

## **BUSINESS LAW (18MBA 108)**

### **Course Objectives:**

- 1. To know basic of rules that keeps social machinery run smoothly by establishing order in the community**
- 2. To spread awareness on “ignorance of law is no excuse”.**
- 3. To aware on adhere to rule of Law.**

### **Module – I**

**Law of Contract :** Contract Act: Indian Contract Act, 1872, Agreement, Contract, Essentials of Contract (Offer & Acceptance, Consideration, Capacity of Parties, Free Consent, and Legality of Object), Performance and Discharge of Contract, Remedies for breach of contract, Quasi-Contract and Contingent Contract.

### **Module – II**

**Special Contract:** Contract of Agency: Mode of creating & revocation of Agency, Rights and Duties of Agents and Principals. Contract of Bailment (Rights and duties of Bailer and Bailee). Sales of Goods Act: Sale and agreement to sell, Condition and Warranty, Transfer of properties, Finder of Goods, Performance of Contract of sale, Unpaid seller and his rights. Consumer Protection Act: Consumers, Rights of Consumers, Redressal Machinery under the Act, Procedure of Complaint, Relief available to the consumers, Procedure of filing appeal, Powers of Redressal agencies

### **Module – III**

**Company Laws:** Indian Companies Act 2013, Salient features and Classes of Company. Lifting of corporate veil, Procedure of Incorporation and Certificate of commencement of business, Memorandum and Articles of Association, Doctrine of ultra vires and Indoor Management, Management of Company: Qualification, Appointment of Directors, Company Meetings, Resolutions, Winding-up of Companies and their modes.

**BUSINESS LAW (BL)**

MNG-108

**MODULE - I**

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**The Indian Contract Act, 1872**

**What is Law?**

Law means a 'set of rules' which regulate our relation and behaviors with other individuals and with state. In the words of Salmond, 'law is the body of principles recognized and by state in the administration of justice

**Why Should One Know Law?**

One should know the law to which he is subject because ignorance of law is no excuse.

**Kinds of Indian law:**

There are thousands of law in India and it may not be possible to strictly classify them. However, Indian law will be broadly be classified according to their purpose and objectives and then sub classified in to main categories.

For legal redressal, Indian law may be classified in to two main categories;

**1. Procedural law;** It is the guide which helps to know the process to present a matter

There are two main statutes in India which regulate the procedures followed in court in court of law for;

A. Code of criminal procedure-1973, for regulating procedure in criminal case.

B. Code of civil procedure -1908 for Commercial law that includes Indian contract-1872, sale goods Act-1930 etc. regulating the procedure in civil case.

**2. Substantive law-** There are thousands of substantive law in India. These law defines rights, liability, obligation of citizen and non-citizens.

Various substantive laws according to their nature and objectives are:-

- A. Commercial law that includes Indian contract Act-1872, Sale of goods Act-1930 etc.
- B. Penal law- these law create, define and provide punishment for various offences according to Indian penal code-1860.
- C. property law.
- D. Taxation law.
- E. Constitutional law.
- F. Cyber law.
- G. Intellectual property law.
- H. Personal law.
- I. Environmental law.

The Indian Contract Act, 1872 codifies the legal principles that govern such 'contracts'. The Act basically identifies the ingredients of a legally enforceable valid

### What is law of contract?

The law of contract is most important and basic part of business/mercantile law. It is the foundation on which superstructure of modern business is built. It is not only merchant and traders but every person who lives in organized society, consciously or unconsciously enters in to contract from sunset to sunrise. When a person buys mobile or hires a taxi or go to cyber café or takes a credit card or he does booking for a orchestra for marriage party, he enters in to and performs contracts though he may be unaware of this fact. Such contracts create legal relations giving rise to certain rights and obligations.

Law of Contract in addition deals with certain special type of contractual relationships like;

1. Indemnity,
  2. Guarantee,
  3. Bailment,
  4. Pledge,
  5. Quasi contracts,
  6. Contingent contracts.
- ✓ It is said on the back drop of Indian contract Act -1872 that, all contracts are agreements but all agreements are not contracts.
  - ✓ The above observation would raise a question in our minds as to what is the exact meaning of the words 'agreements' and 'contracts' and 'promise'.
  - ✓ **Contract;** According to Sec 2(h) of Indian contract Act' 1872, 'an agreement enforceable by law is contract'.
  - ✓ **Salmond defines;** contract is an agreement creating and defining obligations between the parties.
  - ✓ **Agreement;** An agreement is defined in sec 2 (e) as "every promise or every set of promises forming the consideration for each other".
  - Promise ;** A promise is defined in sec 2 ( b) as, ' proposal when accepted becomes a promise.

### Agreement

**Agreement:** Agreement is defined in sec 2 (e) as "every promise or every set of promises forming the consideration for each other.

- a) An agreement involves proposal or offer by one party and acceptance of the same by other party.
- b) It requires existence of two or more persons because a person can not enter in to an agreement with himself.
- c) It implies that the parties have common intention about the subject matter of there agreement.
- d) Two parties should be thinking of the same thing in same sense at the same time. Thus agreement is outcome of two consenting mind.

**Agreement are of two types;**

1. Un-enforceable agreements.
2. Enforceable agreements.

| Agreement not enforceable by law                   | Agreement enforceable by law                     |
|--|--|
| Any essential of a valid contract is not available | All essentials of a valid contract are available |

**1-Un-enforceable agreement:** All those agreements are said to be un-enforceable in which an aggrieved party cannot go to a law court and that is left at the mercy of the parties only.

**2-Enforceable agreements:** parties only. It is simply a gentleman's promise which may or may not fulfilled by promiser. All these agreements remain only an agreements between parties and they never become a contract in the eyes of law, because they are merely social or domestic arrangements.

All those agreements are said to be enforceable in which an aggrieved party has a right to approach law court to get the agreement enforced and other party is held liable either to perform the agreement or face the consequences for breach of that agreements. All these agreements which are enforceable at law are "CONTRACT".

**Enforceable at law:** An agreement to become a contract must give rise to a legal obligation. The common acceptance and communication between the parties must create legal relations and not merely the relation which are purely social or domestic in nature.

Example; Mr Rakesh invites Mr Bijoy to a dinner. Mr Bijoy accepts the invitation. It is purely asocial agreement. If Bijoy fails to arrive at dinner at dinner time due to important work, can not sue Bijoy for not fulfilling the promise, the reason being, there was no intention between two parties to create any legal obligation.

### **Contract**

According to Sec 2(h) of Indian contract Act' 1872, 'an agreement enforceable by law is contract". Salmond defines; contract is an agreement creating and defining obligations between the parties.

| <b>Basis</b>                | <b>Contract Sec. 2(h)</b>   | <b>Agreement Sec. 2(e)</b>   |
|-----------------------------|---|--|
| <b>1. Section :</b>         | Sec. 2(h)   | Sec. 2(e)  |
| <b>2. Definition:</b>       | A contract is an agreement enforceable by law.                                | Every promise or every set of promises forming consideration for each other is an agreements |
| <b>3. Enforceability:</b>   | Every contract is enforceable A contract includes an agreement.               | Every promise is not enforceable..   |
| <b>4. Interrelationship</b> | A contract includes an agreement  | An agreement does not include a contract   |
| <b>5.Scope:</b>             | The scope of a contract is limited, as it includes only commercial agreements | Its scope is relatively wide it includes both social &commercial agreement                   |

### **Types of Contract**

Contract may be classified according to their (1) validity (2) Formation (3) Performance

#### **Classification according to validity**

- Void contract:** - A contract not enforceable by law is void.  
Example- Mr. X agrees to write a book with a publisher. After few days, X dies in an accident. Here the contract becomes void due to the impossibility of performance of the contract.
- Voidable contract 2(i):-** An agreement is a voidable contract if it is enforceable by Law at the option of one or more of the parties there to (i.e. the aggrieved party), and it is not enforceable by option of the other or others.  
Example-A promises to sell his car to B for Rs 20000.His consent is obtained by use of force. The contract is voidable at the option of A. He may avoid the contract or elect to be bound by it.

c) **Illegal Contract:** Illegal contract are those that are forbidden by law. All illegal contracts are hence void also. Because of the illegality of their nature they cannot be enforced by any court of law. In fact even

associated contracts cannot

**Express contract:** - A contract made by word spoken or written. According to section 9, in so far as the proposal or acceptance of any promise is made in words, promise is said to be express.

Example: A says to B 'will you purchase my bike for Rs.20, 000?' B says to A "Yes" without knowing that the bike was purchased by A from bike lifter.

| Difference between Void and illegal Agreement |   |                          |
|---|---|--------------------------|
| Matter  | Void Agreement                          | Illegal Agreement        |
| What  | Void agreement is not prohibited by law | It is prohibited by law. |
| Effect on collateral Transaction              | Enforced                                | Not Enforced             |
| Punishment                                    | No                                      | Yes                      |
| void ab initio                                | May not be void ab initio               | Always void ab initio    |

| Matter                   | Void contract   | Voidable contract  |
|--------------------------|---|--|
| Definition               | It means contract which ceases to be enforceable by law           | It is a contract which one of the parties may affirm or reject at his option.            |
| Rights or remedy         | No legal remedy.  | Aggrieved party has remedy to cancel   |
| Nature                   | Valid when made but subsequently becomes unenforceable.           | It remains voidable until cancelled by party   |
| Performance of Contract. | Party can't demand performance of contract                        | If aggrieved party doesn't cancel it Within reasonable time performance can be demanded. |
| compensation             | There does not arise compensation for non-performance of contract | Person is entitled to compensation for loss or damages for non performance Of contract.  |

### Classification according to formation

e) **Express contract:** - A contract made by word spoken or written. According to section 9, in so far as the proposal or acceptance of any promise is made in words, promise is said to be express.

Example: A says to B 'will you purchase my bike for Rs.20, 000?' B says to A "Yes" without knowing that the bike was purchased by A from bike lifter.

**Implied contract:-** An implied contract is one which is inferred from the act or conduct of parties or course of dealing between them. It not the result of any express promise or promise by the parties but of their particular acts.

Example: A stops a taxi by waving his hand and takes his seat. There is an implied contract that A will pay the prescribed fare.

F) **Quasi contract** - Quasi Contracts are contracts which are created –

- Neither by word spoken
- Nor written

- Nor by the conduct of the parties.

But these are created by the law. In fact, these contracts depend on the principle that nobody will be allowed to become rich at the expense of other

Example:

If Mr. A leaves his goods at Mr. B's shop by mistake, then it is for Mr. B to return the goods or to compensate the price.

- g) **e – Contract:** An e – contract is one, which is entered into between two parties via the internet.

### **Classification according to performance**

- h) **Unenforceable contract:** - where a contract is good in substance but because of some technical defect, one or both the parties cannot sue upon but is described as unenforceable contract. Example: Writing registration or stamping.  
Example: An agreement which is required to be stamped will be unenforceable if the same at all or is is not stamped under stamped.  
**Executed contract:** - A contract in which both the parties have fulfilled their obligations under the contract.  
Example: A contracts to buy a car from B by paying cash, B instantly delivers his car receiving payment from A.
- i) **Executory contract:** - A contract in which both the parties have still to fulfill their obligations.  
Example: D agrees to buy V's cycle by promising to pay cash on 15th July. V agrees to deliver the cycle on 20th July.
- j) **Partly executed and partly executory:** - A contract in which one of the parties has fulfilled his obligation but the other party is yet to fulfill his obligation.

Example : A sells his car to B and A has delivered the car but B is yet to pay the price. For A it is executed contract whereas it is executory contract on the part of B since the price is yet to be paid

### **Classification according to liability**

- k) **Bilateral contract:** - contract in which both the parties commit to perform their respective promises is called a bilateral contract.  
Example : A offers to sell his fiat car to B for Rs.1,00,000 on acceptance of A's offer by B, there is a promise by A to sell the car and there is a promise by B to purchase the car there are two promises.
- l) **Unilateral contract:** - A unilateral contract is a one-sided contract in which only one party has to perform his promise or obligation party has to perform his promise or obligation to do or forbear.

Example :- A wants to get his room painted. He offers Rs.500 to B for this purpose B says to A " if I have spare time on next Sunday I will paint your room". There is a promise by A to pay Rs 500 to B. If B is able to spare time to paint A's room. However there is no promise by B to paint the house. There is only one promise.

- M) **Contract of Record:** A contract of record derives its binding force from the authority of court. The authority of court is invariably through judgment of a court or by way of recognizance. The judgment of a court is technically not a contract as it is not based on the agreement between parties. However the judgment is binding on all the persons who are litigants. The judgment creates certain rights on certain persons and obligation on certain other persons. A recognizance, on the other hand is a written acknowledgement of a debt due to the state generally in the context of criminal proceedings.
- (N) **Contract under Seal:** A contract under seal is one which derives its binding force from its form alone. It

is in writing, duly signed and sealed and delivered to parties. It is also referred to as a deed or a specialty contract.

- (O) **Simple Contract:** All contract which are not made under seal are simple contract. They may be made in writing or word of mouth. All simple contract must be supported by consideration. These contract are also known as Parol contract.

### **Essential Elements of Valid Contract**

**1. Offer and Acceptance:** In the first place, there must be an offer and the said offer must have been accepted. Such offer and acceptance should create legal obligations between parties. This should result in a moral duty on the person who promises (called promisor) or offers to do something. Similarly this should also give a right to other party (called promisee) to claim its fulfillment. Such duties and rights should be legal and not merely moral.

Case law:

A husband promised to pay Rs5000 household allowance every month to his wife,. When husband failed to perform this promise, she brought an action to enforce it. As it is an agreement of domestic nature, it was held that it does not contemplate to create any legal obligation.

**2. Free Consent:** The second element is the 'consent' of the parties. 'Consent' means 'knowledge and approval' of the parties concerned. This can also be understood as identity of minds in understanding the term viz consensus ad idem. Further such consent must be free. Consent would be considered as free consent if it is not vitiated by coercion, undue influence, fraud, misrepresentation or mistake. Wherever the consent of any party is not free, the contract is voidable at the option of that party.

Illustration:- A threatened to shoot B if he (B) does not lend him ` 2000 and B agreed to it. Here the agreement is entered into under coercion and hence voidable at the option of B.

**3. Capacity of the parties:** The third element is the capacity of the parties to make a valid contract. Capacity or incapacity of a person could be decided only after reckoning various factors. Section 11 of the Indian Contract Act, 1872 elaborates on the issue by providing that a person who- should be considered as not competent to enter into any contract. Therefore a person is not eligible to enter in to valid contract ;

- (a) who has not attained the age of majority,
- (b) who is of unsound mind and
- (c) who is disqualified from entering into a contract by any law to which he is subject, be considered as not competent to enter into any contract. Therefore law prohibits (a) Minors (b) persons of unsound mind [excluding the Lucid intervals] and (c should) person who are otherwise disqualified like an alien enemy, insolvents, convicts etc from entering into any contract.

**4. Consideration:** The fourth element is presence of a lawful 'consideration'. 'Consideration' would generally mean 'compensation' for doing or omitting to do an act or deed. It is also referred to as 'quid pro quo' viz 'something in return for another thing'. Such a consideration should be a lawful consideration.

Example:- A agrees to sell his books to B for 100, B's promise to pay 100 is the consideration for A's promise to sell his books. A's promise to sell the books is the consideration for B's.

**5. Lawful object:** The last element to clinch a contract is that the agreement entered into for this purpose must not be which the law declares to be either illegal or void. An illegal agreement is an agreement expressly or impliedly prohibited by law. A void agreement is one without any legal effects.

For Example: Threat to commit murder or making/publishing defamatory are statements or entering into agreements which are opposed to public policy are illegal in nature. Similarly any agreement enforceable at the option of a party is voidable contract. It would remain valid until it is rescinded by the person who has the option to treat it as voidable. The right to treat it as voidable does not invalidate the contract until such right is exercised. All contracts caused by coercion, undue influence, fraud, misrepresentation are voidable. Generally, a contract caused by mistake is void.



## OFFER AND ACCEPTANCE

### OFFER

It has been explained in the previous paragraphs that a proposal or a promise backed by legal consideration is an agreement and such an agreement, if legally enforceable, becomes a contract. It would therefore be clear that the starting point of this chain is a proposal or a promise. It is proposed now to discuss as to what is a proposal/offer, what are the types of offer, etc.

The word 'proposal' and the word 'offer' mean one and the same thing and therefore are used interchangeably.

In terms of Section 2(a) of the *contract* Act-1872 "a person is said to make a proposal when he signifies to another his willingness to do or abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence".

It must be appreciated that 'doing an act' and 'not doing an act' both have the same effect in the eyes of the law, though one is a positive act and the other is a negative act.

Hence there are two important ingredients to an offer;

**Firstly**, it must be expressions of willingness to do or to abstain from doing an act.

**Secondly**, the willingness must be expressed with a view to obtain the assent of the other party to whom the offer is made.

This can be illustrated as follows:

- (a) Where "A" tells "B" that he desires to marry 'B' by the end of 2006, there is no offer made unless, he also asks "will you marry me?", conveying his willingness and tries to obtain the assent of 'B' in the same breadth.
- (b) Where "A" offers to sell his car to "B" it conveys his willingness to do an act. Through this offer not only willingness is being conveyed but also an intention to obtain the assent can be seen.

### Classification of offer:

Offer can be classified as general offer, special/specific offer, cross offer, counter offer, standing/open/continuing offer. Now let us examine each one of them.

- (a) **General offer:** It is an offer made to public at large with or without any time limit, Until the general offer is retracted or withdrawn, it can be accepted by anyone at any time as it is a continuing offer. Example-A issues a public advertisement to the effect that he will give Rs 1000 to anyone who brings back his missing dog amounts to general offer.
- (b) **Special/specific offer:** Where an offer is made to a particular and specified person, it is a specific offer. Only that person can accept such specific offer, as it is special and exclusive to him.
- (c) **Cross offer:** Two offers similar in respect, made by two parties to each other, in ignorance of each other's offer are termed as cross offer.  
For example, if A makes a proposal to B to sell some goods at a specified price and B, without knowing proposal of A, makes a proposal to purchase the same goods at the price specified in the proposal of A, it is not an acceptance, as B was not aware of proposal made by A. It is only cross proposal (cross offer). And when two persons make offer to each other, it can not be treated as mutual acceptance. There is no binding contract in such a case [Tin v. Hoffmen & Co. 1873]
- (d) **Counter offer:** Upon receipt of an offer from an offeror, if the offeree instead of accepting it straightway imposes conditions which have the effect of modifying or varying the offer, he is said to have made a counter offer. Counter offers amounts to rejection of original offer.
- (e) **Standing or continuing or open offer:** An offer which is made to public at large and if it is kept open for public acceptance for a certain period of time, it is known as standing or continuing or open offer.



Tenders that are invited for supply of materials and goods are classic examples of standing offer.  
Rules relating to offer:

**Following are the rules for a valid and legal offer:**

- (a) **The 'offer' must be with intention to create a legal relationship.** Hence if it is accepted, it must result in a valid contract. An invitation to join a friend for dinner is a social activity. This does not create a legal relationship or right or obligation.
- (b) **The offer must be certain and definite.** It must not be vague. If the terms are vague, it is not capable of being accepted as the vagueness would not create any contractual relationship. For example, where 'A' offers to sell 100 litres of oil, without indicating what kind of oil would be sold, it is a vague offer and hence cannot create any contractual relationship. If however there is a mechanism to end the vagueness, the offer can be treated as valid. For example, in the above example if 'A' does not deal in any oil but only in gingilee oil and this is known to every one, the offer cannot be treated as vague offer. This is for the reason that the trade in which 'A' is, is a clear indicator providing a mechanism to understand the terms of offer.
- (c) **The offer must be express or implied.**
- (d) **The offer must be distinguished from an invitation to offer-**An offer must be distinguished from invitation to offer. In case to invitation to offer the aim is only to circulate information of readiness to negotiate business with anybody who on such information comes to enter in to contract. So, a price list, display goods in shelves of show room are attempt to induce offer and not an offer itself.
- (e) **The offer must be either specific or general.**
- (f) **The offer must be communicated to the person to whom it is made.** Otherwise the offeree cannot accept the offer. He cannot accept the offer because he is not aware of the existence of the offer. Such a situation does not create any legal obligation or right on any one.
- (g) **The offer must be made with a view to obtaining the consent of the offeree.**
- (h) **An offer can be conditional** but there should be no term in the offer that non-compliance would amount to acceptance. Thus the offeror cannot say that if non-acceptance is not communicated by a certain time the offer would be treated as accepted.  
Example;- T, who could not read, took an excursion ticket from railway on the front of the ticket was printed 'for condition see back'. One of the condition was that the railway company will not be liable for personal injuries to passenger. T was injured by a railway accident. Held, T was bound by the condition the condition and could not recover any damage

## **LAPSE OF AN OFFER :**

An offer should be accepted before it lapses (i.e. comes to an end). An offer may come to an end in any of the following ways stated in Section 6 of the Indian Contract Act:

1. **By communication of notice of revocation:** An offer may come to an end by communication of notice of revocation by the offeror. It may be noted that an offer can be revoked only before its acceptance is complete for the offeror. In other words, an offeror can revoke his offer at any time before he becomes bound by it. Thus, the communication of revocation of offer should reach the offeree before the acceptance is communicated.
2. **By lapse of time;** where time is fixed for the acceptance of the offer, and it is not acceptance within the fixed time, the offer comes to an end automatically on the expiry of fixed time. Where no time for acceptance is prescribed, the offer has to be accepted within reasonable time. The offer lapses if it is not accepted within that time. The term 'reasonable time' will depend upon the facts and circumstances of each case.
3. **By failure to accept condition precedent:** Where, the offer requires that some condition must, be fulfilled before the acceptance of the offer, the offer lapses, if it is accepted without fulfilling the condition.
4. **By the death or insanity of the offeror:** Where, the offeror dies or becomes, insane, the offer comes to an end if the fact of his death or insanity comes to the knowledge of the acceptor before he makes his acceptance. But if the offer is accepted in ignorance of the fact of death or insanity of the offeror,

the acceptance is valid.

This will result in a valid contract, and legal representatives of the deceased offeror shall be bound by the contract. On the death of offeree before acceptance, the offer also comes to an end by operation of law.

5. **By counter offer by the offeree:** Where, a counter – offer is made by the offeree, and then the original offer automatically comes to an end, as the counter offer amounts to rejection of the original offer.
6. **By not accepting the offer,** according to the prescribed or usual mode: Where some manner of acceptance is prescribed in the offer, the offeror can revoke the offer if it is not accepted according to the prescribed manner.
7. **By rejection of offer by the offeree:** Where, the offeree rejects the offer, the offer comes to an end. Once the offeree rejects the offer, he cannot revive the offer by subsequently attempting to accept it. The rejection of offer may be express or implied.
8. **By change in law:** Sometimes, there is a change in law which makes the offer illegal or incapable of performance. In such cases also, the offer comes to an end.

## Acceptance

Meaning: In terms of Section 2(b) of the Act, “A proposal or offer is said to have been accepted when the person to whom the proposal is made signifies his assent to the proposal to do or not to do something”. In short, act of acceptance lies in signifying one’s assent to the proposal.

