the prospectus

b) Directors of the Company of the time of the issue of the prospectus

c) Persons who have been named in the prospectus either as directors or who have agreed to became directors.

d) Promoters of the Company, and

e) Persons who have authorised the issue of prospectus

Liability of Company, Director, Promoters etc or Remedies for misrepresentation.

10.28. LIABILITY OF COMPANY

If the prospectus contains a mis-statement or omits to disclose a material fact, the person ho has purchased shares on the shares on the basis of the mis-statement has the following two rights against the company.

A) He can rescind the contract

The person who has purchased the shares may apply to the court for the recision of the contract. Subsequent to the order of court, his name will be removed from the Registrar of members and he will get back the money with interest which he paid to the company.

B) He can claim damages

The person who has purchased the shares on the basis of misstatement, can take action against the company to recover damages. But before taking any action he must surrender the shares and claim damages against the company.

10.29. LIABILITY OF DIRECTORS, PROMOTERS, ETC.

The person, such as directions, promoters etc. who are responsible for the issue of prospectus may incurliability in respect of untrue statement in three ways.

1. Civil liability
2. Criminal liability and
3. Liab... under the General Law

.. **Civil Liability**

Section 62 of the Companies Act provides that the directors, promoters etc of the company are liable to pay compensation to every person, who substained any loss by reason of any untrue statement contained in the prospectus.

2. Measures of compensation

Compensation will be forced on the of general law contained in section 73 of the Contract Act. The measures of compensation will be the loss actually by reason of false statement in the prospectus i.e. the different between what the shareholders paid for shares and what they were wroth when they were allotted to him.

10.29.2. Criminal liability (Section 63) : Section 63 provides for criminal liability for misstatement in a prospectus. It lays down that every person who has authorised to the issue of prospectus is liable to punishment with imprisonment which may be extended upto two years or with a fine up to Rs 5,000 or with both.

10.29.3. Liability under the General Law (Common Law) : Where there is mis-statement of a material fact, the persons responsible for prospectus may become liable for damages in an action for deceit (to cheat) which is remedy available in tort (civil wrongs) under the general law. Thus under the general law the shareholder can take action to recover damages on the ground that he was actually deceived or cheated by giving mis-statement in the prospectus.

10.30. UNDERWRITING

The most import method by which a company can sell its shares an debentures it means of underwriting. Underwriters take upon themselves tl responsibility of seeing to it that the shares or documents offered to the public w be taken up. If some shares or debentures remain unsubscribe, the company ne not worry about their sale because underwriters will buy them. For this service underwriters are entitled to a commission not exceeding 5 percent of the issue p of shares and 2.5% of the issue price of debentures.

Definition :

Underwriting may be defined as "an agreement entered into before the shares are brought, before the public that in the event of the public not taking up the whole of them the number mentioned in the agreement, the underwriter, will for an agreed commission take an allotment of such part of such part of the shares as the public has not applied for".

10.31. IMPORTANCE OF UNDERWRITING

The importance of underwriting can be easily appreciated. A company needs a certain minimum amount of money in order to carry on its work. The underwriter ensures that this sum is made available. A new company will find it advantageous to make use of the services of underwriters because, other wise it may find its hopes of starting a business lashed to the ground for want of adequate response from the public. As a result of an agreement with underwriters the company need not wait till the shares have been actually subscribed before entering into contracts for the purchase of fixed assets. The company can go ahead with its plans with confidence, without losing its precious time or business opportunities. It means that the company need not worry about the insufficiency of funds. This is a safeguarded against possible under – subscription.

The company whose issue is underwritten get the benefit of expert advice. A reputed underwriter would not enter into a contract unless the scheme put forward by the company concerned is found to be sound. Generally changes are suggested by the underwriters to enable the company to avoid some pitfalls. The fact that a reputed firm becomes the company to raise its fund requirement. Underwriters maintain working arrangement with other brokers throughout the country and as such they are able to tap the financial resources not only of one particular area but of many others areas as well. Underwriting thus promotes geographical dispersion of the shares of debentures issues by the company.

Underwriter renders useful service to the prospective buyers of securities. An underwriter would rarely underwrite an issue without satisfying himself about is soundness. An investor therefore, runs much less risk when he buys share or debentures which has been underwritten.

Check Your Progresse

1. Who is a promoters?
2. What are the various types of promoters?
3. What are the contents of Memorandum of Association?
4. Explain the scope of object clause
5. How change of company's name could be offered?
6. Explain the scope of doctrine of ultra vires
7. Discus the scope of doctrine of indoor management
8. Define prospectus and stack the contents of prospectus
9. What are the effects of misstatement in prospectus
10. Discuss the civil liability and criminality for misstatement in prospectus

10.32 SUMMARY

The various stages in the formation of a company and the role of promoters are well explained in this unit. The different documents like Memorandum of Association and Articles of Association which have to be filed with the Registrar of companies and its contents difference between them have been discussed. In order to raise the capital a public company offers shares to general public by issuing prospectus to subscribe for shares. The contents of prospectus and the liability promoters and directors for any mis-statement have been elaborately analysed in this unit. Having studied this, we hope now you would have understood all these concepts thoroughly.

10.33. KEY WORDS

Incorporation	-	formed into a legal corporation
Investigation	-	a systematic inquiry
Debentures	-	a certificate issued by a company acknowledging that it has borrowed money
indispensable	-	absolutely necessary
un scrupulous	-	dishonour or unfair
tombstones	-	stone standing or laid over a grave
in lieu of	-	instead of

10.34. ANSWER TO CHECK YOUR PROGRESS

1. Refer to 10.5
2. Refer to 10.5.4
3. Refer to 10.8
4. Refer to 10.8.2
5. Refer to 10.9
6. Refer to 10.10
7. Refer to 10.19
8. Refer to 10.22
9. Refer to 10.26 and 10.27
10. Refer to 10.29

10.35. MODEL QUESTIONS

1. What are the essential characteristic of a company? What are the different stages in the formation of a company?
2. What is a private company? What are privileges?
3. Explain the documents to be filled and the procedure to be followed for h registration of a public company under the companies Act.
4. What is Memorandum Association? How can it be altered?
5. What are the main points of distinction between Memorandum and Articles. State their legal effects.
6. Explain the importance of prospectus. What are the effects of mis-statements in prospects?
7. Write a note on – under writing and its importance.

BUSINESS LAW – II

Time : Three hours

Maximum : 100 marks

PART – A – (5 x 15 = 75)

Answer any FIVE Questions

Each Question carries 15 marks

1. What are the rights and liabilities of the surety?
2. Briefly explain the rights and duties of a bailee.
3. What is expost fact agency? What are the essentials of a valid ratification?
4. What are the implied conditions and warranties in a contract of sale?
5. What are the rights duties of buyer and seller?
6. Distinguish between partnership and Hindu Joint family business.
7. What is presentment for payment and presentment for acceptance?

PART – B – (5 x 5 = 25)

Answer any FIVE Questions

Each Question carries 5 marks

a. What are the differences between contract of indemnity and contract of guarantee?

b. What are the rights of surety?

c. Explain why surety is considered to be favoured debtor?

d. When surety is discharged from liability?

e. What are the differences between partnership and a company?

f. What are the differences between partnership and co-ownership.

g. Write a notes on partnership at will, partnership by holding out.

h. Write a note on – under writing and its importance.