The significance of this is an offer by itself cannot create any legal relationship but it is the acceptance by the offeree which creates a legal relationship. Once an offer is accepted it becomes a promise and cannot be withdrawn or revoked. An offer remains an offer so long as it is not accepted, but becomes a contract as soon as it is accepted

## Rules governing acceptance

- (1)- **Acceptance must be absolute and unqualified:** As per section 7 of the Act, acceptance is valid only when it is absolute and unqualified and is also expressed in some usual and reasonable manner unless the proposal prescribes the manner in which it must be accepted. If the proposal prescribes the manner in which it must be accepted, then it must be accepted accordingly. The above view will be clear from the following example:  
‘A’ enquires from ‘B’, “Will you purchase my car for ` 2 lakhs?” If ‘B’ replies “I shall purchase your car for ` 2 lakhs, if you buy my motorcycle for ` 50000/-, here ‘B’ cannot be considered to have accepted the proposal. If on the other hand ‘B’ agrees to purchase the car from ‘A’ as per his proposal subject to availability of valid Registration Certificate / book for the car, then the acceptance is in place though the offer contained no mention of R.C. book. This is because expecting a valid title for the car is not a condition. Therefore the acceptance in this case is unconditional.
- (2) **The acceptance must be communicated:** To conclude a contract between the parties, the acceptance with varying or too deviant conditions is no acceptance. Such conditional acceptance is a counter proposal and has to be accepted by the proposer, if the original proposal has to be materialized in to a contract. Further when a proposal is accepted, the offeree must have the knowledge of the offer made to him. If he does not have the knowledge, there can be no acceptance. The acceptance must relate specifically to the offer made. Then only it can materialize into a contract. The above points will be clearer from the following examples,
  - (a) M offered to sell his land to N for Rs 280000. N replied purporting to accept the offer but enclosed a cheque for Rs 80000 only. He promised to pay the balance of Rs 200000 by monthly installments of Rs 50000 each. It was held that N could not enforce his acceptance because it conditional one. acceptance must be communicated in some perceptible form . Any conditional acceptance or acceptance
  - (b) A offers to sell his house to B for ` 1000/-. B replied that, “I can pay ` 800 for it. The offer of ‘A’ is

rejected by 'B' as the acceptance is not unqualified. B however changes his mind and is prepared to pay ` 1000/-. This is also treated as counter offer and it is up to A whether to accept it or not. [Union of India v. Bahulal AIR 1968 Bombay 294].

A mere variation in the language not involving any difference in substance would not make the acceptance ineffective. [Heyworth vs. Knight [1864] 144 ER 120].

- (3) **Acceptance must be in the prescribed mode:** Where the proposal prescribes the mode of acceptance, it must be accepted in that manner. Where the proposal does not prescribe the manner, then it must be accepted in a reasonable manner. If the proposer does not insist on the proposal being accepted in the manner in which it has to be accepted, after it is accepted in any other manner not originally prescribed, the proposer is presumed to have consented to the acceptance. Sometimes the acceptor may agree to a proposal but may insist on a formal agreement, in which case until a formal agreement is drawn up there is no complete acceptance.
- (4) **The acceptance must be given within a reasonable time and before the offer lapses.**
- (5) **Mere silence is not acceptance.** The acceptor should expressly accept the offer. Acceptance can be implied also. Acceptance must be given only by that person to whom it is made, that too only after knowing about the offer made to him.  
**Example** A offers to B to buy his house for Rs.5 lakhs and writes "If I hear no more about it within a week, I shall presume the house is mine for Rs.5 lakhs. "B does not respond. Here, no contract is concluded between A and B.

**However, following are the two exceptions to the above rule.**

It means silence amounts as acceptance of offer.

- Where offeree agrees that non – refusal by him within specified time shall amount to acceptance of offer.
  - When there is custom or usage of trade which specified that silence shall amount to acceptance.
- (6) **Acceptance by conduct:** As already elaborated above, acceptance has to be signified either in writing or by word of mouth or by performance of some act. The last of the method, namely 'by some act' has to be understood as acceptance by conduct. In a case like this where a person performs the act intended by the proposer as the consideration for the promise offered by him, the performance of the act constitutes acceptance. In other words, there is an acceptance by conduct.

For example, where a tradesman receives an order from a customer, and the order is executed accordingly by the trader, there is an "acceptance by conduct" of the offer made by the customer. The trader's subsequent act signifies acceptance.

Section 8 of the Act very clearly in this regard lays down that " the performance of the condition(s) of a proposal or the acceptance of any consideration of a reciprocal promise which may be offered with a proposal constitutes an acceptance of the proposal.

### **In case of acceptance by post**

#### **General Rules as to Communication of Acceptance**

Where the acceptance is given by post, the communication of acceptance is complete as against the proposer when the letter of acceptance is posted.

Thus, mere posting of letter of acceptance is sufficient to conclude a contract. However, the letter must be properly addressed and stamped.

2. **Delayed or no delivery of letter** Where the letter of acceptance is posted by the acceptor but it never reaches the offeror, or it is delayed in transit, it will not affect the validity of acceptance. The offeror is bound by the acceptance.
3. **Acceptance by telephones telex or fax** If the communication of an acceptance is made by telephone, tele-printer, telex, fax machines, etc, it completes when the acceptance is received by the offeror. The contract is concluded as soon as the offeror receives not hears the acceptance.

4. **The place of Contract**

In case of acceptance by the post, the place where the letter is posted is the place of contract. Where the acceptance is given by instantaneous means of communication (telephone, fax, tele-printer, telex etc.), the contract is made at the place where the acceptance is received,

5. **The time of Contract** In case of acceptance by post, the time of posting the letter of acceptance to the time of contract. But in case of acceptance by instantaneous means of communication, the time of contract is the time when the offeror gets the communication, the time of contract is the time when offeror gets the communication of acceptance.

6. **Communication of acceptance in case of an agent.**

Where the offer has been made through an agent, the communication of acceptance is completed when the acceptance is given either by the agent or by the principal. In such a case, if the agent of offeror fails to convey the acceptance received from offeree, still the principal is bound by the acceptance.

7. **Acceptance on loudspeakers** - Acceptance given on loudspeaker is not a valid acceptance.

## Consideration

Consideration is a term used in sense of Quid Pro Quo i.e. Something in return.

Meaning: Sec 2(d) defines consideration as "When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or to abstain from doing something, such an act or abstinence or promise is called consideration for the promise.

it can be concluded that :

Consideration = Promise / Performance that parties exchange with each other.

Form of consideration= Some benefit, right or profit to one party / some detriment, loss, or forbearance to the other.

Whether gratuitous promise can be enforced?

The word "gratuitous" means 'free of cost' or 'without expecting any return'. It can therefore be inferred that a gratuitous promise will not result in an agreement in the absence of consideration. For instance a promise to subscribe to a charitable cause cannot be enforced.

### Rules of consideration

(i)**Consideration must move at the desire of the promisor:** Consideration must move at the desire of the promisor, either from the promisee or some other third party. But consideration cannot move at the desire of a third party. Where collector had passed an order that any one using the market constructed by the Zamindar, for the purpose of selling his goods should pay commission to the Zamindar, it was held that it was not a proper order as the desire to receive consideration had not emanated from the Zamindar but from a third party namely the collector [Durga Prasad Vs Baldev (1880) 3, All 221]

ii)**Consideration can flow either from the promisee or any other person:** The consideration for a contract can move either from the promisee or from any other person. This point is made clear even by the definition of the word "consideration", according to which at "the desire of the promisor, the promisee or any other person, doing something is consideration."

That the consideration can legitimately move from a third party is an accepted principle of law in India though not in England.

Example: 'A' by a deed of gift made over certain property to her daughter(D) with condition that her brother(B) should be paid annuity by D. On the same day, D executed a document agreeing to pay annuity accordingly but declined to pay after sometime. B sued D. It was contended on behalf of D, that there was no consideration from B and hence there was no valid contract. This plea was rejected on the ground that the consideration did flow from B's Sister(A) to 'D' and such consideration from third party is sufficient to enforce the promise of D to pay annuity to A's brother (B) [Chinnaya Vs Ramaya(1881) 4.mad.137]

Thus a stranger to a contract can sue upon a contract in India and also in England, where as stranger to a consideration can sue under Indian law though not under English law.

**iii) Executed and Executory consideration:** Where consideration consists of performance, it is called “executed” consideration. Where it consists only of a promise, it is executory.

For example where A pays ` 5000/- to ‘B’ requesting ‘B’ to deliver certain quantity of rice, to which B agrees, then here consideration for B is executed by ‘A’ as he has already paid ` 5000/- whereas ‘B’s promise is executory as he is yet to deliver the rice.

Insurance contracts are of the same type. When A pays a premium of ` 5000/- seeking insurance cover for the year, from the insurance company which the company promises in the event of fire, the consideration paid by A to the insurance company is executed but the promise of insurance company is executory or yet to be executed. A forbearance by the promisor should however be considered as an executed consideration provided the forbearance is sufficient at the time of contract.

**(iv) Past consideration:** The next issue is whether past consideration can be treated as consideration at all. This is because consideration is given and accepted along with a promise concurrently. However the Act recognizes past consideration as consideration when it uses the expression in Section 2(d) ‘has done or abstained from doing’. But in the event of services being rendered in the past at the request or desire of the promisor the subsequent promise is regarded as an admission that the past consideration was not gratuitous. The plaintiff rendered services to the defendant at his desire during his minority. He also continued to render the same services after the defendant attained majority. It was held to be good consideration for a subsequent express promise by the defendant to pay an annuity to the plaintiff but it was admitted that if the services had not been rendered at the desire of the defendant it would be hit by section 25 of the Act. [Sindia Vs Abraham (1985)Z. Bom 755]

**(v) Consideration may not be adequate:** Inadequacy of consideration is no ground for refusing performance of the promise, unless it is evidence of fraud. Inadequate consideration would not invalidate an agreement but such inadequate consideration could be taken into account by the court in deciding whether the consent of the promisor was freely given. consideration need not be material and may be even absent.

**Example:** A agreed to sell a watch worth Rs.500 for Rs.20, A’s consent to the agreement was freely given. The consideration, though inadequate. Will not affect the validity of the contract. However, the inadequacy of the consideration can be considered in order to know whether the consent of the promisor was free or not .

**(vi) consideration must be something which promisor is bound to do:** The performance of an act by a person what he is legally bound to perform, the same cannot be consideration for a contract. Hence, ‘A’ promise to pay money to a police officer to investigate in to crime is void as the officer is under duty to do so by law, for it is without consideration. Hence such a contract is void for want of consideration. Similarly, an agreement by a client to pay to his counsel, a certain sum over and above the fee, in the event of success of the case would be void, since it is without consideration.

**(vii) Consideration must not be unlawful, immoral, or opposed to public policy.**

There is a big difference between a third party to consideration and third party to a contract; while the first can sue, the second cannot sue. Thus a stranger / third Party to an Agreement lead to the doctrine of privity of contract. The doctrine says that only parties to a contract can enforce the contract. The parties stranger to a contract cannot sue and be sued. Example, a contract by the purchaser of a mortgaged property to pay off the mortgage cannot be enforced by the mortgagee who was not a party to the contract between vendor and vendee.

**However there are exceptions to the above principle. These are:**

**1-In the case of a trust,** the beneficiary can sue enforcing his right though he was not a party to the contract between the trustee and the settler.

In Khawja Mohammed Khan Vs Hussain Begum 371.A. 152, where, the father of the bridegroom promised to pay through a contract with the father of the bride, an allowance to the bride, if she married his son, the bride sued her father-in-law after marriage for the allowance which he did not pay as per the contract. It was held



by the Privy Council that though the bride was not a party to the contract between her father and father in law, she could enforce her claim in equity.

**2-In the case of family settlement**, if the terms of settlement are reduced in writing, members of the family who were not a party to the settlement can (also) enforce their claim.

**3.In the case of certain marriage contracts** a female member can enforce a provision for marriage expense based on a petition made by the Hindu undivided family.

**4.Where there is an assignment of a contract**, the assignee can enforce the contract for various benefits that would accrue to him on account of the assignment

**5.In case of part performance of a contractual obligations** or where there is acknowledgment of liability on account of estoppel, a third party can sue for benefits. Where for example 'A' gives ` 25000/- to 'B' to be given to 'C' and 'B' informs 'C' that B is holding it on behalf of C, but subsequently refuses to pay 'C' then 'C' can sue and enforce his claim.

**6.Where a piece of land which is sold to buyer with certain covenants** relating to land and the buyer is kept on notice of the covenants with certain duties, there the successors to the seller can enforce these covenants.

#### **"No consideration. No contract".**

We have all along learnt that an agreement without consideration is void. Not only that, even inadequate consideration would render the enforceability of the contract quite difficult, as the free consent of the parties would become suspect. The Act however contains certain exceptions to this important rule. These are:

(i)**On account of natural love and affection**: A written and a registered agreement made between parties out of natural love and affection does not require consideration. Such an agreement is enforceable even without consideration. It is important that parties should be of near relation like husband and wife to get this exemption (Rajlukhee Devee Vs Bhootnath).

**Example**:-An elder brother, on account of natural love and affection, promised to pay the debts of his younger brother. Agreement was put to writing and registered. Held, agreement was valid.

(ii)**Compensation paid for past voluntary services**: A promise to compensate wholly or in part for past voluntary services rendered by someone to promisor does not require consideration for being enforced. However the past services must have been rendered voluntarily to the promisor. Further the promisor must have been in existence at that time and he must have intended to compensate.

(iii)**Promise to pay debts barred by limitation**: Where there is a promise in writing to pay a debt, which was barred by limitation, is valid without consideration.

**Example** : A owes B Rs.10,000 but the debt is barred by Limitation Act. A signs a written promise to pay B Rs.8,000 on account of debt. This is a valid contract.

(iv)**Creation of Agency**: In term of section 185 of the Act, no consideration is necessary to create an agency

(v)**In case of completed gifts**, no consideration is necessary. This is clear from the Explanation (1) to section 25 of the Act which provides that "nothing in this Section shall affect the validity as between donor and donee of any gift actually made.

### **Free consent**

We have earlier seen that in terms of section 10 of the Indian Contract Act,1872 a legally enforceable agreement should be made with the free consent of the parties who are competent to contract for a lawful consideration with a lawful object. .

In terms of section 13 of the Act, two or more persons are said to have consented when they agree upon the same thing in the same manner. This is referred to as identity of minds or "consensus-ad-idem".

Absence of identity of minds would arise when there is an error on the part of the parties regarding

- a) nature of transaction or
- (b) person dealt with or
- (c) subject matter of agreement .

Consent is free when it is not caused by

- a) coercion,

- b )undue influence,
- c ) fraud,
- d) misrepresentation or mistake (Section 14).

Now let us discuss each of these factors, which should not influence consent.

**(a)Coercion(Section 15):-** “Coercion” is the committing, or threatening to commit any act forbidden by the Indian Penal Code 1860, or the unlawful detaining, or threatening to detain any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

For example, X says to Y ‘I shall not return the documents of title relating to your wife’s property, unless you agree to sell your house to me for ` 5000’. ‘Y’ says, “All right, I shall sell my house to you for ` 5000; do not detain my wife’s documents of title”, X has employed coercion; he cannot therefore enforce the contract. But Y can enforce the contract if he finds the contract to his benefit. An agreement induced by coercion is voidable and not void. That means it can be enforced by the party coerced, but not by the party using coercion.

It is immaterial whether the Indian Penal Code,1860 is or is not in force at the place where the coercion is employed.

Where husband obtained a release deed from his wife and son under a threat of committing suicide, the transaction was set aside on the ground of coercion, suicide being forbidden by the Indian Penal Code. (Amiraju Vs. Seshamma (1974) 41 Mad, 33)

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

**(b)Undue influence (Section 16):** A contract is said to be induced by “undue influence” where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage of the other. A person is deemed to be in a position to dominate the will of the other, when he holds authority, real or apparent over the other, or when he stands in a fiduciary relation to other.

The essential ingredients of undue influence are: One of the parties dominates the will of the other and

- (i) he has real or apparent authority over the other;
- (ii) he is in a position to dominate the will of the other and
- (iii) the dominating party takes advantage of the relation.

Following are the instances where one person can be treated as in a position to dominate the will of the other.

- (i) A solicitor can dominate the will of the client.
- (ii) A doctor can dominate the will of his patient having protracted illness, and
- (iii) A trustee can dominate the will of the beneficiary.

The burden of proof (in situations like the above) that there is no undue influence in an agreement would be on the person who is in a position to dominate the will of the other. For instance the ‘father’ should prove that he had not unduly influenced his son in the case of any given agreement. The stronger party must act in good faith and see that the weaker party gets independent advice.

The following two decisions would enable us to understand the law.

**(a)**Allahabad High Court set aside a gift of the whole of the property by an elderly Hindu to his spiritual advisor.

**(b)** illiterate Muslim lady signing an agreement in favour of the manager herestate.

Difference between Coercion and Undue Influence: Having discussed in detail the concepts of coercion and undue influence, let us understand the difference between the two:-

- (i)**Nature of action: Coercion involves physical force and sometimes only threat. Undue influence involves only moral pressure.
- (ii)**Involvement of criminal action: Coercion involves committing or threatening to commit any act prohibited or forbidden by law, or detention or threatening to detain a person or property. In undue influence there is no such illegal act involved.



(iii) **Relationship between parties:** In coercion there need not be any relationship between parties; whereas in undue influence, there must be some kind of relationship between parties, which enables to exercise undue influence over the other.

(iv) **Exercise by whom:** Coercion need not proceed from the promisor. It also need not be directed against the promisee. Undue influence is always exercised by one on the other, both of whom are parties to a contract.

(v) **Enforceability:** Where there is coercion, the contract is voidable. Where there is undue influence the contract is voidable or court may set aside or enforce it in a modified form.

(vi) **Position of benefits received:** In case of coercion, where the contract is rescinded by the aggrieved party any benefit received has to be restored back. In the case of undue influence, the court has discretion to pass orders for return of any such benefit or not to give any such directions.

(c) **Fraud (Section-17):** Fraud means and includes any of the following act committed by a party to a contract or with his connivance or by his agent with intent to deceive another party thereto or his agent or to induce him to enter into the contract.

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

It is important to note that 'fraud' that results in a contract alone is covered by section 17 of the Act. If there is a 'fraud' but it does not result in a contract, it would not fall within the purview of the Act.

The following can be taken as illustration of fraud:

- A director of a company issues prospectus containing misstatement knowing fully well about such misstatement. It was held any person who had purchased shares on the faith of such misstatement can repudiate the contract on the ground of fraud.
- B discovered an ore mine in the Estate of 'A'. He conceals the mine and the information about the mine. 'A' in ignorance agrees to sell the estate to 'B' at a price that is grossly undervalued. The contract would be voidable on the ground of fraud.
- Buying goods with the intention of not paying the price is an act of fraud.
- A seller of a property should disclose any material defect in the property. Concealing the information would be an act of fraud. Any other act committed to deceive is fraud.

Mere silence would amount to fraud under certain circumstances.

Although a mere silence as to facts which is likely to affect the willingness of a person to enter into a contract is no fraud, where there is a duty to speak or where his silence is equivalent to speech, then such silence amounts to fraud.

(d) **Misrepresentation [Section 18]:** "Misrepresentation" does not involve deception but is only an assertion of something by a person which is not true, though he believes it to be true. Misrepresentation could arise because of innocence of the person making it or because he lacks sufficient or reasonable ground to make it. A contract which is hit by misrepresentation can be avoided by the person who has been misled.

For example, A makes the statement on an information derived, not directly from C but from M. B applies for shares on the faith of the statement which turns out to be false. The statement amounts to misrepresentation, because the information received second-hand did not warrant A to make the positive statement to B [Section 18 (1)]

Now let us analyse the difference between fraud and misrepresentation.

(i) **Extent of truth varies:** **One of the important difference between fraud and misrepresentation** is that in case of fraud the person making the representation knows it fully well that his statement is untrue & false. In case of misrepresentation, the person making the statement believes it to be true which might later turn out to be untrue. In spite of this difference, the end result is that the other party is misled.

(ii) **Right of the person concerned who suffers:** Fraud not only enables the party to avoid the contract but is also entitled to bring action. Misrepresentation merely provides a ground for avoiding the contract and not for bringing an action in court.

(iii)**Action against the person making the statement:** In order to sustain an action for deceit, there must be proof of fraud. As earlier discussed fraud can be proved only by showing that a false statement was made knowing it to be false or without believing it to be true or recklessly without any care for truth. One is for action against deceit and the other is action for recession of the contract. In the case of mis-representation the person may be free from blame because of his innocence but still the contract cannot stand.

(iv)**Defences available to persons:** In case of misrepresentation, the fact that plaintiff had means of discovering the truth by exercising ordinary diligence can be a good defence against the repudiation of the contract, whereas a defence cannot be set up in case of fraud other than fraudulent silence.

But, where it is possible to discover the truth with ordinary diligence, and though the consent might have been obtained by misrepresentation or silence, then the contract For instance where 'A' misrepresents to 'B' that his sugar factory can produce 500 tons of sugar and whereas it actually produced 300 tones of sugar and if 'B' had the opportunity to examine the accounts through which he could have found out the truth and if in spite of that he had entered into a contract, he can not repudiate it.

| <b>Difference between Fraud &amp; Misrepresentation</b> |   |  |
|---|---|--|
|   | <b>Fraud</b>  | <b>Misrepresentation</b>   |
| <b>Meaning</b>  | wrongful representation is made willfully to deceive the party.   | Innocently made to deceive the other party.  |
| <b>Knowledge of falsehood</b>                           | The person making the wrong statement does not believe it to be true.<br>Right to claim damage  | The person making the statement believes it to be true.<br>Can't claim damage  |
| <b>Means of discovering of truth</b>                    | In case of fraud the contract is voidable even though the aggrieved party had the means of discovering the truth with ordinary diligence. | In case of misrepresentation the contract is not voidable if the aggrieved contract is not voidable if the aggrieved party had the means of discover truth with ordinary diligence |

**(e)Mistake-** The fifth significant element that vitiates consent is 'Mistake'. Where parties to an agreement are under a mistake as to a matter of fact which is essential to the agreement, then the agreement is void. As we all know a void agreement cannot be enforced at all.

Example: 'A' agrees to sell certain cargo which is supposed to be on its way in a ship from London to Bombay. But in fact, just before the bargain was struck, the ship carrying the cargo was cast away because of storm and rain and the goods were lost. Neither of the parties was aware of it. The agreement is void. [Couturier vs Hasite 5 H.L.C.673]

Mistake must be a matter of fact and not of law. Where 'A' and 'B' enter into contract believing wrongly that a particular debt is not barred by law of limitation, then the contract is valid because there is no mistake of fact but of law only. However a question on foreign law would become a matter of question of fact. Similarly the existence of a particular private right though depends upon rules of law, is only a matter of fact. For instance where a man promises to buy a property which already belongs to him without him being aware of it, then such a promise is not binding on him. However a family arrangements or a compromise of doubtful rights cannot be avoided on the ground of mistake of law.

Yet another issue to remember in mistake is that it must be of an essential fact. Whether the fact is essential or not would again depend on how a reasonable man would regard it under given circumstances. A mere wrong opinion as to the value is not an essential fact.

While deciding whether a contract is hit by mistake or not it must be remembered that 'Mistake' is not unilateral. Both the parties should be under mistake. A unilateral mistake would not render the contract invalid. For example where 'A' agrees to purchase from 'B' 18 carat gold thinking it to be pure gold but 'B' was not instrumental for creating such an impression then contract between 'A' and 'B' should be treated as valid. From the foregoing it is clear that:-

- a. Mistake should be a matter of fact
- b. Mistake should not be a matter of law
- c. Mistake should be a matter of essential fact
- d. Mistake should not be unilateral but of both the parties, and
- e. Mistake renders agreement void and neither party can enforce the contract against each other

### Key Points

- When two or more persons agree upon the same thing in the same sense, they are said to have consent. Consent is said to be free when it has not been obtained by coercion, undue influence, fraud, misrepresentation or mistake.
- Coercion –An act or threat of a person with an intention of causing any person to enter into an agreement by –(i) committing / threatening to commit any act forbidden by IPC, or (ii) unlawfully detaining or threatening to detain any property of another. Such a contract is voidable.
  - Undue influence –It is used by a dominant party on a weaker one to get an unfair advantage in a contract. In the following circumstances, the party stand in a dominant position-
- Where party holds real/apparent authority over the others, or party stands in a fiduciary relationship to the other, or where the party make a contract with a party in mental or bodily distress.
- A contract caused by undue influence is voidable. Even court is also empowered to set aside such contract absolutely or conditionally.
  - Fraud-Intentional misrepresentation or concealment of material facts of a contract with an intention to deceive and induce the other party to enter into an agreement.
- Silence merely not amount to fraud, except-it's duty to speak, or silence is equivalent to speech, or stating half truth.
  - Misrepresentation- An innocent/ unintentional false statement/ assertion of fact in the making of an agreement.
- Remedies in the above cases are same, except the right to claim damages in case of fraud.
  - Mistake- An erroneous belief about something. It may be either of fact or of law. Mistake renders the contract void. Unilateral mistake made by one of the parties. It is a valid contract, unless it is caused by misrepresentation or fraud. Even unilateral mistakes as to fact renders the contract void.

### Capacity of parties

The next issue for consideration is, who is competent to contract?

Every person who

(a) has attained the age of majority

(b) is of sound mind and

(c) is not otherwise disqualified from contracting, is competent to contract. Now let us discuss each one of these requirements.

Age of majority:-According to section 3 of **Indian majority Act-1875** every person domiciled in Indian attains majority on the completion of 18 years of age.

**Excetipon:- 21 years- in the following cases.**

a. **Where a guardian of a minor's person or property** is appointed under the Guardian and wards Act, 1890.

b. **Where minor's property has passed under the superintendence of the court of wards.**

Position of Agreements by Minor:-

**1. Validity:** - An agreement with a minor is void-ab-initio

**Example :** Mr. D, a minor, mortgaged his house for Rs.20000 to a money – lender, but the mortgagee, i.e. the

money – lender, paid him a sum of Rs.8000. Subsequently, the minor sued for setting aside the mortgage. Held that the contract was void, as Mr. D was minor **and** therefore he is not liable to pay anything to the lender.

### **RULES GOVERNING MINOR'S AGREEMENT.**

- 1) A minor's has received any benefit under a void contract, he cannot be asked to return the same.  
If a minor has received any benefit under a void contract, he cannot be asked to return the same.
- 2) Fraudulent representation by a minor- no difference in the status of agreement. The contract remains void.
- 3) A minor with the consent of all the partners, be admitted to the benefits of an existing partnership.
- 4) Contracts entered into by minors are void-ab-initio. Hence no specific performance can be enforced for such contracts.
- 5) Minor's parent/guardians are not liable to a minor's creditor for the breach of contract by the minor.
- 6) A minor can act as an agent but not personally liable. But he cannot be principal.
- 7) A minor cannot become shareholder of a the company except when the shares are fully paid up and transfer by share.
- 8) A minor cannot be adjudicated as insolvent.
- 9) Can enter into contracts of Apprenticeship, Services, Education, etc:
  - i. A minor can enter into contract of apprenticeship, or for training or instruction in a special art, education, etc.
  - ii. These are allowed because it generates benefits to the Minor.

#### **11. Guarantee for and by minor**

A contract of guarantee in favor of a minor is valid. However, a minor cannot be a surety in a contract of guarantee. This is because, the surety is ultimately liable under a contract of guarantee whereas a minor can never be held personally liable.

#### **12. Minor as a trade union member**

Any person who has attained the age of fifteen years may be a member for registered trade union, provided the rules of the trade union allow so. Such a member will enjoy all the rights of a member.

**Age of majority:** In terms of the Indian Majority Act, 1875, every domiciled Indian attains majority on the completion of 18 years of age. However where a guardian is appointed by a court to protect the property of a minor and the court takes charge of the property before the person attains 18 years, then he or she would attain majority on completion of 21 years.

Now let us analyze the position with regard to the minor's agreement -

- (i) **An agreement entered into by a minor is altogether void:** An agreement entered into by a minor is void and the question of its enforceability does not arise.
- (ii) **Minor can be a beneficiary:** Though a minor is not competent to contract, nothing in the Contract Act prevents him from making the other party bound to the minor. Thus, a promissory note duly executed in favour of a minor is not void and can be sued upon by him, because he though incompetent to contract, may yet accept a benefit.  
A minor cannot become partner in a partnership firm. However, he may with the consent of all the partners, be admitted to the benefits of partnership (Section 30 of the Indian Partnership Act, 1932).
- (iii) **Minor can always plead minority:** Any money advanced to a minor cannot be recovered as he can plead minority and that the contract is void. Even if there had been false representation at the time of borrowing that he was a major, the amount lent to him cannot be recovered. as it would amount to enforcing void contract.
- (iv) **Ratification of agreement not permitted:** A minor on his attaining majority cannot validate any agreement which was entered into when he was minor, as the agreement was void. Similarly a minor cannot sign fresh promissory notes on his attaining majority in lieu of promissory notes executed for a loan transaction when he was minor, or a fresh agreement without consideration.
- (v) **Liability for necessities:** A person who supplied necessities of life to a minor or his

family, is entitled to be reimbursed from the properties of a minor, not on the basis of any contract but on the basis of an obligation resembling a contract. Necessaries of life not only include food and clothing but also education and instruction. They also include 'goods' and 'services'.

- (vi) **Contract by guardian are valid:** Though an agreement with minor is void, but contract can be entered into with the guardian on behalf of the minor is valid. The guardian must be competent to make the contract and the contract should be for the benefit of the minor. For instance a guardian can make an enforceable marriage contract on behalf of the minor. Similarly father of bride can enter the contract with the father of bridegroom for payment of certain allowance to the bride. But not all contracts by guardian are valid. A guardian cannot bind a minor in a contract to purchase immovable properties [Mir Sarwarjan vs. Fakharuddin (1912) 39. Cal. 232]. However, a court appointed guardian can bind a minor in respect of certain sale of property ordered by the court.

**(b)Sound mind:** The next important requirement by way of capacity to contract is "sound mind". A person will be considered to be of sound mind if he at the time of entering into a contract is capable of understanding it and forming a rational judgment as to its effect upon his interest.

**A person of unsound mind (Lunatic Idiot Drunken and Intoxicated )**

**Person of Unsound Mind** A person who is usually of unsound mind, but occasionally of sound mind can make a contract when he is of sound mind. Similarly, a person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

At time of entering into a contract, a person must be sound mind. Law presumes that every person is of sound mind unless otherwise it is proved before court. An agreement by a person of unsound mind is void. The following are categories of a person considered as person of a unsound mind.

**An idiot-** An idiot is a person who is congenital (by birth) unsound mind. His incapacity is permanent and therefore he can never understand contract and make a rational judgment as to its effects upon his interest. Consequently, the agreement of an idiot is absolutely void ab initio. He is not personally liable even for the payment of necessities of life supplied to him.

**Delirious persons-** A person delirious from fever is also not capable of understanding the nature and implications of an agreement. Therefore, he cannot enter into a contract so long as delirium lasts.

**Hypnotized persons-** Hypnotism produces temporary incapacity till a person is under the effect of artificial induced sleep.

**Mental decay-** There may be mental decay or senile mind due to old age or poor health.

When such person is not capable of understanding the contract and its effect upon his interest, he cannot enter into contract.

**Lunatic-** is person who is mentally deranged due to mental strain or other personal experience. He does not suffer permanently of unsound mind. He can enter into contract during lucid intervals i.e., during period when he is of sound mind.

**(c)Person Disqualified by law to be a party in a contract (Alien enemy , Foreign Sovereign ,Convict, Corporation and Company, Insolvent)**

**1- Body corporate or company or corporation**

Contractual capacity of company is determined by object clause of its memorandum of association. Any act done in excess of power given is ultra – virus and hence void.

**2- Alien enemy** An 'alien' is a person who is a foreigner to the land. He may be either an 'alien friend' or an 'alien enemy'. If the sovereign or state of the alien is at peace with the country of his stay, he is an alien friend. An if a war is declared between the two countries he is termed as an alien enemy.

During the war, contract can be entered in to with alien enemy with the permission of central government.

**3- Convict** can't enter into a contract while he is undergoing imprisonment. But he can enter into a contract with permission of central government while undergoing imprisonment. After the imprisonment is over, he becomes capable of entering into contract. Thus the incapacity is only during the period of sentence.

**4- Insolvent** -When any person is declared as an insolvent, his property vests in receiver and therefore, he can't enter into contract relating to his property. Again he becomes capable to enter into contract

when he is discharged by court.

- 5- **Foreign sovereigns**, diplomatic staff and representative of foreign staff can enter into valid contract. However, a suit cannot be filed against them, in the Indian courts without the prior sanction of the central Government.

**Third party to a contract cannot sue or a stranger to a contract cannot sue.**

Only those persons, who are parties to a contract, can sue and be **sued** upon the contract.

This Rule is called "**Doctrine of privity of contract.**"

**Exception.**

i. **Trust**:-In case of trust a beneficiary can sue upon the contract.

Example: A transferred certain properties to B to be held by him in trust for the benefit of C.

In this case, C although not a party to the trust, can sue for the benefits available to him under the trust.

This exception to the rule of Privity of contract has been recognized.

ii. **Family settlement** / Marriage contract:-In case of family settlement members who were not originally party to the contract can also sue upon it.

A female members can enforce a provision for marriage expenses made on partition of HUF.

Example: H sued her father – in – law K to recover Rs.15,000 being arrears of allowance called Pin money payable to her by K under an agreement between K and H's father, consideration being H's marriage to K's son D. Both H and D were minors at the time of marriage.

Held, the promise can be made enforceable by H.

Provision of marriage expenses of female members of a Joint Hindu Family, entitles the female member to sue for such expenses on a partition between male members.,

Two brothers, on partition of family joint properties, agreed to invest in equal shares for their mother's maintenance. Held, the mother was entitled to require her sons to make the investment.

iii. **Acknowledgement of liability**:-Where a person admits his Liability, if he refused thereafter, he will be stopped from denying his liability.

**Example** X receives money from Y for paying it to Z. X admits the receipt of that amount to Z. Z can recover the amount from X, even though the money is due from Y.

iv. **Assignment of contract** Assignee (the person to whom benefits of contract are assigned) can enforce upon the contract.

v. Contract entered into through an **agent**.

vi. **Covenants** running with land.

**Stranger to consideration**:-"Stranger to contract" must be distinguished from a stranger to consideration, consideration need not necessarily be provided by the promisee. it may flow from a third party also. such a person is 'stranger to consideration.

## Legalities of object

Now let us discuss two other important ingredients of a valid contract namely lawful object and lawful consideration. Speaking generally all persons enjoy freedom for entering into contracts of their choice. But this contractual freedom or their right to enter into agreements is not absolute. There is a limitation on such contractual freedom as they are bound by certain general provisions of law. The above observation can be illustrated with the following example: suppose 'A' agrees to pay ` 100/- to B on 'B' stealing 'C's purse, then no Court can compel 'A' to pay 'B' even if he manages to steal 'C's purse because it would amount to encouraging these things.

**Where consideration and object is opposed to public policy:** Agreement, either because of their object or consideration being opposed to public policy are void and not enforceable. Therefore the meaning of the expression 'public policy' is very important. It can be interpreted in a narrow sense or in a broad sense. If it is understood in a narrow sense, it would cut into rights of people to enter into even genuine agreements.



'Public policy' as a concept is evolved basically to develop an orderly society and for good of the community. But framing public policy itself is a difficult exercise since a too restrictive approach would stifle the rights of people and a too liberal approach would open the gate for many illegal transactions. Therefore policy on 'public policy' has to be developed with circumspection. Public policy has been described as "an unruly horse, which if not properly bridled, may carry its rider he knows not where". Time immemorial following activities/agreements have been identified as "opposed to public policy".

(a)**Trading with enemy:** Any trading or business activity with a person who owes allegiance to a Government of a country with whom India is at war without any license from Government of India is void. This is because such a trade would be against the interest of Government of India and people of India.

Any agreement made during peace time would be suspended automatically and cannot be carried on further until hostilities come to an end.

(b)**Stifling prosecution:** Any agreement to stifle or prevent illegally any prosecution is void as it would amount to perversion or abuse of justice. The principle is that one should not make a trade of felony. It must be understood however that under the Code of Criminal Procedure, 1973 many offences are compoundable. Therefore any agreement towards compounding of an offence to avoid prosecution is not void but is very much enforceable. Thus, where 'A' agrees to sell certain land to 'B' in consideration of 'B' abstaining from taking any criminal proceeding against 'A' with respect to an offence which is compoundable, the agreement is not opposed to public policy.

(c)**Maintenance and Champerty:** Maintenance is promotion of litigation in which the litigant has no interest. Champerty is bargain whereby one party agrees to assist the other in recovering property with a view to sharing the profit of litigation. These agreements for maintenance and champerty are void in England but not in India. Hence these are not opposed to public policy. But where such advances are made by way of gambling in litigation, the agreement to share the subject of litigation is certainly opposed to public policy and therefore is void.

(d)**Interference with course of law and justice:** Any agreement with the object of inducing a judicial officer or administrative officer of the state to act corruptly or not impartially is void. Similarly an agreement to use influence in a litigation in a underhand manner is void. For instance through an agreement 'A' agrees to reward 'B' if he abstains from being a witness in a suit against 'A' is void. But an agreement to pay for to a holy man for prayers for success of a suit is valid.

(e)**Marriage brokerage contract:** An agreement to negotiate a marriage for reward is void. Such marriage brokerage contracts are opposed to public policy.

(f)**Interest against obligation:** The following are examples of agreement that are void as they tend to create an interest against obligation.

## **Quasi Contract and contingent contract**

### **Contingent contract**

In terms of Section 31 of the Act, contingent contract is a contract to do or not to do something, if some event collateral to such contract does or does not happen. Contracts of indemnity and contracts of insurance fall under this category.

For instance if 'A' contracts to pay 'B' ` 100000/- if B's house is destroyed by fire then it is a contingent contract.

### **Essentials of a contingent contract**

- (a) The performance of a contingent contract would depend upon the happening or non- happening of some event or condition. The condition may be precedent or subsequent
- (b) The event referred to is collateral to the contract. The event is not part of the contract. The event should be neither performance promised nor a consideration for a promise.  
Where 'A' agrees to deliver 100 bags of wheat and 'B' agrees to pay after delivery, this is a conditional contract and not a contingent contract. Similarly where 'A' promises to pay 'B' ` 10000/- if he marries 'C' is not a contingent contract but a conditional contract.
- (c) The contingent event should not be a mere 'will' of the promisor. The event should be contingent in



addition to being the will of the promisor.

For example if 'A' promises to pay 'B' ` 10000/- if 'A' left for Delhi from Mumbai on a particular day, it is a contingent contract because though 'A's leaving for Delhi is his own will, it cannot happen only at his will.

The rules relating to enforcement of a contingent contract are laid down in sections 32, 33, 34 and 36 of the Act.

- (a) **Contingency is the “happening of an event”:** Where a contract identifies happening of a future contingent event, the contract cannot be enforced until and unless the event ‘happens’. If the happening of the event becomes impossible, then the contingent contract is void. For instance ‘X’ enters into a contract to buy ‘Y’s car provided ‘Y’ survives ‘A’. Here ‘Y’ surviving ‘A’ or ‘A’ dying before ‘Y’ is the event on which the contract is contingent and they cannot be enforced until ‘A’ dies.
- (b) **Contingency is the non-happening of an event:** Where a contingent contract is made contingent on a non-happening of an event, it can be enforced only when its happening becomes impossible. For example where ‘P’ agrees to pay ‘Q’ a sum of money if a particular ship does not return, the contract becomes enforceable only if the ship sinks so that it cannot return.
- (c) **Contingent on the future conduct of a living person:** A contract would cease to be enforceable if it is contingent upon the conduct of a living person when that living person does some thing to make the ‘event’ or ‘conduct’ as impossible of happening. For example where ‘A’ agrees to pay ‘B’ a sum of money if ‘A’ marries ‘C’. ‘C’ marries ‘D’. This act of ‘C’ has rendered the event of ‘A’ marrying ‘C’ as impossible; it is though possible if there is divorce between ‘C’ and ‘D’.
- (d) **Contingent on an impossible event:** A contingent agreement to do a thing or not to do a thing if an impossible event happens is void and hence is not obviously enforceable. The situation would not change even if the parties to the agreement are not aware of such impossibility. ‘A’ agrees to pay ‘B’ ` one lakh if sun rises in the west next morning. This is an impossible event and hence void.

## Quasi contract

Even in the absence of a contract, certain social relationships give rise to certain specific obligations to be performed by certain persons. These are known as quasi contracts as they create same obligations as in the case of regular contract.

Quasi contracts are based on principles of equity, justice and good conscience.

### Salient features of quasi contracts are:

- (a) In the first place, such a right is always a right to money and generally, though not always, to a liquidated sum of money.
- (b) Secondly, it does not arise from any agreement of the parties concerned, but it imposed by the law; and
- (c) Thirdly, it is a right which is available not against all the world, but against a particular person or persons only, so that in this respect it resembles a contractual right.

**There are five circumstances which are identified by the Act as quasi contracts. These five circumstances do not result in regular contracts.**

- (a) **Claim for necessities supplied to persons incapable of contracting:** Any person supplying necessities of life to persons who are incapable of contracting is entitled to claim the price from the other person’s property. Similarly where money is paid to such persons for purchase of necessities,

reimbursement can be claimed.

For example if 'A' supplies necessities of life to 'B' a lunatic or to his wife or child whom 'B' is liable to protect and maintain, then 'A' can claim the price from the property of 'B'. For such claim to be valid 'A' should prove the supplies were to the actual requirements of 'B' and his dependents. No claim for supplies of luxury articles can be made. If 'B' has no property 'A' obviously cannot make his claim.

- (b) **Right to recover money paid for another person:** A person who has paid a sum of money which another is obliged to pay, is entitled to be reimbursed by that other person provided the payment has been made by him to protect his own interest.

Here the person who makes the payment must honestly believe that his own interest demands payment. [Muni Bibi vs. Trilokinath].

In a case the plaintiff agreed to purchase certain mills and to save it from being sold to outsiders paid certain arrears of municipal dues. Here the payment made by the plaintiff was held to be recoverable as he had interest in the property as prospective buyer.

- (c) **Obligation of person enjoying benefits of non-gratuitous act:** In term of section 70 of the Act "where a person lawfully does anything for another person, or delivers anything to him not intending to do so gratuitously and such other person enjoys the benefit thereof, the latter is bound to pay compensation to the former in respect of, or to restore, the thing so done or delivered.

The above can be illustrated by a case law where 'K' a government servant was compulsorily retired by the government. He filed a writ petition and obtained an injunction against the order. He was reinstated and was paid salary but was given no work and in the mean time government went on appeal. The appeal was decided in favour of the government and 'K' was directed to return the salary paid to him during the period of reinstatement. [Shyam Lal vs. State of U.P. A.I.R (1968) 130]

- (d) **Responsibility of finder of goods:** In terms of section 71 'A person who finds goods belonging to another and takes them into his custody is subject to same responsibility as if he were a bailee'.

Thus a finder of lost goods has:

- (i) to take proper care of the property as men of ordinary prudence would take
- (ii) no right to appropriate the goods and
- (iii) to restore the goods if the owner is found.

Where 'P' a customer in 'D's shop puts down a brooch worn on her coat and forgets to pick it up and one of 'D's assistants finds it and puts it in a drawer over the week end. On Monday, it was discovered to be missing. 'D' was held to be liable in the absence of ordinary care which a prudent man would have taken.

- (e) **Liability for money paid or thing delivered by mistake or by coercion:** In terms of Section 72 of the Act, "a person to whom money has been paid or any thing delivered by mistake or under coercion, must repay or return it. Every kind of payment of money or delivery of goods for every type of 'mistake' is recoverable. [Shivprasad vs Sirish Chandra A.I.R. 1949 P.C. 297]

**Time immemorial, following activities/ agreements have been identified as;  
"opposed to public policy".**

The meaning of the expression 'public policy' is very important. It can be interpreted in a narrow sense or in a broad sense. If it is understood in a narrow sense, it would cut into rights of people to enter into even genuine agreements. 'Public policy' as a concept is evolved basically to develop an orderly society and for good of the community. But framing public policy itself is a difficult exercise since a too restrictive approach would stifle the rights of people and a too liberal approach would open the gate for many illegal transactions. Therefore policy on 'public policy' has to be developed with circumspection. Public policy has been described as "an unruly horse, which if not properly bridled, may carry its rider he knows not where".

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**(e) Marriage brokerage contract:** An agreement to negotiate a marriage for reward is void. Such marriage brokerage contracts are opposed to public policy.

**(f) Interest against obligation:** The following are examples of agreement that are void as they tend to create an interest against obligation. The object of such agreements is opposed to public policy.

- (1) An agreement by an agent to receive without his principal's consent compensation from another for the performance of his agency is invalid.
- (2) A promise by a trustee to do something in violation of his duty is unlawful
- (3) A, who is the manager of a firm, agrees to pass a contract to X if X pay to A ` 2000 privately; the agreement is void.

**(g) Sale of public offices:** While appointing a person to certain important and high public office, merit alone should be the criteria. Any attempt to influence or any agreement to influence anyone in this regard should be seen as an act 'opposed to public policy'. 'Public policy' also demands that there should be no money consideration and if it is there, it could be opposed to public policy. This is for the reason presence of money consideration would convert the situation as sale of public office.

Following are illustrations in this regard.

- (1) An agreement to pay money to public servant in order to induce him to retire from his office so that another person may secure the appointment is void.
  - (2) An agreement to procure a public recognition like Padma Vibhushan for reward is void.
  - (3) The sale of the office of a mutawali of wakf is opposed to public policy, because the office of mutawali is connected with matters of public interest.
- (h) Agreement for the creation of monopolies:** Agreements having for their object the establishment of monopolies are opposed to public policy and therefore void. It is also hit by the MRTP Act.

- (i) Agreement in restraint of marriage (Section 26): Every agreement in restraint of marriage of any person other than a minor, is void. So if a person, being a major, agrees for good consideration not to marry, the promise is not binding.
- (j) Agreement in restraint of trade (Section 27): Any agreement through which a person is restrained from exercising a lawful profession, trade or business of any kind is to that extent void. The object of this law is to protect trade. The restraint, even if it is partial, will make the agreement void. Example: X, a shop keeper, in a particular locality agrees to pay 'Y' his rival in business certain compensation, if 'Y' close his business in that locality the agreement is void.

The principle of law however has a number of exceptions which are discussed hereunder.

- (i) where a person sells his business along with the goodwill to another person, agrees not to carry on same line of business in certain reasonable local limits, such an agreement is valid.
- (ii) In terms of Section 36 of the Indian Partnership Act, 1932 an agreement through which an outgoing partner will not carry on the business of the firm for a reasonable time will be valid, though it is in restraint of trade.
- (iii) Again in terms of Section 54 of the Partnership Act, 1932 partners among themselves may agree that upon dissolution of the firm some of them may not carry on the business of the firm. Such an agreement is valid.
- (iv) Section 55 of the Indian Partnership Act, 1932 provides that where a full firm is sold by partners along with goodwill to a buyer, there can be an agreement that they would not carry on the business of the dissolved firm for certain period and within certain local limits and such an agreement will be valid.
- (v) An agreement of service through which an employee commits not to compete with his employer is not in restraint of trade.  
Example: 'B' is a Doctor and he employs 'A' a junior Doctor as his assistant. 'A' agrees not to practice as Doctor during the period of his employment with 'B' as a Doctor independently. Such an agreement will be valid.
- (vi) An agreement between manufacturer and a wholesale merchant that the entire production during a period will be sold by the manufacturer to the wholesale merchant is not in restraint of trade.
- (vii) An agreement among sellers not to sell a particular product below a particular price is not an agreement in restraint of trade.
- (k) **Agreement in restraint of legal proceedings (Section 28):** An agreement in restraint of legal proceedings resulting in restriction of one's right to enforce legal rights is void. Similarly any agreement which abridges the usual period for commencing the legal proceedings is also void. Further these agreement are also void in view of section 23 of the Indian Contract Act, 1872 as the object of the agreements are to defeat the provision of law.  
Nevertheless, a clause in an fire insurance policy stipulating that if the claim is made and rejected and if no suit is instituted within three months after such a rejection, all the benefits under the policy will be forfeited, is valid. However, there are certain exceptions to the above rule:
  - (i) A contract by which the parties agree that any dispute between them in respect of any subject shall be referred to arbitration and that only the amount awarded in such arbitration shall be recoverable is a valid contract. For instance, in agreement between the holder of a fire insurance policy and the insurance company that no suit shall be instituted until the question of the amount of damage sustained by the assured has first been ascertained by a reference to an arbitrator is a perfectly valid agreement.
  - (ii) Similarly, a contract by which the parties agree to refer to arbitration any question between them which has already arisen or which may arise in future, is valid; but such a contract must be in writing.

We have already seen that certain agreements are void ab initio under the Contract Act, like agreements by incompetent persons [Section 11], agreement with unlawful object or consideration [Section 23], agreement made under mutual mistake of fact [Section 20], agreement without consideration [Section 25], agreement in restraint of marriage, trade or legal proceedings etc., as they are opposed to public policy.

In addition to the above, there are also other agreements which are expressly declared as void.

**(a) Where consideration is unlawful in part:** By virtue of Section 24 of the Indian Contract Act, "If any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object is unlawful, the agreement is void".

This Section is obviously a corollary to Section 23 of the Act. Where the consideration is unlawful, the entire agreement is void as the agreement has to be looked as a whole. The general principle of law is where the legal part of an agreement can be separated from the illegal part, then the legal part if it can be given effect by rejecting the bad part and retaining the good part, then the good part is given effect. But where no such separation is possible, the contract is altogether void.

Example: 'A' has business interest in Indigo, as a manufacturer. He also has interest in illegal traffic of other goods. Where 'A' employs 'B' for a salary of ` 2000/- to act as superintendent of A's entire business, the agreement is void as the object of A's promise unlawful in part.

**(b) Agreement the meaning of which is uncertain (Section 29):** Where the meaning of the terms of an agreement is uncertain or if it is not capable of being understood with certainty, then the agreement is void. But where the meaning is capable of being made certain, then the agreement is valid. For example where 'A' enters into an agreement to supply 100 tones of oil, the agreement is not valid as the meaning of it is uncertain since what type of oil that is promised to be supplied is not clear. But on the other hand if 'A' is a dealer of coconut oil only, then the meaning of the agreement would crystallize very easily and then the agreement would be valid.

## **Performance of contract**

Performance of contract takes place when the parties to a contract fulfill their obligations arising under the contract within the time and in manner prescribed. Sec 37(para 1) lays down that the parties to a contract must either perform or offer to perform, their respective promises, unless such performance is dispensed with or excused.

### **Offer to perform**

Sometimes it so happens that the promisor offers to perform his obligation under the contract at proper time and place but the promisee does not accept the performance. This is known as "attempted performance" or "tender". It makes promisor not responsible for non performance, nor does he thereby lose his right under the contract. Thus, a tender performance is equivalent to real performance. And entitles him to sue the promisee for breach of contract.

**A. Tender or offer of performance to be valid must satisfy the following conditions:-**

(i) It must be unconditional

**Ex :- 'X' offers to 'Y' the principal amount of the loan. This is not a valid tender**

since the whole amount of principal and interest is not offered.

(ii) It must be made at a proper time and place.

Ex:- If the promisor wants to deliver the goods at 1 am. This is not a valid tender unless it was so agreed;

(iii) Reasonable opportunity to examine goods.

Ex:- Delivery of something to the promisee by the promisor must have reasonable opportunity of inspection.

(iv) It must be for the whole obligation :- goods and amount.

Ex:- 'X' a debtor, offers to pay 'Y' the debt due in installments and tenders the first installment. This is not a valid tender minor deviation – not invalid [Beharilal v Ramgulam]

(v) It must be made to the promisee or his duly authorized agent.

Ex:- It must be person who is willing to perform his part of performance.

(vi) In case of payment of money, tender must be of the exact amount due and it must be in the legal tender.

## Type of Tender

### Tender of goods and services

When a promisor offers to delivery of goods or service to the promisee, it is said to be tender of goods or services, if promisee does not accept a valid tender, It has the following effects:

- (i) The promisor is not responsible for non – performance of the contract.
- (ii) The promisor is discharged from his obligation under the contract. Therefore, he need not offer again.
- (iii) He does not lose his right under the contract. Therefore, he can sue the promisee.

### Tender of money

Tender of money is an offer to make payment. In case a valid tender of money is not accepted, it will have the following effects:

- (i) The offeror is not discharged from his obligation to pay the amount.
- (ii) The offeror is discharged from his liability for payment of interest from the date of the tender .

### Basic principle of performance

- 1) In a contract where there are two parties, each one has to perform his part and demands the other to perform.
- 2) Discharged of this obligation is the primary principle of performance of contract.
- 3) The parties would be treated as having been free from obligation only under the provisions of any law after performance of respective promises.
- 4) Until such time, the performance is neither excused nor dispensed with. Not only the promisor has a primary duty to perform, even the representative in the event of death of a promisor, is bound by the promise to perform, unless a contrary intention appears from the contract [Section 37].

### The promise under a contract can be performed by any one of the following

- (i) **Promisor himself:** Invariably the promise has to be performed by the promisor where the contracts are entered into for performance of personal skills, or diligence or personal confidence, it becomes absolutely necessary that the promisor performs it himself.
- (ii) **Agent:** Where personal consideration is not the foundation of a contract, the promisor or his representative can employ a competent person to perform it.
- (iii) **Representatives:** Generally upon the death of promisor, the legal representatives of the deceased are bound by the promise unless it is a promise for performance involving personal skill or ability of the promisor. However the liability of the legal representative is limited to the value of property inherited by him from the promisor.
- (iv) **Third Person:** The question here is whether a total stranger to a contract who is identified as a third person can perform a promise. Where a promisee accepts performance from a third party he cannot afterwards enforce it against the promisor. Such a performance, where accepted by the promisor has the effect of discharging the promisor though he has neither authorized nor ratified the act of the third party.
- (v) **Joint promisors:** Where two or more persons jointly promise, the promise must be performed jointly unless a contrary intention appears from the contract.  
Where one of the joint promisors dies, the legal representative of the deceased along with the other joint promisor(s) is bound to perform the contract.  
Where all the joint promisors die, the legal representatives of all of them are bound to perform the promise.

### The law set out above can be illustrated with the following examples:

- 1. A promises B to pay ` 1000/- on delivery of certain goods. A may perform this promise either himself or causing someone else to pay the money to B. If A dies before the time appointed for payment, his representative must pay the money or employ some other person to pay the money. If B dies before the time appointed for the delivery of goods, B's representative shall be bound to deliver the goods to A and A is bound to pay ` 1000/- to B's representative.
- 2. A promises to paint a picture for B for a certain price. A is bound to perform the promise himself. He



cannot employ some other painter to paint the picture on his behalf. If A dies before painting the picture, the contract cannot be enforced either by A's representative or by B.

3. A delivered certain goods to B who promise to pay ` 5000/-. Later on B expresses his inability to clear the dues. C, who is known to B, pays ` 2000/- to A on behalf of B. Before making this payment C did tell B nothing about it. Now A can sue B only for the balance and not for the whole amount.

This discussion arises in the context of the observation that the obligations of a promisor would bind the legal representative also (only) to the extent of value of property inherited by them. This became the law that legal representatives are successors.

**Succession:** When the benefits of a contract are succeeded by a process of law, both the burden and the benefit would some times devolve on the legal heir. For example 'B' is the son of 'A'. Upon A's death 'B' will inherit all the assets and liabilities of 'A' [These assets and liabilities are also referred to as debts and estates] Thus 'B' will be liable to all the debts of 'A', but if the liabilities inherited are more than the value of the estate [assets] inherited it will be possible to pay only to the extent of assets inherited.

**Joint promisor** -In terms of Section 43 of the Act,

- (i) when two or more persons make joint promise, the promisor can compel any one of the joint promisors to perform the whole of promise.
- (ii) in the above situation, the performing promisor can enforce contribution from other joint promisors, in the absence of express agreement to the contrary.

Example: Where A, B and C have jointly signed a promissory note for ` 3000/-, and where 'A' is compelled to pay the entire amount of ` 3000/-, he is entitled to recover by way of contribution of ` 1000/- each from the other two joint promisors namely B and C unless agreed to otherwise mutually.

In the above situation again, if one of the joint promisors namely 'B' is unable to contribute ` 1000/-, 'A' is entitled to recover ` 1500/- from 'C' who is the remaining joint promisor instead of ` 1000.

From the above, it is clear that the liability of joint promisors is joint and several and in the absence of any special contract to the contrary, the amount due can be recovered from any one of the joint promisors.

For example X, Y and Z jointly borrow from P, ` 3000/-. Because the liability of the borrower is joint and severed, 'P' can recover the amount either from X or from Y or from Z or from all of them jointly. A joint promisor cannot claim that he be sued along with all other joint promisors only. If, however the promisee sues one of the promisors and obtains a decree against him, he is precluded from bringing a fresh suit against the remaining borrowers.

In the matter of release of one of the joint promisors, by another joint promisor, it must be understood that such a release does not discharge other joint promisors nor does the released joint promisor stand released to other joint promisor or promisors. [Section 44 of the Act].

**Joint promisee**-The rights of two or more promisees who are known as joint promisees is discussed in Section 45 of the Act. In terms of the said section "When a person has made a promise to two or more persons jointly, then unless a contrary intention appears from the contract, the right to claim performance rests, as between him and them, with them during their joint lives, and after the death of any of them with the representatives of such deceased person jointly with the survivor or survivors, and after the death of the last survivor, with the representatives of all jointly".

For example, A, in consideration of ` 5,000 lent to him by B and C, promises B and C jointly to repay the sum with interest on a specified day but B dies. In such a case right to demand payment shall rest with B's legal representatives, jointly with C during C's lifetime and after the death of C, with the legal representatives of B and C jointly as 'B' and 'C' both are joint promisees". The above principle of joint promises is applicable for partners, joint mortgagees and members of a Hindu Undivided Family. In all these cases there is no single promisee. Therefore it is mentioned, then it can be performed any time on that day but during business hours only.

A promisee may refuse to accept delivery (of goods), if it is delivered after business hours. For example if



the promisor wishes to deliver goods at a time which is beyond business hours, the promisee can refuse.

**As regards the place of performance**, where no place is fixed for the performance of a promise, it is the duty of the promisor to ask the promisee to fix a reasonable place. No distinction is made between an obligation to pay money and an obligation to deliver goods or discharge any other obligation. But generally the promise must be performed or goods must be delivered at the usual place of business.

Where the promisor has not undertaken to perform the promise without an application by the promisee and the promise is to be performed on a certain day, it is the duty of the promisee to apply for performance at a proper place and within usual hours of business.

**If promisor refuses to perform his promise**

Where a party to a contract has refused to perform the promise he has made or had disabled himself from performing his promise in its entirety, the promisee may put an end to the contract, unless his acquiescence in the continuance of the contract has been conveyed either by words or by deeds [conduct] [Section 39]. Thus from the above it could be seen that the following two rights accrue to the aggrieved party-

- (i) To terminate the contract and
- (ii) To indicate by words or conduct that he is interested in its continuance.

In case the promisee decides to continue the contract, he would not be entitled to put an end to the contract on this ground immediately. In either case, the promisee would be able to claim damages that he suffers as a result of the breach of contract.

**Effect of one party preventing another from performing promise [Section 53]:** When in a contract consisting of reciprocal promises one party prevents the other from performing his promise, the contract becomes voidable at the option of the party so prevented. The person so prevented is entitled to get compensation for any loss he may have sustained for the non-performance.

The above can be illustrated with the following illustrations by way of two case laws.

- (a) Where there is a contract for sale of standing timber and as per the terms seller is expected to cut and cord the standing timber before the buyer takes delivery but seller cords only a part of it, but neglects to cord the rest of it, then the buyer has a right to avoid the contract and claim compensation for any loss sustained.
- (b) In the well known case of *O'Neil vs. Armstrong*, an Englishman was engaged by the Captain of a Japanese ship to act as fireman on a voyage from England to Japan. During the course of the voyage Japan declared war against China. The Englishman had to leave service because had he continued in service he would have incurred penalties under Foreign Enlistment Act. In effect because of the war, the Englishman was prevented from discharging his part of the contract. The suit filed by him was decreed in his favour in spite of being opposed by the Japanese shipping company. It should be appreciated that the Captain of Japanese ship could not have brought a case against the Englishman for non-performance as the Japanese themselves were responsible for preventing the Englishman from performing his part of the contract.  
Sometimes the parties would be prevented from discharging a part of the contract but not the entire contract. In such a case, the party so prevented need not avoid the full contract but perform the rest of it.

**Alternative promise one branch being illegal:** "In the case of the alternative promise, one branch of which is legal and the other illegal, the legal branch alone can be enforced".

For example, in the nearest reversionary heir of B, agreed to transfer his inheritance to C, if he succeeded to B; and he did not transfer his own estate to C. It was held that first promise was not enforceable, as it amounted to an agreement to transfer an estate on the mere chance of succession prohibited by Section 6 of the Transfer of Property Act, but the second promise was enforceable under Section 58 as an alternative promise. [*Mahadeo Prasad Singh vs. Mathura* 132 L.C. 321 A]

### **whether time is essence of a contract?**

Section 55 of the Act regulates the position of performance of contract where time is of essence. In terms of this Section, where it is understood between parties that time is an essential element, and where one party is unable to perform his part of the promise either in full or in part within the time specified, then the contract is voidable at the option of the party either in full or in part to the extent of non performance of the contract within the time. In these cases the contract is not voidable if time is not of essence of the contract, but the promisee is entitled for compensation for loss, if any, suffered on account of such failure.

In a contract where time is of essence and promisor is unable to perform his part within the time, as already stated the contract becomes voidable at the option of the other party. However the other party agrees that the promisor would perform his part subsequently after the time fixed, the promisee cannot claim any compensation for loss or damage or injury unless he gives any notice to the promisor of his intention to do so.

Ordinarily from a plain examination of a contract it would be difficult to ascertain from the terms of the contract whether time is essence of the contract. A promisee may have failed to perform his contract within the specified time. Yet time may not be treated as essence of the contract in that case. Whether time is essence of a contract has to be decided from the terms of the contract.

In mercantile contracts, as business world is ruled by 'time' and 'money'. Any stipulation as to 'time' and 'money' is an essential condition.

The general principles that are followed can be enunciated as under.

- (i) In transaction on sale of gold, silver, blue chip, shares, time of delivery is of essence. Here time will be treated as essence of contract.
- (ii) In transaction involving sale of land, redemption of mortgages, though certain time frame is fixed, any delay is not valued seriously provided justice can be done to parties. Of course even in sale of land, time can be made as an essence of contract by express words.

Contract cannot be avoided where time is not of essence: When there is delay in performing promise on executing a contract where the time is not of essence, parties concerned cannot avoid the contract. However in such cases promises must be performed within a reasonable time otherwise it becomes voidable at the option of the promisee.

Effect of acceptance of performance out of time: Even where time is of essence, the party who is entitled to avoid the contract can waive the condition relating to "performance within time"; but in such cases he cannot claim any compensation for loss if any suffered unless he has put the other party on notice.

### **Discharge Of Contract**

Discharge of a contract means termination of contractual relation between the parties to a contract in other words a contract is discharged when the rights and obligations created by it are extinguished

#### **Mode of discharge of contract**

1. **By performance-** Actual, & Attempted
2. **By mutual agreement-** . Novation – Sec 62, Rescission –Sec 62, Alteration –Sec 62, Remission –Sec 63, Waiver, Merger
3. **By Operation of law-** Death 2. Merger 3. Insolvency 4. Unauthorized alteration
4. **By lapse of Time**
5. **By breach of contract-** Actual & Anticipatory
6. **By impossibility of performance**

#### **1-Discharge by performance-**

Fulfillment of obligations by a party to the contract within the time and in the manner prescribed in the contract.

- (a) Actual performance –no party remains liable under the contract. Both the parties performed.
- (b) Attempted performance or tender.: -Promisor offers to perform his obligation under the contract but the promisee refuses to accept the performance. It is called as attempted performance or tender of

performance. But the contract is not discharged.

## **2-Discharge by mutual agreement**

- (a) **Novation** [Sec 62] –Novation means substitution of a new contract in the place of the original contract new contract entered into in consideration of discharge of the old contract. The new contract may be.  
Between the same parties (by change in the terms and condition)  
Between different parties (the term and condition remains same or changed)

Following conditions are satisfied:-

- (1) All the parties must consent to novation
- (2) The novation must take place before the breach of original contract.
- (3) The new contract must be valid and enforceable.

**Example:** A owes B Rs.50,000. A enters into an agreements with B and gives B a mortgage of his estate for Rs.40,000 in place of the debt of Rs.50,000. (Between same parties)

A owes money Rs.50,000 to B under a contract. It is agreed between A, B & C that B shall henceforth accept C as his Debtor instead of A for the same amount.

Old debt of A is discharged, and a new debt from C to B is contracted. (Among different parties)

- (b) **Rescission** [62]:-Rescission means cancellation of the contract by any party or all the parties to a contract. X promises Y to sell and deliver 100 bales of cotton on 1st Oct his go down and Y promises to pay for goods on 1st Nov. X does not supply the goods. Y may rescind the contract.
- (c) **Alteration** [62] :-Alteration means a change in one or more of the terms of a contracts with mutual consent of parties the parties of new contracts remains the same.  
Ex:-X Promises to sell and delivers 100 bales of cotton on 1st Oct. and Y promises to pay for goods on 1st Nov. Afterwards X and Y mutually decide that the goods shall be delivered in five equal installments at his godown. Here original contract has been discharged and a new contract has come into effect.
- (d) **Remission** [63]:-Remission means accepting a lesser consideration than agreed in the contract. No consideration is necessary for remission. Remission takes place when a Promisee-  
(a) dispense with (wholly or part) the performance of a promise made to him.  
(b) Extends the time for performance due by the promisors  
(c) Accept a lesser sum instead of sum due under the contract  
(d) Accept any other consideration that agreed in the contract  
A promise to paint a picture for B. B afterwards deny to do so. A is no longer bound to perform the promise.  
(e) Waiver:-Intentional relinquishment of a right under the contract.  
(f) Merger :- conversion of an inferior right into a superior right is called as merger.  
(Inferior right end)

## **The main difference between the ;**

| <b>Novation</b>   | <b>Alteration</b>  |
|---|--|
| Novation involves changes in the terms of contract. It also sometimes means change in the parties to contract. It in fact operates as a substitution of the old contract. | In alteration there are only changes in the term of contract by mutual consent. The no substitution of old terms; only some terms and conditions change. |
|   |  |

### 3) Discharge by operation of law

(a) **Death** :-involving the personal skill or ability, knowledge of the deceased party one discharged automatically. In other contract the rights and liability passed to legal represent.

Example : A promises to perform a dance in B's theatre. A dies. The contract comes to an end.

(b) **Insolvency**:- when a person is declared insolvent. He is discharged from his liability up to the date of insolvency.

Example: A contracts to sell 100 bags of sugar to B. Due to heavy loss by a major fire which leaves nothing to sell, A applies for insolvency and is adjudged insolvent. Contract is discharged.

(c) **By unauthorized material alteration** –without the approval of other party – comes to an end – nature of contract substance or legal effect.

Example : A agrees upon a Promissory Note to pay Rs.5,000 to B. B the amount as Rs.50,000. A is liable to pay only Rs.5,000.

(d) **Merger**: When an inferior right accruing to a party in a contract merges in to a superior right accruing to the same party, then the contract conferring inferior right is discharged.

Example: A took a land on lease from B. Subsequently, A purchases that land. A becomes owner of the land and ownership rights being superior to rights of a lessee, the earlier contract of lease stands terminated.

5. **Rights and liabilities** vest in the same person: Where the rights and liabilities under a Contract vest in the same person, the contract is discharged.

**Example**: A Bill of Exchange which was accepted by A, reaches A's hands after being negotiated and endorsed through 4 other parties. The contract is discharged.

### 4) Discharge by Lapse of time

Where a party fails to take action against the other party within the time prescribe under the limitation Act, 1963. All his rights come end. Ex;- Recover a debt – 3 Years recover an immovable property – 12 years

Ex.-On 1<sup>st</sup> July 20X1, X sold goods to Y to Rs 1,00,000 and Y had made no payment till August 20X4. state the legal position on 1<sup>st</sup> Aug 20X4 .

(a) If no. credit period allowed

(b) If 2 month credit period allowed.

### 5) Discharge by Breach of contract Failure of a party to perform his part of contract

(a) **Anticipatory Breach of contract** :-Anticipatory breach of contract occurs when the party declares his intention of not performing the contract before the performance is due .

(i) **Express repudiation**: -S agrees to supply B 100 tonnes of specified category of iron on 15.01.2006 on 31.12.2005. S express his unwillingness to supply the iron to B.

(ii) **Party disables himself**: -Implied by conduct.

Ex.-S agrees to sell his fiat car to B on 15.01.2006 on 31.12.05 S sells his fiat car to T.

(b) **Actual Breach of contract** :-If party fails or neglects or refuses to perform his obligation on the due date of performance or during performance. It is called as actual breach.

During performance – party has performed a part of the contract.

**Consequences of Breach of contract**:- The aggrieved party (i.e. the party not at fault) is discharged from his obligation and get rights to proceed against the party at fault. The various remedies available to an aggrieved party.

### 6) Discharge by Impossibility performance

(a) Effect of Initial Impossibility

(b) Effect of supervening Impossibility

(a) **Initial Impossibility** – at the time of making contract, if both parties know from beginning about impossibility of performance of contract, the contract is void. Ex; put life into dead body.

If both don't know about impossibility of performance – the contract becomes void.

If one party knows about impossibility of performance, he is entitled to compensate to other party.

(b) **Effect of supervening Impossibility**:-

Where an act becomes impossible after the contract is made, contract becomes void.

When contract becomes unlawful, beyond the control of promisor, contract becomes void.

When Promisor alone knows about the Impossibility, he has to compensate loss of other party.

When an agreement is discovered to be void or where a contract becomes void

**Cases when a contract is discharged on the ground of supervening Impossibility;-**

(a) Distraction of subject matter - Failure of the ultimate purpose of contract –

(b) Death or personal Incapacity

(c) Declaration of war

(d) change of Law

(e) Destruction of subject-matter or Non occurrence of a particular state of thing necessary for performance.

Supervening Impossibility which does not make contract void are;-

Difficulty of performance due to Commercial Impossibility (due to natural calamities, delay in transport)

Default of a third party - Strikes, knockout and civil disturbance.

Partial Impossibility – coronation of king and to sailing around the lake by boat.

Agreements become void when it becomes impossible to perform them due to a variety of reasons. This is known as “impossibility of performance” and dealt with by section 56 of the Act

**In terms of Section 56 of the Act “An agreement to do an act impossible in itself is void. A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.**

Where one person has promised to do something which he knew, or with reasonable diligence, might have known, and which the promisee did not know to be impossible or unlawful, such promisor, must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise”.

- (1) **Impossibility existing at the time of contract:** Even at the time of entering into the agreement, it may be impossible to perform certain contracts at the beginning or inception itself. The impossibility of performance may be known or may not be known to the parties
  - (i) If the impossibility is known to the parties : Where ‘A’ agrees to pay ‘B’ ` 5000/- to ‘B’ if he would swim from Bombay in Indian ocean to ‘Aden’ in 7 days time, this is an agreement where both the parties known that it is impossible to swim the distance between ‘Bombay’ to ‘Aden’ in 7 days time and hence is void.
  - (ii) If unknown to the parties: Even where both the promisor and the promisee are ignorant of the impossibility the contract is void.
  - (iii) If known only to the promisor: Where the promisor alone knows it is impossible to perform or even if he does not know but he should have known about the impossibility with reasonable diligence, the promisee is entitled to claim compensation for the loss suffered because of failure of the promisor to perform.
- (2) **Supervening impossibility:** When performance of a promise becomes impossible on account of subsequent developments of events or change in circumstances, which are beyond the contemplation of parties, the contract becomes void. Supervening impossibility can arise due to a variety of circumstances as stated below.
  - (i) Accidental destruction of the subject matter of the contract : ‘A’ had agreed with ‘B’ to hire for rent his music hall for holiday concerts on certain specified dates. The music hall was destroyed before the specified dates and hence it became impossible to hold stage concerts. It was held that as the music hall ceased to exist; it is a case of supervening impossibility and both the parties were excused from the performance of the contract [Taylor vs. Caldwell 3B&S826].
  - (ii) Non-existence or non occurrence of a particular state of things: It was agreed to by the defendant through a contract to have from the plaintiff a flat for specified days for witnessing the coronation procession of King Edward VII. The said procession was cancelled and it did not take place. Therefore the defendant refused to pay the balance rent. It was held that the foundation of the contract had totally failed and here the balance of rent amount cannot be recovered from the defendant. [Krell vs. Henry 2 KB. 740]
  - (iii) Incapacity to perform a contract of personal services: In case of contract of personal service, disability

or incapacity to perform, caused by an Act of God e.g. illness, constitutes lawful excuse for non-performance of the contract [Robinson vs. Davison L.R.6Ex.269]

- (iv) **Change in law:** Performance of a contract may also become impossible due to change in law subsequently. The law passed subsequently may prohibit the act which may form part as basis of contract. Here the parties are discharged from their obligations. For example 'A' and 'B' may agree to start a business for sale of lottery and contribute capital for the business. If the business of sale of lottery ticket is banned by a subsequent law, parties need not keep up their legal obligations.
- (v) **Outbreak of war:** Out break of war may affect the enforceability of contracts in many ways like
  - (a) emergency legislations controlling prices
  - (b) relaxation of trade restrictions and
  - (c) prohibiting or restraining transaction with alien enemy.

**Doctrine of Frustration:** The idea of "supervening impossibility" is referred to as 'doctrine of frustration' in U.K. In order to decide whether a contract has been frustrated, it is necessary to consider the "intention of parties as are implied from the terms of contract".

However in India the 'doctrine of frustration' is not applicable. Impossibility of performance must be considered only in term of section 56 of the Act. Section 56 covers only 'supervening impossibility and not implied terms'. This view was upheld by Supreme Court in *Satyabrata Ghose vs Mugneeram Bangur* A.I.R.(1954) S. C. 44 and *Alopi Prasad vs Union of India* A.R. 1960 S.C.588.

**A contract would not require performance under circumstances spelt out in Sections 62 to 67 of the Act. These circumstances are (i) novation, (ii) rescission, (iii) alteration and (iv) remission.**

Section 62 of the Act provides that "if the parties to a contract agree to substitute a new contract for it or to rescind or alter it, the original contract need not be performed".

- (a) **Effect of novation:** Novation means substitution. Where a given contract is substituted by a new contract it is novation. On novation, the old contract ceases. It need not be performed. Novation can take place with mutual consent. However novation can take place by substitution of new contract between the same parties or between different parties. Novation results in discharge of old contract. This can be illustrated as follows -  
A owes money to B under a contract. It is agreed between A, B and C that B shall thenceforth accept C as his debtor, instead of A. The old debt of A to B is at an end, and a new debt from C to B has been contracted.
- (b) **Effect of rescission:** In case of rescission, the old contract is cancelled and no new contract comes in its place. A contract is also discharged by rescission. Some times parties may enter into an agreement to rescind the previous contract. Sometimes, the contract is rescinded by implication or by non-performance for a long time without each other complaining about it.  
Difference between novation and rescission: While novation involves rescission, there is no novation in rescission. Both in novation and rescission the contract is discharged by mutual agreement. In both cases parties enter into a new contract to come out of the old contract.  
The new agreement is the consideration for rescission.
- (c) **Effect of alteration:** Where the contract is altered, the original contract is rescinded. Hence the old one need not be performed whereas the new one has to be performed. Alteration involves both rescission and novation. The line of difference between alteration and novation is very thin. While there can be very minor alterations, there can not be unilateral material alteration to a contract. If it is done it will be void.  
Novation and alteration: Both in novation and in alteration the old contract need not be performed.

## Breach of contract



Where there is a default by one party from performing his part of contract on due date then there is breach of contract.

**Breach of contract can be actual breach or anticipatory breach.**

**1-Actual breach of contract occurs at the time when the performance is due , one party fails or refuses to perform his obligation under the contract.**

Where a person repudiates a contract before the stipulated due date, it is anticipatory breach. In such events, the party who has suffered injury is entitled for damages. Further he is discharged from performing his part of the contract.

**2-Where the promisor refuses to perform his obligation even before the specified time for performance and signifies his unwillingness, then there is an anticipatory breach. In such event, aggrieved party can claim damage**

Illustration: 'X' agrees to sell 'Y' certain quantity of wheat at a certain price. viz @ ` 100/- per quintal by 3rd March. However on 2nd February X gives notice of his unwillingness to sell the given goods. Price of wheat on that date is ` 110/- per quintal. 'Y' has a right to repudiate the contract on the same day instead of waiting for the date of performance. On that day 2nd February, he is entitled to recover damages of ` 10/- per quintal this being the difference between market price and contracted price. If on the other hand, he chooses to wait till 3rd March and the price on that date is ` 125/-, he can recover damages @ ` 25/- per quintal. The third possibility is that if between 2nd February and 3rd March, Government prohibits sale of wheat, then the contract becomes void and Y will not be able to recover any damage whatsoever. Hence from this illustration it would be clear that when the promisee postpones his right to repudiate the promise, it would operate to the advantage of the promisor also depending on circumstances.

## **REMEDIES FOR THE BREACH OF CONTRACT**

Remedy means course of action available to an aggrieved party when other party breaches the contract.

1. Rescission of contract
2. Suit for damage
3. Suit for specific performance
4. Suit for Injunction
5. Quantum Meruit

### **(1)Rescission of contract.(sec-39.)**

⇒ It means right to party to cancel contract.

⇒ In case of breach of contract, other party may rescind contract.

#### **Effects of rescission of contract.**

Aggrieved party is not required to perform his part of obligation under contract.

Aggrieved party claims compensation for any loss.

Party is liable to restore benefit, if any.

#### **When can Court Grant Rescind Contract?**

Court can rescind the contract in the following situation:

-If Contract is voidable.

-If Contract is unlawful.

### **(2)Suit for damage**

It means monetary compensation allowed for loss. Purpose is to compensate aggrieved party and not to punish party as fault. In India, rules relating to damages are based on English judgment of Hadley vs Baxendale.

The facts of case were – H's mill was stopped due to the breakdown of the shaft. He delivered the shaft to common carrier to repair it and agree to pay certain sum of repair it and agree to pay certain sum of money for doing this work. H has informed to B that delay would result into loss of profit. B delivered the shaft after reasonable time after repair. H filed suit for loss of profit. It was held that B is not liable for loss of profit. The court laid down rule that damage can be recovered if party has breach of contract.



### (3) Suit for Specific Performance

It means, demanding an order from court that promise agreed in contract shall be carried out.

When is specific performance allowed?

Where actual damages arising from breach is not measurable.

Where monetary compensation is not adequate remedy.

When specific performance is not allowed?

When damages are an adequate remedy.

Where performance of contract requires numbers of minute details and therefore not possible for court to supervise.

- Where contract is of personal in nature.
- Where contract made by company beyond its power. (ultra – vires)
- Where one party to contract is minor
- Where contract is inequitable to either party.

Example : A agree to sell B, an artist painting for Rs.30,000. Later on, he refused to sell it. Here B can file suit against A for specific performance of the contract.

### (4) Suit for Injunction

⇒ It means stay order granted by court. This order prohibits a person to do particular act.

⇒ Where there is breach of contract by one party and order, of specific performance is not granted by court, injunction may be granted.

**Example:** Film actress agreed to act exclusively for W for a year and for no one else.

During the year she contracted to act for Z.

### Kinds of Damages

**The liability to pay damages is of four kinds. They are:**

- (i) liability for special damages
- (ii) liability for exemplary damages
- (iii) liability to pay nominal damages and
- (iv) liability to pay damages for deterioration caused by delay. Now let us discuss each one of them-

**(i) Liability for special damages:** Where it is understood between parties that in the event of breach of contract, there would be special damages also in addition to normal damages, then special damages would be payable. In our given example above if the tailor had informed about the special circumstances, special damages would have become payable.

**(ii) Liability for exemplary damages:** These situations may arise mainly in two cases namely (i) breach of promise to marry and (ii) wrongful dishonour of cheques of customer by bank.

In case of breach of promise to marry, the damages are awarded taking into account the injury or humiliation which the aggrieved person would have suffered.

In case of wrongful dishonor of cheques the damages would depend upon the loss of credit and reputation suffered by the customer. The damages could be very heavy if loss had been suffered by a businessman, when compared to a non-businessman customer.

For example Mrs. G, a non-trader paid a cheque for £90 and 16 shillings drawn on Westminster Bank to her landlord for rent. The cheque was dishonored by the bank. But she was awarded damages of only 40 shilling as nominal damages. [Gibbons vs. Westminster Bank (1939) 2 K.B. 882]

Similarly where the value of cheque is small, the damages could be very heavy in comparison to a situation where the value of cheque is heavy. This is on the theory that dishonor of a small value of cheque would cause more damages to the honor of the customer.

**(iii) Liability to pay nominal damages:** Nominal damages are awarded in those cases of breach of contract where no damage has been suffered. Such damages are awarded only to establish the right to decree for breach of contract. Such damages are for nominal amounts like ten rupees or even ten paise.

**(iv) Damages for deterioration caused by delay:** Compensation can be recovered even without notice for damages or 'deterioration' caused to goods on account of delay by carriers amounting to breach of contract. Here the word "deterioration" means not only physical damages but also loss of opportunity. In *Wilson vs. Lancashire and Yorkshire Railway Company* 50 LJCP 232, the plaintiff bought velvet with a view to making it into caps for sale during spring. But due to delay in transit, he was unable to use the velvet for making caps for sale during season.

It was held that the fall in value of sale of cloth in consequence of the same having arrived after the season amounted to deterioration. It was here held that the plaintiff is entitled for compensation without notice.

**In case of a contract for sale of good-**

- (i) where the buyer breaks the contract, the damages would be the difference between contract price and market price as on the date of breach.
- (ii) where the seller breaks the contract, the buyer can recover the difference between market price and contract price as on date of breach.

Where if the seller retains the goods after the contract has been broken by the buyer- there the seller cannot recover from the buyer any further loss even if the market falls. Again he is not liable to have the damages reduced if the market rises.

In *Jamal vs. Mulla Dawood* (1961) 43.I.A. 6, the defendant agreed to purchase from the plaintiff, certain shares on December 30, but wrongfully rejected them when tendered on date.

**Quantum Meruit**

The phrase 'quantum meruit' literally means "as much as earned" or "according to the quantity of work done". A person who has begun a civil contract work and has to later stop the work because the other party has made the performance impossible, is entitled to receive compensation on the principle of 'Quantum Meruit'.

**Following are instances where 'quantum meruit' may arise:**

- (a) Where the work has been done and accepted under a contract which is subsequently discovered to be void. In such a case, the person who has performed his part of the contract is entitled to recover the amount for the work done and the party, who receives and accepts the benefit under such contract, must make compensation to the other party.
- (b) Where a person does some act or delivers something to another person with the intention of receiving payment, the other person is bound to make payment if he accepts such services or goods or enjoys the benefits.
- (c) Where the contract is divisible and where a party performs a part of the contract and refuses to perform the remaining part, the party in default may sue the other party who enjoyed the benefit of the part performance.
- (iii) Suit for specific performance: Where damages are not an adequate remedy in the case of breach of contract, the court may in its discretion on a suit for specific performance direct the party in breach, to carry out his promise according to the terms of the contract.

**(MODULE-II)**

**AGENCY**

In the modern world conduct of business is not possible without the help of agents. Therefore it is necessary to know the law relating to agency. The law of agency is contained in sections 182 to 238 of the Indian Contract Act, 1872.

The Indian Contract Act, 1872 does not define the word 'Agency'. However the word 'Agent' is defined as "a person employed to do any act for another or to represent another in dealings with third persons". The third person for whom the act is done or is so represented is called "Principal". (Section 182)

Thus 'Agency' is a comprehensive word used to describe the relationship between one person and another,

where the first mentioned person brings the second mentioned person into legal relation with others.

The Rule of Agency is based on the maxim “Qui facit per alium, facit per se.” means, he who acts through an agent, can act himself.

**Salient features of agency:** Following are the four salient features of agency

- (i) **Basis:** The basic essence of ‘agency’ is that the principal is bound by the acts of the agent and is answerable to third parties.
- (ii) **Consideration not necessary:** Unlike other regular contracts, a contract of agency does not need consideration. In other words, the relationship between the ‘principal’ and ‘agent’ need not be supported by consideration.
- (iii) **Capacity to employ an agent:** A person who is competent to contract alone can employ an agent. In other words, a person in order to act as principal must be a major and of sound mind.
- (iv) **Capacity to be an agent:** A person in order to be an agent must also be competent to contract. In other words, he must also be a person who has attained majority and is of sound mind.

**There are five general methods of creating agency.** These are;

- (i) Agency by Express agreement
- (ii) Agency by Implied agreement
- (iii) Agency by Ratification
- (iv) Agency by necessity and
- (v) Agency by actual authority and apparent authority.

**Modes of creation of agency:**

**(1) Agency by Express agreement**

A person may employ another person as his agent by entering into an express agreement with him. The agreement may be either oral or written.

**(2) Agency by Implied agreement** –The relationship of principal and agent need not be expressly constituted and can arise by implication of law as well. Authority to act as agent can be inferred from nature of business, circumstances of case, the conduct of principal or the courses of dealing between parties. Thus, if a person realises rent and gives it to landlord, he impliedly act for land- lord as an agent.

**Agency created by implied agreement are;-**

**1) Agency by estoppel** - If a person makes a representation (by his words or conduct) to a third person that a certain person is his agent; and the third party believing such representation to be true, enters into a contract with the pretended agent.

Then – the person making the representation is prevented from denying the truth of agency. He may be held liable as a principal by such third party.

**2) Agency of holding out** - Such an agency comes into existence when a person by his affirmative or positive conduct leads third persons to believe that person doing some act on his behalf is doing with authority.

**3) Agency by ratification**

**Meaning-** If a person (viz., pretended agent) acts on behalf of another person (viz, the principal) the pretended agent acts without the knowledge or consent of the principal; and Afterwards, the principal accepts such act. Then – Agency by ratification comes into existence.

**Effects of ratification**

- The principal is bound by the acts ratified by him as if such acts had been performed by his authority.
- Ratification relates back to the actual date of the act that is ratified and not from the date when the act ratified.

## ESSENTIALS OF A VALID RATIFICATION (Sec. 197 to 200)

**a) Full knowledge** - No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective. In other words, the principal must have full knowledge of all the material facts.

**b) Whole transaction**- It must be done for whole transaction in fact; ratification of the part of a transaction operates as a ratification of the whole transaction.

**c) Act on behalf of another person**- The acts done by a person (i.e. pretended agent) on behalf of another person (i.e. pretended principal) can only be ratified.

**d) By the principal** - Ratification can be made by only such person for whom the act was done.

**Existence of principal** - The principal must be in existence at the time when the act was done in his name

**Contractual capacity**- The principal must have contractual capacity both at the time of entering into the contract and at the time of ratification.

**f) Lawful acts**- Only those acts which are lawful can be ratified. Void, illegal, or ultra vires acts cannot be ratified.

**g) Acts within principal's power** Ratification can be made only for such acts which principal had the power to do.

**h) Communication** Ratification must be communicated to the third party so as to bind him .

**I) Within reasonable time** Ratification must be made within reasonable time of the act purported to be ratified.

**(4) Agency by necessity**- Sometimes circumstances would compel and a relation of agency would fall in place. This is often out of necessity. For example a captain of a ship can borrow money at other ports where there are no agent to act on behalf of the owner, to carryout repairs. The captain becomes an agent by necessity. To constitute an agency by necessity following conditions must be fulfilled.

**(i)** Agent should be in a position of not being able to communicate in time with the principal

**(ii)** There must have been an actual and definite commercial necessity

**(iii)** The agent must have acted bonafide and for the benefit of principal

**(iii)** The agent must have adopted most reasonable and practicable course of action.

### Authority of Agent

**Actual authority and apparent authority:** Actual authority to act as agent stems from a consent. The consent to act may be oral or in writing. Some time the authority can also be 'implied authority'. The implied authority is incidental or usual or customary. It would depend on the circumstance of the case.

The authority of the agent is 'apparent' where the principal represents or is regarded by law as having represented that another has, authority. Under the doctrine of 'apparent authority', the 'principal' is bound to third parties by the acts of that person though he had not given such authority or had limited the authority by instructions not made known to third party. The notion of apparent authority is essentially confined to relationship between the principal and third party.

**The agent's authority is governed by two principles namely (a) in normal circumstances and (b) in emergency.**

**Let us examine these two situations -**

**(i)** Agent's authority in normal circumstances: An agent has the power and authority to do all acts lawful and necessary in the normal circumstances in discharge of his functions. For instance, where 'A' who lives in Andamans employs 'B' as his agent to collect his debts in Kanyakumari, 'B' has all the authority including the authority to pursue legal proceedings. Similarly 'B' can also give valid discharge. Again for example, where 'A' executes a power of attorney in favour of 'B' in running a silk factory, but the power of attorney did not authorize 'B' to borrow and if 'B' borrowed, it was stated to be an act in excess of his authority

**(ii)** Agent's authority in emergency: An agent has the authority in an emergency to do all such acts as a man of ordinary prudence would, for protecting his principal from losses under similar circumstances.

A typical case is where the 'agent' who handles perishable goods like 'mangoes' can decide the time, date and place of sale, not necessarily as per instructions of the principal but with the intention of protecting the principal from losses. Here the agent acts in an emergency and acts as a man of ordinary prudence.

**Notice to an agent:** Any notice given to an agent or information obtained by agent will be deemed to be given to the principal. Thus where the agent of an insurance company negotiates with a customer who had lost an eye

in an accident, the insurance company is deemed to have knowledge of the fact.

### **Duties of Agent**

- (i) **Duty in conducting principal's business:** The agent should conduct the business of the principal as per directions of the principal or in the absence of any directions as per the custom prevalent in the business
- (ii) **The agent is liable to the principal for any loss if he deviates from the above duty/ obligation** where he did not act according to instruction of the principal. It was held by the Supreme Court in a case that the agent had to compensate the principal where the agent did not act according to the instructions of the principal. In the given case the agent was under instruction to insure the goods of the principal but he did not. There was an explosion in the Bombay dock and as a result all the goods of the principal, along with others, was destroyed. The Government passed an ordinance that where ever there was a fire insurance policy, full amount would be paid to the owners and where there was no insurance cover, half the amount would repaid. The principal was paid half the losses and he sued the agent for the balance loss and the agent was ordered by court to pay the balance amount to compensate him for loss.
- (iii) **Requirements as to skill and diligence:** Agent must act always as a person with diligence and skill normally exercised in the trade. He would otherwise be responsible to compensate the principal for any loss suffered by the principal for want of his skill.  
Where 'A' acts as an agent for 'B' and sells rice to 'C' in the usual course of business without verifying about C's solvency and if 'C' goes insolvent, then 'A' is responsible for losses arising to 'B'.
- (iv) **Agents duty to account:** The agent has to maintain and render proper accounts to principal whenever demanded. He is bound to pay the principal all sums received. He is bound to maintain accounts even if the contract is illegal or void.
- (v) **Duty to communicate:** The agent must in order to obtain instruction, communicate and contact the principal as a man of ordinary diligence.

### **Rights of an agent**

- (i) **Right of lien on principal's property:** An agent is entitled to retain the goods, properties and books for any remuneration, commission etc due to him. The possession of such property should be however lawful.
- (ii) **Right of indemnification for lawful acts:** The principal is bound to indemnify the agent against all consequences of lawful acts done in exercise of his authority. For example 'A' of Delhi appoints 'B' of Mumbai as agent to sell his merchandise. As a result 'B' contracts to deliver the merchandise to various parties. But 'A' fails to send the merchandise to 'B' and 'B' faces litigations for non-performance. Here 'A' is bound to protect 'B' against the litigations and all costs, expenses arising out of that.
- (iii) **Right of indemnification against acts done in good faith:** Where the agent acts in good faith on the instruction of principal, agent is entitled for indemnification of any loss or damage from the principal. Where 'P' appoints 'A' as his agent and directs him to sell certain goods which in fact turned out to be not those belonging to 'P' and if third parties sue 'A' for this act, 'A' is entitled for reimbursement and indemnification for such act done in good faith.  
However the agent cannot claim any reimbursement or indemnification for any loss etc arising out of acts done by him in violation of any penal laws of the country.
- (iv) **Right of retention:** The agent can retain, out of the sums received from the principal, such amounts towards reimbursement of expenditure, remuneration and advances paid by him on account towards the business and render accounts only for the balance.
- (v) **Right of remuneration:** The agent in the normal course is entitled for remuneration as per the contract. In the absence of any agreed amount of remuneration, he is entitled for usual remuneration which is customary in the business. However he is not entitled for any remuneration for acts done through misconduct/negligence.

We have already seen that basic principle of agency is that agent acts on behalf his principal and therefore cannot personally enforce the contract. Similarly he is also not personally bound for any act.

### **Personal liability of agent**

However under certain circumstances like, where the agent exceeds his authority, or has no authority or the principal does not ratify the act of the agent, the agent is personally liable. This is known as **doctrine of implied warranty of authority**. The rules with regard to personal liability of an agent are set out hereunder.

- (i) where the contract expressly provides for personal liability of the agent



- (ii) where the agent signs the negotiable instrument without indicating that he is signing it for the principal
- (iii) where the agent works for a foreign principal
- (iv) where the agent acts for a principal who cannot be sued viz Ambassador of a country etc.
- (v) where a Govt. servant enters into a contract on behalf of Union of India in disregard of Article 299(1)
- (vi) where according to usage in trade in certain kinds of business agents are personally liable.
- (vii) where the agency is coupled with interest. An agency will be treated as such where the agent himself has interest in the subject matter. The 'interest' of the agent to come under this category should not be an ordinary 'interest' like towards remuneration etc., but should be a special interest.

**An 'undisclosed principal'** comes into play where an agent having the authority to contract, does not disclose the fact, concealing not only the name of the principal but also the fact that there is a principal; here the agent gives an impression that he acts on his own.

In 'undisclosed principal', the mutual rights, of principal, agent and third party are as follows:

- (a) the liability of the agent is his own since he has not disclosed that there is a principal
- (b) where the third party comes to know about the existence of the principal he can sue the agent or the principal.
- (c) the third party's interest would stand protected evenly, and would not suffer even if the principal surfaces and intervenes at a later date.
- (d) third party has a right to refuse, if the principal discloses himself, on the ground that had he known about the principal he would not have entered into the contract.

### **The Duties and liability of the principal**

- (a) When agent acts within the scope of his authority: The principal is liable for the acts of the agent done within the scope of his actual or apparent authority. Where there are specific restrictions on the authority of the agent, then the principal is not bound by act of agent.
- (b) Principal is bound by notice given to agent: The principal is bound by the notice given to the agent. Knowledge of the agent is knowledge of the principal. Knowledge of a bank manager is knowledge of the bank. Therefore the principal is bound except where the agent does acts that are fraudulent.
- (c) Liability by estoppels: Where the agency is by the doctrine of estoppel, the principal is bound by the same doctrine.
- (d) Liability for misrepresentation: The principal is liable for any fraud or misrepresentation done by the agent within his authority regardless of the fact that the act has resulted in benefit to the agent or the principal.  
But, the principal is not liable for acts of agent done in excess of authority. Some times the acts can be separated as 'within the authority' and 'beyond the authority'. Principal is bound for those acts which are within the authority. But where acts are not separable, the principal may repudiate the entire transactions.
- (e) Unnamed principal: Where the existence of the principal is known but his name is not known, the principal is liable for the acts of the agent. Third parties can sue the principal for the acts of the agent, unless agent refuses to disclose the identity of the principal.
- (f) To pay agent commission or remuneration as agreed.
- (g) To indemnify (compensate) agent for injury caused by principal's neglect.

### **Rights of principal**

- (1) To recover damages. If the principal suffers any loss due to disregard of agent of direction of principal or does not follow the custom of trade in absence of direction of principal and the principal suffers due to lack of requisite skill, care or diligence on the part of agent, principal can recover damages from agent.
- (2) To obtain an account of secret profit. If the agent, without the knowledge and assent of principal, makes a secret profit out of agency, the principal has right to recover them from agent. Not only this, the agent also forfeits his right to any commission in respect of transaction.
- (3) To resist agent's claim for compensation against liability incurred. When the principal can show that the agent has acted as principal himself and not merely as agent, he can resist the agent's claim for compensation



against liability incurred by him in such transaction.

### **The termination / Revocation of agency..**

In terms of Section 201 of the Act, following are the circumstances when the authority conferred on the agent gets terminated:

- (a) Revocation of authority by the principal
- (b) Renunciation of agency by the agent
- (c) Completion of business of agency
- (d) Death or insanity of principal or agent and
- (e) Insolvency of the principal

The rights of the principal to revoke the authority of the agent and the right of the agent to renounce are each exercised at their will and pleasure.

Following are the general principles in this regard:

- (a) Even where the agent gets interested in the subject matter, that would not be a ground for the principal to terminate the agency. The agency becomes an agency coupled with interest.
- (b) The principal cannot revoke the authority after the authority has been exercised.
- (c) The agent's authority cannot be revoked if the agent has partially exercised the authority.
- (d) Where there is an implied or express contract, agency may continue for a period of time. The agency can not be terminated without compensation.
- (e) Reasonable notice must be given for termination, otherwise the agent is entitled for compensation.
- (f) Revocation and Renunciation must be express or implied.

### **Where the agency cannot be terminated, it is called irrevocable agency.**

(a) **Where agency is coupled with interest** then it is a case where the agent has interest in the subject matter of agency. In this case, agency cannot be terminated except where there is an express provision, to cause prejudice to the interest of the agent. For the agency coupled with interest does not come to an end on the death, insanity, or the insolvency of the principal.

(b) **Where the agent has incurred personal liability**, principal cannot revoke the agency leaving the agent to face the liability. For instance where 'A' appoints 'B' as his agent and 'B' purchases as per orders of 'A' some rice in his personal name, A cannot revoke the authority

(c) **Where the agent has partly exercised the authority**, the authority cannot be revoked, where 'A' appoints 'B' as his agent to procure 10 bags of rice and 'B' procures in the name of 'A' then 'A' cannot revoke his authority.

Sub agency refers to case where an agent appoints another agent. The appointment of sub agent is not lawful, because the agent is a delegatee and a delegatee cannot further delegate. This is based on the Latin principle "delegatus non potest delegare".

The appointment of a sub agent would be valid if the terms of appointment originally contemplated it. Sometimes customs of the trade may provide for appointment of sub agents. In both these cases the sub agent would be treated as the agent of the principal.

Position of sub agent vis a vis third parties where the sub agent is properly appointed

(a) **Where the sub-agent is properly appointed:** Where a sub agent is properly appointed, the principal is bound by his acts and is therefore responsible to third parties as if he were an agent originally appointed by the principal.

(b) **In the case of appointment without authority:** In case where the appointment of sub agent takes place without authority, the principal is not bound by the acts of sub agent and sub agent is not bound to the principal. It is the agent who is the principal of sub agent. Where the sub-agent purportedly acts in the name of first principal, that first principal may ratify the act of sub agent. However if the sub agent acts in his own name or in the name of the agent who has without authority delegated to the sub agent the business which is in fact of the principal, the principal cannot ratify such acts of sub agent.

Substituted agents are not sub agents. They are agents of the principal. Where the principal appoints an agent and if that agent identifies another person to carry out the acts ordered by principal, then the second person is not to be treated as a sub agent but only as an agent of the original principal.

For example, 'A' directs 'B' his solicitor to sell his property by auction and 'B' appoints 'C' an auctioneer. In this regard, 'C' is an agent of 'A' and not a sub agent.

While selecting a "substituted agent" the agent is bound to exercise same amount of diligence as a man of ordinary prudence and if he does so he will not be responsible for acts or negligence of the substituted agent.

For example 'X' consigns goods to 'Y' a merchant for sale. 'Y' in due course employs an auctioneer in goods to sell goods of 'X' and also allows him to receive the proceeds of sale. The auctioneer becomes insolvent afterwards without handing over the proceeds. Here 'Y' will not be responsible to 'X' as he has discharged his duties as a man of ordinary prudence and diligence.

## **Bailment**

Bailment means 'handing over' or 'change of possession'. As per Section 148 of the Act. **Bailment is an act whereby goods are delivered by one person to another for some purpose, on a contract. When the purpose is accomplished, the goods shall be returned or otherwise disposed of according to the directions of the person delivering them.** The person who delivers the goods is the 'bailor' and the person to whom the goods are delivered is the 'bailee'.

For example where 'X' delivers his car for repair to 'Y', 'X' is the bailor and 'Y' is the bailee.

**The essential characteristics of bailment are-**

- (a) Bailment is based upon a contract. Sometimes it could be implied by law as it happens in the case of finder of lost goods.
- (b) Bailment is only for moveable goods and never for immovable goods or money.
- (c) In bailment possession of goods changes. Change of possession can happen by physical delivery or by any action which has the effect of placing the goods in the possession of bailee.
- (d) In bailment bailor continues to be the owner of goods as there is no change of ownership.
- (e) Bailee is obliged to return the goods physically to the bailor. The bailee cannot deliver some other goods, even not those of higher value.

### **General issues:**

1-In bailment both custody and possession must change but not the ownership. But where a person is in custody without possession he does not become a bailee. For example servants of a master who are in custody of goods of the master do not become bailees.

2-Possession and custody do not however mean physical delivery of goods. Constructive delivery could also create a bailor and bailee relationship. This arises in situations where the bailee is already in possession of goods but agrees to be a bailee through a contract.

3-Deposit of money in a bank is not bailment since the money returned by the bank would not be identical currency notes.

Similarly depositing ornaments in a bank locker is not bailment, because ornaments are kept in a locker whose key are still with the owner and not with the bank. The ornaments are in

Possession of the owner though kept in a locker at the bank.

### **Different forms of Bailment:**

Following are the popular forms of bailment

- (1) Delivery of goods by one person to another to be held for the bailor's use.
- (2) Goods given to a friend for his own use without any charge
- (3) Hiring of goods.

- (4) Delivering goods to a creditor to serve as security for a loan.
- (5) Delivering goods for repair with or without remuneration.
- (6) Delivering goods for carriage.

**Duties of Bailor:** The duties of bailor are spelt out in a number of Sections. These are enumerated hereunder:

- (i) The bailor must disclose all defects/faults in the goods bailed. If the bailor does not disclose, he would be responsible for any loss or damage suffered by the bailee while keeping the goods in his custody. The bailor is particularly responsible for defects in goods hired to bailee whether bailor was aware of such defects or not.
- (ii) Where the bailment is gratuitous, the bailor must reimburse the bailee for any expenditure incurred in keeping the goods.
- (iii) the bailor should reimburse any expense which the bailee may incur by way of loss in the process of returning the goods or complying with other directions for returning the goods.
- (iv) the bailor must compensate the bailee for the loss or damage suffered by the bailee that is in excess of the benefit received, where he had lent the goods gratuitously and decides to terminate the bailment before the expiry of the period of bailment.
- (v) the bailor is bound to accept the goods after the purpose is accomplished. If bailor fails, he is responsible for any loss or damage to the goods and has to reimburse for expenses incurred by the bailee for keeping the goods safely.

**Rights of Bailor:** The following are the rights of bailor:

- (1) Bailor has a right to enforce the duties of the bailee such as -
  - (a) right to claim damages for loss caused to the goods by the negligence of bailee;
  - (b) right to claim compensation for loss caused by an unauthorized use of the goods bailed;
  - (c) right to claim damages arising out of mixing the goods of the bailor with his own goods.
- (2) Bailor has a right to terminate the contract if the bailee does anything which is inconsistent with the conditions of bailment. For example 'A' lets on hire his horse to 'B' for his own riding but 'B' uses the horse for driving his carriage. 'A' has a right to terminate the contract of bailment.
- (3) Bailor in the case of gratuitous bailment has a right to demand the goods back even before the expiry of the period of bailment. If in the process, loss is caused to the bailee, bailor is bound to compensate.
- (4) Bailor has a right to claim the increase or profit from the goods bailed which may have occurred from the goods value. For example where 'A' bails his cow to 'B' and if the cow gives birth to a calf, 'B' is bound to return the cow and the calf to 'A'.

The bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence with regard to quantity, bulk and value would take.

In such a case he will not be responsible, in the absence of special contract, for any special loss or destruction or deterioration of the goods bailed, since he has taken as much care as a man of ordinary prudence.

For example if X bails his ornaments to 'Y' and 'Y' keeps these ornaments in his own locker at his house along with his own ornaments and if all the ornaments are lost/stolen in a riot 'Y' will not be responsible for the loss to 'X'. If on the other hand 'X' specifically instructs 'Y' to keep them in a bank, but 'Y' keeps them at his residence, then 'Y' would be responsible for the loss [caused on account of riot].

**Bailee has right to terminate:** The bailee has the right to terminate a contract of bailment if the bailor does anything inconsistent with bailment conditions.

**Duty In addition to the two important duties of having to take care of the goods bailed and being responsible for loss/injury/damage to goods, bailee has other following duties under the Act.**

- (i) Bailee has no right to make unauthorized use of goods bailed
- (ii) Bailee has no right to mix the goods bailed with his own goods without the consent of the bailor.
- (iii) Bailee has to return the goods on expiration of period of bailment
- (iv) Bailee has a duty to return any extra profit accruing from goods bailed. Where A bails his cow to 'B'

and if the cow gives birth to a calf, 'B' must return both the cow and the calf to 'A'

- (v) Bailee has duty not to do anything inconsistent with the condition of bailment.
- Rights of bailee: The bailee has the following rights [These rights are also the duties of the bailor]-
- (i) to claim compensation for any loss arising from non-disclosure of known defects in the goods
  - (ii) to claim indemnification(compensation) for any loss or damage as a result of defective title.
  - (iii) to deliver back the goods to joint bailors according to the agreement or directions
  - (iv) to deliver the goods back to the bailor whether or not the bailor has the right to the goods
  - (v) to exercise his 'right of lien'. This right of lien is a right to retain the goods and is exercisable where charges due in respect of goods retained have not been paid. The right of lien is a particular lien for the reason that the bailee can retain only these goods for which the bailee has to receive his fees/remuneration.
  - (vi) to take action against third parties if that party wrongfully denies the bailee of his right to use the goods

### **Suit by bailor & bailee against wrong doers**

Both bailor and bailee have right to sue a third party who has deprived the bailee to the use or possession of goods bailed. Any relief obtained against such deprivation or injury can be shared between the bailor and bailee according to their respective interest.

We have already seen in an earlier study unit, that the duties of 'finder of lost goods' are that of the bailee. Such a 'finder of lost goods' is as good as a bailee and he enjoys all the rights and carries all the responsibilities of a bailee.

Apart from the above, the 'finder of lost goods' can ask for reimbursement for expenditure incurred for preserving the goods but also for searching the true owner. If the real owner refuses to pay compensation, the 'finder' cannot sue but retain the goods so found.

Further where the real owner has announced any reward, the finder is entitled to receive the reward. The right to collect the reward is a primary and a superior right even more than the right to seek reimbursement of expenditure.

Lastly the finder though has no right to sell the goods found in the normal course, he may sell the goods if the real owner cannot be found with reasonable efforts or if the owner refuses to pay the lawful charges subject to the following conditions:

- a) when the article is in danger of perishing and losing the greater part of the value or
- b) when the lawful charges of the finder amounts to two-third or more of the value of the article found.

### **General lien**

A general lien is the right to retain the property of another for a general balance of account. In contract the particular lien is the right to retain the particular goods bailed for non-payment of charges/remuneration.

Bankers, factors, wharfingers, policy brokers and attorneys of law have a general lien in respect of goods which come into their possession during the course of their profession.

For instance a banker enjoys the right of a general lien on cash, cheques, bills of exchange and securities deposited with him for any amounts due to him. For instance 'A' borrows

Rs. 500/- from the bank without security and subsequently again borrows another Rs.1000/- but with security

of say certain jewellery. In this illustration, even where 'A' has returned Rs. 1000/- being the second loan, the banker can retain the jewellery given as security to the bank for second loan. The same jewellery can be adjusted towards the first loan which is not yet repaid to bank.

Under the right of general lien, the goods cannot be sold but can only be retained for dues. The right of lien can be waived through a contract.

Interestingly, Chartered Accountants have a general lien against the books of their clients which come into their possession against professional fees not paid to them by those clients.

### **Particular lien**

Particular lien: In accordance with the purpose of bailment if the bailee by his skill or labour improves the goods bailed, he is entitled for remuneration for such services. Towards such remuneration, the bailee can retain the goods bailed if the bailor refuses to pay the remuneration. Such a right to retain the goods bailed is the right of particular lien. He however does not have the right to sue.

Where the bailee delivers the goods without receiving his remuneration, he has a right to sue the bailor. In such a case the particular lien may be waived. The particular lien is also lost if the bailee does not complete the work within the time agreed.

**Difference between general lien and particular lien: The difference between the two can be summarized as follows:**

**(G)** It is a right to detain/retain any goods of the bailor for general balance of account outstanding

**(P)** It is a right exercisable only on such goods in respect of which charges are due.

**(G)** A general lien is not automatic but is recognized through an agreement. It is exercised by the bailee only by name. It is automatic

**(P)** It can be exercised against goods even without involvement of labour or skill. It comes into play only when some labour or skill is involved

**(G)** Bankers, factors, wharfingers, policy brokers etc. are entitled to general lien

**(P)** Bailee, finder of goods, pledgee, unpaid seller, agent, partner etc are entitled to particular lien

## **THE SALE OF GOODS ACT, 1930**

### **COMMENCEMENT AND APPLICABILITY OF THE ACT**

This act extends to whole of India, except the State of Jammu and Kashmir.

This act came into force w.e.f. 1 July 1930.

The 'contract of sale' includes both a sale as well as an agreement to sell.

The word Indian was omitted the title of the Act in 1963 (22 sept.)

This Act does not deal with the sale of immovable property.

The transaction relating to immovable properties, e.g., the sale, lease, gifts, etc., are governed by a separate Act known as 'Transfer of Property Act, 1882'. This Act is beyond the scope of this book.

### **DEFINITIONS (Sec. 2)**

**Buyer – Sec 2 (1)** A person, who buys or agrees to buy the goods.

**Delivery Sec (2)** It means voluntary transfer of possession from one person to another.

**Delivery State Sec 2(3)** Goods are said to be in delivered state, when they are in such state that the Buyer would be bound to take the delivery of them in accordance with the contract.

**Documents of title to Goods 2(4)** A document of the title to goods may be described as any document used as proof of the possession or control of goods, authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented.

Section 2(4) of the Sale of Goods Act, 1930 recognizes the following as documents of title to goods:

- (i) Bill of lading,
- (ii) Dock warrant,
- (iii) Warehouse keeper's certificate,
- (iv) Wharfinger's certificate,
- (v) Railway receipt,
- (vi) Multi – modal transport document,
- (vii) Warrant or order for the delivery of goods, and
- (viii) Any other document used in the ordinary course of business as document of title (as described in the preceding paragraph).

### **Document of Title v. Document showing the title :**

A document of title enables a person named therein to transfer the property by mere endorsement and delivery, whereas a document showing title does not confer any right to transfer by way of endorsement and delivery.

For example, a share certificate shows that the person named therein is entitled to the shares represented by it, but does not allow transfer of the shares by mere endorsement and delivery of the certificate.

**Goods – Sec 2 (7)** Goods mean every kind of movable property other than **actionable claims and money**, and it includes. stock and shares, growing crops, grass and things attached to or forming part of land which are agreed to be severed before sale or under the contract of sale.

You may notice that 'money' and 'actionable claims' have been expressly excluded from the term 'goods'. 'Money' means the **legal tender**. 'Money' does not include old coins and foreign currency. They can, therefore, be sold or bought as goods. Sale and purchase of foreign currency is, however, also regulated by the **foreign Exchange Management Act**,

**Actionable claims', like debts**, are things which a person cannot make use of, but which can be claimed by him by means of a legal action. Actionable claims cannot be sold or purchased like goods, they can only be assigned, as per the provisions of Transfer of property Act.



Grass, growing crops, trees to be cut and then their log wood to be delivered as goods. Similarly, things like goodwill, copyright, trade mark, patents, water, gas electricity are all goods and may be the subject matter of a contract of sale.

**Seller – Sec 2 (13)** A person, who sells or agrees to sell the goods,.

**Agreement to sell-** Where transfer of property in goods takes place at future date.

**Sale-** Where transfer of property in goods takes place at the time of contract.

### **ESSENTIAL ELEMENTS OF VALID CONTRACT OF SALES**

The following are the essentials of valid contract of sale:

There must be two parties, one seller and other buyer.

- Seller and buyer must be different.
- Part owner can sell goods to another part owner.
- Partners are not regarded as separate persons for the purpose of sale of the partnership property. They are the joint owners of the goods and as such they cannot be both sellers and buyers.

But, a partner may buy goods from the firm or sell goods to the firm.

There must be movable goods as subject matter of contract.

There must be a transfer of property in goods. It means general property.

There must be price involved. Price means money consideration for sale of goods.

#### **•Exchange of goods for goods is barter.**

If Exchange is for partly goods and partly for money it is sale.

All essential elements of valid contract must be observed.

The contract of sale can be entered into, expressly or impliedly.

Formation. The contract of sale may provide for any of the following methods.

- Immediate delivery of goods.
- Immediate payment of price but delivery at some future date.
- Immediate payment of price and immediate delivery of goods.
- Delivery or payment or both made in installments.
- Delivery or payment or both will be made at future date.

### **TRANSFER OF “PROPERTY IN GOODS”**

Property means general property in goods and not merely special property in goods. It means ownership of goods. Special property in goods means possession of goods.

Cases where property in goods is not transferred:

- Bailment
- Creating charge or pledge

#### **Difference between Sale and Agreement to Sell**

| <b>SALE</b>                               | <b>AGREEMENT TO SELL</b>          |
|---|-----------------------------------|
| Immediate transfer of ownership to buyer. | Ownership remains with the seller |

|   |  |
|---|--|
| It is executed contract   | It is an executory contract  |
| It creates right in rem for buyer.  | It provides right in personam for buyer and seller   |
| Seller can sue for price – if seller remains paid.                                    | Seller can sue for damages   |
| Risk passes to buyer.   | Risk doesn't pass to buyer   |
| Buyer can get goods even if seller has become insolvent.                              | Buyer can get proportionate share in whole of the Money recovered by sell of his asset but can't get goods back. |
| Delivery to official receiver if buyer becomes insolvent before the payment of price. | Delivery can be refused by seller if buyer becomes insolvent.  |

### CLASSIFICATION OF GOODS

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

#### Existing goods

Existing goods are the goods, which are owned and possessed by the seller at the time of sale. Existing goods may be of three types;

(a) **Specific Goods:** The goods, which are identified and agreed upon by the parties at the time of contract of sale.

- It should be noted that the goods must be both identified and agreed upon.

(b) **Unascertained Goods:**

- These are the goods, are not identified and agreed upon at the time of the contract of sale.
- These goods are merely described by the parties at the time of contract of sale.

(c) **Ascertained Goods:**

- There are the goods, which are identified after the formation of contract of sale. When the un-ascertained goods are identified and agreed upon by the parties, the goods are known as ascertained goods.

#### Future Goods:

Future goods are those goods, which do not exist at the time of the contract of sale.

These goods are to be manufactured or acquired by the seller after the making of the contract of sale.

Future goods cannot be sold, but there can only be an agreement to sell.

**Example:** A, a manufacturer agrees to sell 5 tables and 50 chairs to B at Rs.10,000. B agrees to purchase it.

However, tables and chairs are yet to be manufactured by A.

#### Contingent goods:

It is a kind of future goods. It is goods, the acquisition of which is contingent upon the happening or non – happening of an uncertain event.

**Example:** A agrees to sell the goods loaded on the ship “Titanic”, which is coming from London to Bombay. The

ship may or may not arrive. So, these goods will be called as contingent goods.

| Basis                     | Futures Goods   | Contingent Goods   |
|---------------------------|---|--|
| 1. Meaning                | Goods that are yet to be manufactured produced or acquired  | Goods, the acquisition of which depends upon a contingency after making contract of sale. Which may or may not happen? |
| 2. Element of uncertainty | Acquisition of Future Goods does not depend upon and uncertainty  | The procurement of Contingent Goods is dependent upon an uncertain event   |
| 3 Scope                   | Future Goods do not include Contingent Goods because of the element of certainty  | They are wider in scope, it includes future Goods  |
| 4. Effect of Contract     | Where by a contract of Sale, the Seller purports to effect a sell of goods the acquisition for which the contract operates. | There may be a contract of present sale of future Goods which is uncertain by contingency.                             |

### Price of Goods

Price means the money consideration for a sale of a Goods 2(10)

#### The following are the modes of determining price: [Sec. 9]

Price is specified under the contract. It is the most common method of determining the price. Here, parties decide the price in advance. Price may be determined as per the method specified in contract.

**Example :** Delivery of rice on 1st December 2008 at the rate prevailing on that day.

Price may be determined in accordance to custom and usage of trade. This method is applicable if parties regularly trade.

Where the price is not fixed as above, the buyer shall pay the seller a reasonable price.

‘What is a reasonable price is a question of fact and circumstances.

**Fixation of price by third party. (Sec. 10)** If it is so, contract shall specify name of third party.

If third party fails to specify, contract is void but if goods are delivered to buyer and used by him, he is required to pay reasonable price.

If the third party is prevented from fixing price, defaulting party is liable for the damages.

### Consequences of Destruction of Specific Goods – Sec 7 – 8

The consequences of destruction of specific goods can be discussed under the following three heads:

If goods perish before making the contract

- Contract is void – ab – initio, due to mistake as to existence of subject matter.

- It is to be noted that if the seller has knowledge about the destruction of goods, even then the enters into the contract of sale with buyer, then seller is bound to compensate to the buyer.

Where a part of the goods is perished before making contract

- If the goods was divisible, then the contract can be enforced party and if the goods was indivisible, then the contract becomes void – ab – inito.

**Example:** A contracted to sell one wagon containing 700 bags of groundnut to B. Unknown to A, 109 bags had been stolen at the time of sale, Therefore, A made a delivery of 591 bags.

Held, the sale was void.

If goods perish after the “Agreement to sell; but before’ Sale [Sec. 8]

The contract is void if subsequently the goods have perished, and there is no fault on the part of the buyer or seller in perishing the goods.

**Example:** A horse was delivered upon trial for 8 days. However, the horse died within 8 days, without the fault of buyer or seller. Held, the seller must bear the loss, as the contract was void.

However, parties to the contract may provide otherwise also.

Section 7 and 8 are applicable only in case of specific goods.

Therefore, if unascertained goods are destroyed either before or after making the agreement, the contract shall not become void. Thus, in an agreement to sell unascertained goods, even if the entire stock of goods is destroyed, the contract that not become void and the seller will have to perform his promise.

**Example** ‘A’ agreed to sell to ‘B’ 100 bags of wheat from his stock of 1,000 bags in his godown.

The entire stock was destroyed by fire. ‘A’ is bound to deliver 100 bags of wheat or else he will be liable for damages.

If the contract does not otherwise provide, then –

Stipulation as to time of payment is not deemed to be essence of contract.

Stipulation as to time of delivery is deemed to be essence of contract.

### **CONDITIONS AND WARRANTIES :**

Generally, at the time of sale, the seller makes some representation, statements of stipulations for the price of his goods. Some of representations are in nature of opinion others are in nature of facts. Representation as to fact which becomes a part of contract of sale is called as **stipulation**.

Stipulation may be condition or warranty depends upon its importance in relation to contract. **Stipulation which is essential to the main purpose of contract is known as condition.**

Breach of condition gives the aggrieved party right to terminate the contract. **Stipulation which is collateral to the main purpose of the contract is warranty.**

Breach of warranty gives rise to the aggrieved party right to claim damages but contract cannot be terminated.

The conditions and warranties may be express or implied.

Express conditions and warranties are those, which the parties agree expressly, i.e. orally or in writing.

Implied conditions are those, which are implied by the law in the absence of any agreement to the contrary.

## IMPLIED CONDITIONS

The following are the implied conditions which are contained in the Sales of Goods Act:

### Conditions as to title – sec 14(a)

There is an implied condition on the part of the seller that

- In the case of sale, the seller has a right to sell the goods, and
- In the agreement to sell, the seller will have a right to sell the goods at the time of passing of ownership in goods.

If the title of seller is said to be defective, the buyer must return the goods to the true owner and recover the price from the seller.

### Conditions as to description – Sec 15

Where the goods are sold by description, there is an implied condition that the goods shall correspond to the description.

**Example;** A machine was sold. The buyer has not been the machine, but the seller described it as a new one. However, it was found to be a very old one. Held, the machine was not according to the description.

### Sale by sample – Sec 17

Where the goods are sold by sample, the following are implied conditions.

- The bulk shall correspond to sample in quality.
- The buyer shall be given a reasonable opportunity to compare the goods with the sample.
- The goods shall be free from any defect, rendering them un – merchantable. It is to be noted that this implied condition applies only in the case of latent defects, i.e. those defects which cannot be discovered by ordinary inspection. In fact, such defects are discovered when the goods are put to use or by examination in laboratories. The seller is not liable for apparent or visible defects which can be discovered by examination.

**Sale by description as well as sample – Sec 15** If the sale is by sample as well as description, both conditions shall be satisfied. Goods must correspond with sample as well as description.

**Example :** A agreed to sell to C some oil described as “Foreign refined oil” and warranted only equal to sample. The goods supplied were equal to sample, but contained a mixture to hemp oil. Held, C could reject the goods.

**Conditions as to quality and fitness for buyer’s purpose –Sec 16** Where the buyer, expressly or impliedly, tells the seller the particular purpose for which he needs the goods and relies on the skill or judgment of the seller, there is an implied condition that the goods shall be reasonably fit for such purpose.

When the article can be used only for one particular purpose, the buyer need not inform the seller the purpose for which the goods are required.

**Example:** A purchased a hot water bottle from a chemist. While the bottle was being used by A’s wife, it burst and injured A’s wife. Held, the seller was liable for damages as the bottle was not fit for the purpose for which it was meant .

### Exceptions to the implied condition as to quality or fitness

The condition as to quality or fitness’ well not apply, if the buyer is suffering from an abnormality ,which

renders the goods unsuitable for a particular purpose and the buyer does not inform the seller about that abnormally.

**Example** A purchased a coat. He had abnormally sensitive skin, By wearing the coat, he got skin complaint. Held, there was no breach of condition, as he had not disclosed the abnormally of his skin. Where the goods can be used for a number of purposes, the buyer should inform the particular purpose for which such goods were required. If the does not disclose, there is no such conditions of quality or fitness.

#### **Conditions as to merchantability**

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

**Merchantability'** means that there is no defect in the goods, which renders them unfit for sale. Thus, a watch that will not keep time and a pen that will not write cannot be regarded as merchantable.

**Example:** A radio set was sold to a layman. The set was defective. It did not work in spite of repairs, Held, the buyer could return the set and claim refund.

**Condition as to wholesomeness** In the case of eatable and food– stuff, there is an implied condition that the goods shall be wholesomeness, i.e., free from any defect which renders them unfit for human consumption.

**Example:** APurchased milk from B, a milk dealer. The milk contained typhoid germs. A's wife on taking the milk got infected and died. Held, A was entitled to get damages .

#### **IMPLIED WARRANTIES**

The following are the implied warranties which are contained in the Sales of Goods Act:

In the absence to any contract showing contrary intention, there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. If the buyer is disturbed in the enjoyment of the goods, he can claim damages from the seller.

**Warranty against encumbrances –Sec 14** Unless the circumstances of the case are such as to show a contrary intension, there is an implied warranty that the goods shall be free from any charge or encumbrance in favour of any party not declared to the buyer before or at the time contract is made.

However, there will not be any such warranty if charge is declared to buyer at the time of sale.

An implied warranty as to quality or fitness for a particular purpose may be annexed by the usage of trade. In case of sale of dangerous goods, the seller is under obligations to warn the buyer about the probable danger. Failure to do so will make the seller liable to pay damages.

**Example :** A sold a tin of disinfectant to B, knowing that it was likely to be dangerous to the tin, whereupon disinfectant powder went into her eyes, causing her injury. Held, A was liable in damages to B, as he failed to warn B of the probable danger.

| Basis       | Condition                             | Warranty                               |
|-------------|---------------------------------------|--|
| Stipulation | Essential to main purpose of contract | Subsidiary to main purpose of contract |



|              |   |   |
|--------------|---|---|
| If Breached? | Buyer has right to cancel contract  | Buyer has no right to cancel the contract   |
| Treatment    | Breach of condition may be treated as breach of conditions, thus breach of contract | Breach of warranty treated as breach of warranty. It does not lead to breach of contract. |

### **DOCTRINE OF CAVEAT EMPTOR**

The doctrine of 'Caveat Emptor' means "let the buyer beware".

It means that the buyer while purchasing goods must act with a "third eye and ear",

- He should be careful to see that the goods purchased will serve his purpose well.
- If the buyer is not careful and he finds later on that the goods do not serve his purpose, he cannot hold the seller liable for it.
- The seller is under no obligation to tell the defects of his articles.

However, in the following exceptions Doctrine of caveat emptor is not applicable:

- Implied conditions as to quality or fitness. It means when buyer has specified his purpose and relied on skill of seller, the doctrine of caveat emptor is not applicable.

When goods are sold by description, it should be of merchantable quality, In such case, doctrine of caveat emptor is not applicable.

In case of edible items, implied condition of wholesome ness is applicable and if goods are not fit for human consumption then buyer is not liable but seller will be liable.

## **Consumer Protection Act.**

### **Consumer Rights, Consumerism and Business**

#### **Consumer Rights**

Every year, March 15 is observed as "World Consumer Right Day". Its significance is that in 1962 on this day, John Fitzgerald Kennedy, the then president of the US declared four consumer rights. Later, International Organization of Consumers Union (IOCU) added three more rights to the list. The government of India too included these rights in its 20-point programme. These have also been incorporated in the United Nations Charter of Human Rights. These are:

#### **Some of the rights of consumers are:**

- Right against exploitation by unfair trade practices.
- Right to protection of health and safety from goods and services that are available to the consumer.
- Right to be informed about the quality and performance standards, ingredients of the products, possible adverse effects etc.
- Right to be heard if there is any grievance or suggestion.
- Right to get genuine grievances redressed.
- Right to a physical environment that will protect and enhance the quality of life.

#### **Consumerism:**

Consumerism is a movement directed to protect the consumer and ensure that the consumer gets the best return in exchange for the money he spends.

Consumer education for our country is a must for the:

- Creation of critical awareness,
- Active consumer involvement,
- Imbibing social responsibility
- Realizing ecological responsibility ,
- Consumer Solidarity.

### **Objective of consumerism**

- To assist countries in achieving or maintaining adequate protection for their population as consumers.
- Facilitate production and distribution patterns responsive to the needs and desires of consumers.
- Encourage high levels of ethical conduct for those engaged in the production and distribution of goods and services.
- Assist countries in curbing abusive business practices by all enterprises which adversely affect consumers.
- Facilitate development of independent consumer groups.
- To further international cooperation in the field of consumer protection
- Encourage the development of market conditions which provide consumers with greater choice at lower levels.

### **Utility of Consumerism**

Producers and sellers will not take the consumer for granted.

Consumerism will provide feedback for businesses and enable producers to understand consumer grievances, needs and wants.

Consumerism will make the Government more responsive to consumer interests, prompt it to take necessary measures to protect the rights of consumers.

Help consumer and producer to get together and co-operate to get rid of unscrupulous traders.

### **Role of consumerism.**

Consumerism has the following roles to play:

- **Consumer Education:** Consumer is given information about various consumer goods and services in relation to prices, standard trade practices etc.
- **Product Rating:** Agencies such as **Consumer Education and Research Society (CERS), Ahmedabad;** carry out tests and report the result of such tests. Liaison with Government and with Producers.

### **Responsibility of consumers**

- Consumer should not make vague or general complaints and should also have supporting information and proof such as a bill.
- Consumer should try to understand the viewpoint of the seller.
- Consumers in asserting their rights should not inconvenience or hurt other sections of the public ie resort to rasta roko movements, bandh etc.

Consumers should complain against a system and not attack individuals.

**In India, the Government has taken a number of measures to protect consumer interests:**

#### **Statutory Regulation:**

Government of India is empowered to regulate the terms and condition of sale, nature of trade and commerce etc. Important legislation in this respect include the Competition Act,

- Essential Commodities Act,
- Prevention of Food Adulteration Act,
- Prevention of Black marketing and Maintenance of Supplies of Essential Commodities Act,
- Consumer Protection Act etc.

Growth of Public Sector was designed to enhance consumer welfare by increasing production and making

available goods and services at fair prices, curbing private monopolies and reducing market imperfections.

### **The Consumer Protection Act 1986**

**The Consumer Protection Act 1986** is a social welfare legislation which was enacted as a result of widespread consumer protection movement. It is an important landmark in consumer protection endeavors in India, which provides for a system for the protection of consumer rights and the redressal of consumer disputes. This Act extends to the whole of India except the State of Jammu and Kashmir, and save as otherwise expressly provides by the Central Government by notification, it applies to all goods and services.

The objective of the Act is to provide for the better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer councils and authorities for the settlement of consumer disputes and for matters connected therewith.

### **Objects of the Act**

1. Promoting and protecting the rights of consumers.
2. Providing for the establishment of consumer councils and other authorities.
3. Providing speedy and simple redressal machinery at district, state and central levels for settling consumer disputes and matters connected therewith.

### **Salient Features of the Act**

1. The Act applies to all goods and services unless specifically exempted by the Central Government.
2. It covers all the sectors whether private, public or cooperative.
3. The Act envisages the establishment of the Consumer Protection Councils at the central and state levels, whose main objects will be to promote and protect the rights of the consumers.
4. The Consumer Protection Act extends to whole of India except the State of Jammu and Kashmir and applies to all the goods and services unless otherwise notified by the Central Government.
5. The provisions of this act are in addition to and not in derogation of the provisions of any other law for the time being in force.
6. The provisions of the Act are compensatory in nature.

### **Defination of;-**

#### **1-Consumer (According to Sec. 2(1) (d) :**

Consumer means any person, who :

#### **i. Buys any goods for a consideration:**

- **Which has been paid or promised or partly paid promised, or**
- **Under any system of deferred payment.**
- 

‘Consumer’ also includes any user of such goods other than the buyer himself. The use of such goods must be with approval of the buyer for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment. But consumer does not include a person who obtains goods for resale or for any commercial purpose.

Commercial purpose does not include use by a consumer of goods bought and used by him exclusively for the purpose of earning his livelihood, by means of self-employment.

#### **ii. Hires or avails of any services for a consideration which has been paid or promised or partly paid and partly**

promised, or under any system of deferred payment. Consumer also includes any beneficiary of such services other than the person who hires or avails of such services. The beneficiary must acquire the use of such services with the approval of the hirer for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment. A patient hiring services of doctor for consideration has been held to be consumer.

**2. Disputes** (According to Section 2(1) (e) )

Consumer Dispute means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

**3. Defect** (According to Section 2(1) (f))

A defect means any fault, imperfection, or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force, or under any contract, express or implied, or as is claimed by the trader in any manner whatsoever, in relation to any goods.

**4. Deficiency** (According to Section 2 (1) (g))

Deficiency means any fault, imperfection or shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

In order to promote and protect the rights and interests of consumers, quasi judicial machinery is sought to be set up at district, state and central levels.

The main object of these bodies is to provide speedy and simple redressal to consumer disputes. It is one of the benevolent pieces of legislation intended to protect the consumers at large from exploitation.

**Consumer protection council:**

The Act provides for the establishment of a Central Consumer Protection Council by the Central Government and a State Consumer Protection Council in each State by the respective State Governments.

Central Council shall consist of the Minister in charge of consumer affairs in the Central Government who shall be its Chairman .

**Objective of Council:**

- Right to be protected against marketing of goods and services which are hazardous to life and property.
- Right to be informed about the quality, quantity , purity, standard and price of goods and services so as to protect the consumer against unfair trade practices.
- Right to be assured access to a variety of goods at competitive prices.
- Right to be heard and assured that consumers interests will receive due consideration at appropriate forums.
- Right to seek redressal against unfair trade practices
- Right to consumer education.

**Grounds for Appeal for the Jurisdiction to Redressal Forums**

Consumers can appeal for jurisdiction to the consumer redressal forums upon any of the five grounds:

**Consumer Act and Unfair Trade Practices**

False Offer or Bargain Price

Offering of Gifts, Prizes etc., and Conducting Promotional Contests

Product Safety Standards

Hoarding or Destruction of Goods Act

**Who can File a Complaint [Section 2 (b) & 12]**

A complaint in reference to any goods sold or delivered or services rendered may be filed by any of the following:

- By the consumer himself to whom such goods have been sold or delivered or such service rendered;
- Any voluntary consumer association registered under Companies Act, 1956 or under any other law for the time being in force; or
- One or more consumers, where there are numerous consumers having the same interest.

In addition to the above, the following are also considered as a consumer and hence they may file a complaint:

- Beneficiary of goods/services, legal representative of the deceased consumer, legal heirs of the deceased consumer, spouse of the consumer, a relative of consumer, and insurance company.

### **Consumer Protection Rules (1987).**

#### **Consumer Disputes Redressal Agencies**

Under the Consumer Protection Act, 1986 Consumer Disputes Redressal Agencies (CDRA), have been established. The Consumer Protection Act provides for a **3-tier approach** in resolving consumer disputes.

#### **These three tiers are:**

- A Consumer Disputes Redressal Forum to be known as the "**District Forum**".

This is to be established by the state government in each district of the state by means of a notification.

- A Consumer Disputes Redressal Commission to be known as the "**State Commission**".

This has also to be established by the state government in the state by means of a notification.

- A consumer Disputes Redressal commission to be known as the "**National commission**" is to be established at Central Government level.

#### **I -District Forum**

A District Forum deals with cases where the value of claim is upto **Rs.20 lakhs**.

**Territorial Jurisdiction:** A case is supposed to fall within the purview of District Council when, at the time of the institution of the complaint:

The party against whom the claim is made actually and voluntarily resides or carries on business, or has a branch office or personally works for gain in that area, or

Where there are more than one opposing or contesting parties, each such party actually and voluntarily resides or carries on business or

Where there are more than one opposing or contesting parties, and any such party actually and voluntarily resides or carries on business or has a branch office, Or personally works for gain in that area; provided the other parties not so residing or working agrees.

The cause of action, wholly or in part, arises in that area.

#### **Procedure on admission of complaint**

Every complaint shall be accompanied with such amount of fee and payable in such manner as may be prescribed.

On receipt of a complaint, the District Forum may, by order, allow the complaint to be proceeded with or rejected. However, a complaint shall not be rejected unless an opportunity of being heard has been given to the complainant.

The admissibility of the complaint shall ordinarily be decided **within 21 days** from the date on which the complaint was received.

Where a complaint is allowed to be proceeded with, the District Forum may proceed with the complaint in the manner provided under this Act. However, where a complaint has been admitted by the District Forum, it shall not be transferred to any other court or tribunal or any authority set up by or under any other law for the time being in force.

**Complaint relating to goods.** Reference of complaint to opposite party. The District Forum shall, on admission of a complaint, if it relates to any goods, refer a copy of the complaint to the opposite party mentioned in the complaint. Further it shall direct the opposite party to give his version of the case within a period of **30 days**. This period may be extended by a further period not exceeding **15 days** as may be granted by the District Forum.

**Denial of allegation etc. by opposite party.** Where the opposite party on receipt of a complaint referred to him denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the **Direct Forum**, **the District Forum shall proceed to settle the consumers dispute in the following manner :**

- ***Reference of sample to laboratory where the complaint alleges a defect in the goods which cannot be determined without proper analysis or test of the goods.***

In such a case the District Forum shall obtain a sample of the goods from the complainant, seal it and authenticate it and refer the sample so sealed to be appropriate laboratory for an analysis or test whichever may be necessary. The direction for such analysis or test shall be made with a view to finding out whether such goods suffer from any defect alleged in the complaint or suffer from any other defect. The laboratory shall report its findings to the District Forum within a period of **45 days** of the receipt of the reference or within such extended period as may be granted by the District Forum.

- ***Deposit of fees :*** Before any sample of the goods is referred to any appropriate laboratory for analysis or test, the District Forum may require the complainant to deposit to the credit of the Forum such fees as may be specified. Such fees are meant for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in questions.
- ***Remission of fees to laboratory and forwarding of report to apposite party.*** The District Forum such fees as may be specified. Such fees are meant for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question.
- ***Objections by any of the parties.*** If any of the parties disputes the correctness of the findings of the appropriate laboratory, or disputes the correctness of the methods of analysis or test adopted by the appropriate laboratory, the District Forum shall require the opposite party or the complaint to submit in writing his objections in regard to the report made by the appropriate laboratory.
- ***Reasonable opportunity to parties of being heard and issue of order.*** The District Forum shall give a reasonable opportunity to the complainant as well as the opposite party of being heard as to the correctness or otherwise of the report made by the appropriate laboratory and also as to the objection made in relation thereto. Thereafter, it shall issue an appropriate order under Sec.14.



***Complaint relating to services.***

If the complaint admitted by the District Forum relates to any services (or to goods in respect of which the procedure specified above cannot be followed), the District Forum shall refer a copy of such complaint to the opposite party directing him to give his version of the case within a period of 30 days or such extended period not exceeding **15 days** as may be granted by the District Forum.

***Denial etc. of allegation by the opposite party.*** The opposite party may, on receipt of a copy of the complaint, deny or dispute the allegations contained in the complaint, or omit or fail to take any action to represent his case within the time given by the District Forum.

***Settlement of dispute.*** In case of denial etc. of the allegation by the opposite party, the District Forum shall proceed to settle the consumer dispute -----

- *Ex parte* on the basis of evidence brought to its notice by the complainant and the opposite party, where the opposite party *denies or disputes* the allegations contained in the complaint, or
- *Ex parte* on the basis of evidence brought to its notice by the complainant where the opposite party *omits or fails to take any action* to take any action to represent his case within the time given by the Forum.
- Where the complainant fails to appear on the date of hearing before the District Forum, the District Forum may either dismiss the complaint for default or decide it on merits.

***Proceedings of the District Forum final.*** The proceedings complying with the procedure laid down above cannot be called in question in any Court on the ground that the principals of natural justice have not been completed with.

***Death of a complainant.*** In the event of death of a complainant who is a consumer or of the opposite party against whom the complainant has been filed, the provisions of Order XXII of the First Schedule to the Code of Civil Procedure, 1908 shall apply subject to the modification that every reference therein to the plaintiff and the defendant shall be construed as reference to a complainant or the opposite party, as the case may be.

***Period.*** Every complaint shall be heard as expeditiously as possible and endeavor shall be made to decide the complaint within a period of **3 months** from the date of receipt of notice by opposite party where the complaint does not require analysis or testing of commodities and within **5 months**, if it requires analysis or testing of commodities.

No adjournment shall be ordinarily granted by the District Forum unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by the Forum.

The District Forum shall make such orders as the costs occasioned by the adjournment as may be provided in the regulations made under this Act.

In the event of a complaint being disposed of after the period so specified, the District Forum shall record in writing, the reasons for the same at the time of disposing of the said complaint.

Where during the pendency of any proceedings before the District Forum, it appears to it necessary, it may pass such interim order as is just and proper in the facts and circumstances of the case.

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#### **Relief Available Against Complaint [Section 14 & 22]**

If the firm is convinced that the goods were really defective or that the complaint about the service is proved, the forum shall have to order any of the following things to be done by the opposite party:

- To remove the defect pointed out by the appropriate laboratory for the goods in question.
- To replace the goods with new goods of similar description that shall be free from any defect.
- To refund to the complainant the amount paid as price, or as the case may be, the charges paid by the complainant.
- To pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party.
- To remove the defects or deficiencies in the services in question.
- To discontinue the unfair trade practice or the restrictive trade practice or not to repeat it.
- Not to offer the hazardous goods for sale.

#### **2-State Consumer dispute Redressal Commission**

1) Subject to the other provisions of this Act, the State Commission shall have jurisdiction:-

a) to entertain

i) complaints where the value of the goods or services and compensation, if any, claimed exceeds **rupees twenty lakhs but does not exceed rupees one crore; and**

ii) appeals against the orders of any District Forum within the State; and

b) to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the State, where it appears to the State Commission that such District Forum has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested or has acted in exercise of its jurisdiction illegally or with material irregularity.

### **3- National Consumer Disputes Redressal Commission**

It is established by the Central government by means of a notification.

The Act thus envisages a hierarchy of three redressal forums:

District Forum , State Forum, & National Forum

**Jurisdiction of National Council** Subject to the other provisions of this Act, the National Commission shall have jurisdiction—

(i) complaints where the value of the goods or services and compensation, if any, claimed exceeds **rupees one crore**; and

ii) appeals against the orders of any State Commission

b) – to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any State Commission where it appears to the National Commission that such State Commission has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested, or has acted in the exercise of its jurisdiction illegally or with material irregularity.

**Limitation** (1) The District Forum, the State Commission or the National Commission shall not admit a complaint unless it is filed **within two years from the date on which the cause of action has arisen**.

2) Notwithstanding anything contained in sub-section (1), a complaint may be entertained after the period specified in sub-section (1), if the complainant satisfies the District Forum, the State Commission or the National Commission, as the case may be, that he had sufficient cause for not filing the complaint within such period: Provided that no such complaint shall be entertained unless the National Commission, the State Commission or the District Forum, as the case may be, records its reasons for condoning such delay.

## **COMPANY LAW**

### **Module-III**

#### **Introduction**

The Companies Act, 2013 (hereafter 'The Act') consolidates and amends the law relating to the companies in India and replaces the Companies Act, 1956 in phases, which is 56 years old. The new Act intends to improve corporate governance and to further strengthen regulations for the corporate sector with the introduction of key provisions as to:-

- Duties and Liabilities of Directors/Independent Directors,
- Auditor Rotation,
- Establishment of Serious Fraud Investigation Office (SFIO),
- Constitution of National Financial Reporting Authority (NFRA),
- Class Action Suit,
- Corporate Social Responsibility (CSR) etc.

#### **The Companies Act, 2013 is administered by:-**

- The Central Government through the Ministry of Corporate Affairs (MCA) and
- The Offices of Registrar of Companies,
- Official Liquidators,
- Public Trustee,
- Director of Inspection,

- National Company Law Tribunal (NCLT),
- National Company Law Appellate Tribunal (NCLAT), etc.

**The Registrar of Companies (ROC) controls the task of incorporation of new companies and the administration of running companies.**

### **Definition of company**

“In terms of the Companies Act, 2013 ‘company’ means a company incorporated under the Act, or under the previous company law” [Sec. 2(20)].

A company may be an incorporated company or a Corporation, or an unincorporated company. An incorporated company is a single and legal (artificial) person distinct from the individuals constituting it, whereas an unincorporated company, such as a partnership, is a mere collection or aggregation of individuals. Therefore, unlike a partnership, a company is a corporate body and a legal person having status and personality distinct and separate from that of the members constituting it.

### **Characteristics/Advantages of company**

#### **1. Independent corporate existence**

The outstanding feature of a company is its independent corporate existence. It is a distinct legal person existing independent of its members. By incorporation under the Act, the company is vested with a corporate personality which is distinct from the members who compose it.

A well-known illustration of this principle is the decision of the House of Lords in *Salomon v. Salomon & Co.* [(1898) AC 22].

#### **2. Limited Liabilities**

The privilege of limiting liability for business debts is one of the principal advantages of doing business under the corporate form of organization. Where the subscribers exercise the choice of registering the company with limited liability, the members’ liability becomes limited or restricted to the nominal value of the shares taken by them or the amount guaranteed by them. No member is bound to contribute anything more than the nominal value of the shares held by him.

#### **3. Perpetual successions**

An incorporated company never dies. It is an entity with perpetual succession. Perpetual succession means that the membership of a company may keep changing from time to time, but that does not affect the company’s continuity. The death or insolvency of individual members does not, in any way affect the corporate existence of the company “Members may come and go but the company can go on forever”.

It continues to exist even if all its human members are dead. Even where during the war all the members of a private company, while in general meeting, were killed by a bomb, the company survived not even a hydrogen bomb could have destroyed it. [*K’9 Meat Supplies (Guildford) Ltd., Re* 1966 (3) All. ER 320.]

#### **4. Separate properties**

A company, being a legal person, is capable of owning, enjoying and disposing of property in its own name. The company becomes the owner of its capital and assets. The shareholders are not the several or joint owners of the company’s property. The company is the real person in which all its property is vested, and by which is controlled, managed and disposed of [*Bacha F Guzdar v. C.I.T.* AIR 1955 SC 74.]. The property is vested in the company as a body corporate, and no changes of individual membership affect the title. The property, however much, the shareholders may come and to remains vested in the company, and the company can convey, assign, mortgage, or otherwise deal with it irrespective of these mutations.

#### **5 .Transferable Shares**

When joint stock companies were established the great object was that their shares should be capable of being easily

transferred. Accordingly, the Companies Act, 2013 in Section 44 declares: 'The shares or debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company'. Thus incorporation enables a member to sell his shares in the open market and to get back his investment without having to withdraw the money from the company. This provides liquidity to the investor and stability to the company.

## **6. Common seal**

Since the company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under the seal of the company. The common seal acts as the official signature of the company. Prior to the Companies (Amendment) Act, 2015 the common seal is a seal used by a corporation as the symbol of its incorporation and also a statutory requirement for a company. As a departure from this concept, the Companies (Amendment) Act, 2015 has deleted the requirement of having Common Seal compulsorily.

After this amendment, in case a company does not have a common seal, the authorization shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

## **Classes of Companies**

A company may be incorporated as a One Person Company (OPC) a new concept all together in the Companies Act, 2013, Private Company or a Public Company, depending upon the number of members joining it. Again it may either be an unlimited company, or may be limited by shares or by guarantee or by both. On the basis of control, companies can be classified as associate company, holding company and subsidiary company. Some other forms of classification of companies are: foreign company, Government Company, small company, dormant company, Nidhi Company and company formed for charitable objects.

Companies may be classified into various classes on the following basis:

### **1. On the Basis of Incorporation**

#### **(a) Statutory companies**

These are the companies which are created by a special Act of the Legislature, e.g., the Reserve Bank of India, the State Bank of India, the Life Insurance Corporation, the Industrial Finance Corporation, the Unit trust of India and State Financial Corporations These are mostly concerned with public utilities, e.g. railways, tramways, gas and electricity companies and enterprises of national importance. The provisions of the Companies Act, 2013 do not apply to them unless the special act specifies such application. Banking Regulation Act, 1949 is a special legislation concerning banking companies.

#### **(b) Registered companies**

These are the companies which are formed and registered under the Companies Act, 2013, or were registered under any of the earlier Companies Acts.

### **2. On the basis of liability**

#### **(a) Company limited by shares**

Section 2 (22) of the Companies Act, 2013, defines that when the liability of the members of a company is limited by its memorandum of association to the amount (if any) unpaid on the shares held by them, it is known as a company limited by shares. It thus implies that for meeting the debts of the company, the shareholder may be called upon to contribute only to the extent of the amount, which remains unpaid on his shareholdings. His separate property cannot be encompassed to meet the company's debt.

#### **(b) Company limited by guarantee**

Section 2 (21) of the Companies Act, 2013 defines it as the company having the liability of its members limited by the

memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the member of a guarantee company is limited up to a stipulated sum mentioned in the memorandum. Members cannot be called upon to contribute beyond that stipulated sum.

### **(c) Unlimited company**

Section 2 (92) of the Companies Act, 2013 defines unlimited company as a company not having any limit on the liability of its members. In such a company the liability of a member ceases when he ceases to be a member. The liability of each member extends to the whole amount of the company's debts and liabilities but he will be entitled to claim contribution from other members.

## **3. On the basis of members**

### **(a) One person company**

#### **(1) The Concept of One Person Company (OPC)**

The concept of One Person Company (OPC) has now been introduced in India, through Section 2 (62) of Companies Act, 2013 thereby enabling Entrepreneur(s) carrying on the business in the Sole Proprietor form of business to enter into a Corporate Framework. Though this concept is new in India but it is already a part of many other countries like China, Australia, Pakistan and UK etc.

According to Section 2 (62) of the Companies Act, 2013 'One Person Company' means a company which has only one person as a member. A company formed under one person company may be either:

- a) A company limited by shares, or
- b) company limited by guarantee, or
- c) An unlimited company.

One Person Company is a hybrid of Sole-Proprietor and Company form of business, and has been provided with concessional/relaxed requirements under the Act.

#### **(2) Features of One Person Company (OPC)**

- a) Only One Shareholder: Only a natural person, who is an Indian citizen and resident in India, shall be eligible to incorporate a One Person Company.
- b) Nominee for the Shareholder: The Shareholder shall nominate another person who shall become the shareholders in case of death/incapacity of the original shareholder. Such nominee shall give his/her consent and such consent for being appointed as the Nominee for the sole Shareholder. Only a natural person, who is an Indian citizen and resident in India, shall be a nominee for the sole member of a One Person Company.
- c) Director: Must have a minimum of One Director, the Sole Shareholder can himself be the Sole Director. The Company may have a maximum number of 15 directors.

### **(b) Private Company [Section 2 (68)]**

According to Section 2 (68) of Companies Act, 2013 a 'private company' means a company having a minimum paid-up share capital as may be prescribed, and which by its articles:

- (1) restricts the right to transfer its shares.
- (2) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member;

Provided further that:



- a) persons who are in the employment of the company, and
- b) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members, and
- (3) Prohibits any invitation to the public to subscribe for any securities of the company.

The Companies (Amendment) Act, 2015 has omitted 'of one lakh rupees or such higher paid-up share capital' from the definition of Private Company w.e.f. 25.05.2015. The impact of this amendment is that today one can have a company of paid up capital of mere ` Two (with each subscriber giving a rupee as subscription) for a private company and ` Seven for a public company.

### **(c) Public company [Section 2 (71)]**

According to Section 2 (71) of Companies Act, 2013 a 'public company' means a company which:

- (1) is not a private company.
- (2) has a minimum paid-up share capital, as may be prescribed:
- (3) Seven or more members are required to form the company.

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

The Companies (Amendment) Act, 2015 has omitted "of five lakh rupees or such higher paid-up capital," from the definition of Public Company w.e.f. 25.05.2015.

### **(d) Small Company [Section 2 (85)]**

According to Section 2 (85) of Companies Act, 2013 a "small company" means a company, other than a public company:

- (1) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees. Or
- (2) turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees:

Provided that nothing in this clause shall apply to:

- a) a holding company or a subsidiary company.
- b) a company registered under Section 8, or
- c) a company or body corporate governed by any special Act.

Some of the advantages enjoyed by the small companies are:

- a) holding of two board meetings instead of four – one each in the first and second half years and the gap between the two meeting should not be more than 90 days. (section 173(5))
- b) Not required to give cash flow statements with the financial statements (section 2(40))

## **4 . On the basis of control**

Holding company and Subsidiary company

'Holding' and 'Subsidiary' Companies are relative terms. A company is a holding company of another if the other is its subsidiary.

According to Section 2 (46) of the Companies Act, 2013 'holding company', in relation to one or more other companies, means a company of which such companies are subsidiary companies.

According to Section 2 (87) of the Companies Act, 2013 'subsidiary company' or 'subsidiary', in relation to any other company (that is to say the holding company), means a company in which the holding company :

- (a) controls the composition of the Board of Directors, Or
- (b) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

## **5 . On the basis of Listing in the recognized Stock Exchange**

### **(a) Listed company (also widely held)**

According to Section 2 (52) of the Companies Act, 2013, a 'listed company' means a company which has any of its securities listed on any recognized stock exchange. Whereas the word securities as per the Section 2 (81) of the Companies Act, 2013 has been assigned the same meaning as defined in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956.

### **(b) Unlisted company**

Unlisted Company means company other than listed company.

## **6. Other types**

### **(a) Government Company**

According to Section 2 (45) of the Companies Act, 2013, a 'Government company' means any company in which not less than fifty one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

### **(b) Foreign Company**

According to Section 2 (42) of the Companies Act, 2013, 'foreign company' means any company or body corporate incorporated outside India which:

- (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode. And
- (b) Conducts any business activity in India in any other manner.

### **(c) Associate Company**

According to Section 2 (6) of the Companies Act, 2013, 'associate company' in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

As per the Explanation given under the Section, the clause, 'significant influence' means control of at least twenty per cent of total share capital, or of business decisions under an agreement.

### **(d) Dormant company**

Where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.

'Significant accounting transaction' means any transaction other than:

- (1) payment of fees by a company to the Registrar.
- (2) payments made by it to fulfil the requirements of this Act or any other law. (3) allotment of shares to fulfil the requirements of this Act, and
- (4) payments for maintenance of its office and records.

**(e) Nidhi Companies**

Company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift (cost cutting) and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefits and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies. [Section 406 of the Companies Act, 2013]

**(f)**

**(g) Public financial institutions**

According to Section 2 (72) of the Companies Act, 2013 the following institutions are to be regarded as public financial institutions:

- (1) The Life Insurance Corporation of India established under the Life Insurance Corporation Act, 1956.
- (2) The Infrastructure Development Finance Company Limited,
- (3) Specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.
- (4) Institutions notified by the Central Government under Section 4A (2) of the Companies Act, 1956 so repealed under Section 465 of this Act.
- (5) Such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India:

Provided that no institution shall be so notified unless:

- (a) it has been established or constituted by or under any Central or State Act. Or
- (b) not less than fifty-one per cent of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.

**Conversion of Public Company into a Private Company**

A public company can be converted into a private company by passing a special resolution, after altering its articles so as to include therein the restrictions contained in Section 2(68) of the Act. A special resolution passed to convert a public company into a private company is binding on dissenting shareholders provided it is bona fide, is in the interest of the company as a whole, and is consistent with the objects in the Memorandum of Association. Any alteration made in the articles to convert a public company into a private company shall take effect only with the approval of the Tribunal which shall make such order as it may deem fit.

**Conversion of private company into public company**

Similarly where a private company alters its articles by passing special resolution in such a manner that they no longer includes the restrictions and limitations which are required to be included in the articles of a private company, then such company shall cease to be a private company from the date of such alteration.

**Filing with the registrar**

Every alteration of the articles and a copy of the order of the Tribunal approving the alteration of articles in respect of conversion of public company into private company or private company into public company shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same.

Any alteration of the articles registered as above shall, subject to the provisions of this Act, be valid as if it were originally in the articles.

## **Incorporation of Company**

### **(a) Formation of company**

Persons who form the company are known as promoters. It is they, who conceive the idea of forming the company. They take all necessary steps for its registration.

Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company.

- (1) Public Company: In the case of a public company with or without limited liability any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration.
- (2) Private Company: In exactly the same way, 2 or more persons can form a private company.
- (3) One person company (OPC): One person, where the company to be formed is to be One Person Company.

### **(b) Procedural aspects of incorporation of company**

Section 7 of the Companies Act, 2013 provides for the procedure to be followed for incorporation of a company.

- (1) Filing of the documents and information with the registrar: For the registration of the company following documents and information are required to be filed with the registrar within whose jurisdiction the registered office of the company is proposed to be situated:
  - The memorandum and articles of the company duly signed by all the subscribers to the memorandum.
  - A declaration by person who is engaged in the formation of the company (an advocate, a chartered accountant, cost accountant or company secretary in practice), and by a person named in the articles (director, manager or secretary of the company), that all the requirements of this Act and the rules made there under in respect of registration and matters precedent or incidental thereto have been complied with.
  - An affidavit from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles stating that:
    - 1) he is not convicted of any offence in connection with the promotion, formation or management of any company, or
    - 2) he has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under this Act or any previous company law during the last five years,
    - 3) and that all the documents filed with the Registrar for registration of the company contain information that is correct and complete and true to the best of his knowledge and belief.
  - The address for correspondence till its registered office is established.

The particulars (names, including surnames or family names, residential address, nationality) of every subscriber to the memorandum along with proof of identity, and in the case of a subscriber being a body corporate, such particulars as may be prescribed.

The particulars of the interests of the persons mentioned in the articles as the first directors of the company in other firms or bodies corporate along with their consent to act as directors of the company in such form and manner as may be prescribed.

Particulars provided in this provision shall be of the individual subscriber and not of the professional engaged in the incorporation of the company [The Companies (Incorporation) Rules, 2014].

>Issue of certificate of incorporation on registration: The Registrar on the basis of documents and information filed, shall register all the documents and information in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

>Allotment of corporate identity number (CIN): On and from the date mentioned in the certificate of incorporation, the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

>Maintenance of copies of all documents and information: The company shall maintain and preserve at its registered office copies of all documents and information as originally filed, till its dissolution under this Act.

### **Formation of OPC**

- a) The memorandum of OPC shall indicate the name of the other person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.
- b) The other person whose name is given in the memorandum shall give his prior written consent in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation.
- c) Such other person may be given the right to withdraw his consent
- d) The member of OPC may at any time change the name of such other person by giving notice to the company and the company shall intimate the same to the Registrar
- e) Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.
- f) Only a natural person who is an Indian citizen and resident in India (person who has stayed in India for a period of not less than 182 days during the immediately preceding one calendar year):
  - 1) shall be eligible to incorporate a OPC.
  - 2) shall be a nominee for the sole member of a OPC.
- g) No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.
- h) No minor shall become member or nominee of the OPC or can hold share with beneficial interest.
- i) Such Company cannot be incorporated or converted into a company under Section 8 of the Act. Though it may be converted to private or public companies in certain cases. The procedure of conversion is given in the Rules 6 & 7 of the Companies (Incorporation) Rules, 2014.
- j) Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporate.
- k) OPC cannot convert voluntarily into any kind of company unless two years have expired from the date of incorporation, except where the paid up share capital is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.
- l) If One Person Company or any officer of such company contravenes the provisions, they shall be punishable with fine which may extend to ten thousand rupees and with a further fine which may extend to one thousand rupees for every day after the first during which such contravention continues.

### **Effect of registration**

According to Section 9 of the Companies Act, 2013, from the date of incorporation (mentioned in the certificate of

incorporation), the subscribers to the memorandum and all other persons, who may from time to time become members of the company, shall be a body corporate by the name contained in the memorandum. Such a registered Company shall be capable of exercising all the functions of an incorporated company under this Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name.

From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from the incorporators and there comes into existence a binding contract between the company and its members as evidenced by the Memorandum and Articles of Association [Hari Nagar Sugar Mills Ltd. vs. S.S. Jhunjhunwala AIR 1961 SC 1669]. It has perpetual existence until it is dissolved by liquidation or struck out of the register. A shareholder who buys shares, does not buy any interest in the property of the company but in certain cases a writ petition will be maintainable by a company or its shareholders.

**A legal personality emerges from the moment of registration of a company and from that moment the persons subscribing to the Memorandum of Association and other persons joining as members are regarded as a body corporate or a corporation in aggregate and the legal person begins to function as an entity.** A company on registration acquires a separate existence and the law recognises it as a legal person separate and distinct from its members [State Trading Corporation of India vs. Commercial Tax Officer AIR 1963 SC 1811].

It may be noted that under the provisions of the Act, a company may purchase shares of another company and thus become a controlling company. However, merely because a company purchases all shares of another company it will not serve as a means of putting an end to the corporate character of another company and each company is a separate juristic entity [Spencer & Co. Ltd. Madras vs. CWT Madras (1969) 39 Comp. Case 212].

#### **(Differences between a Public Company and a Private company)**

- 1. Minimum number:** The minimum number of persons required to form a public company is 7. It is 2 in case of a private company.
- 2. Maximum number :** There is no restriction on maximum number of members in a public company, whereas the maximum number cannot exceed 200 in a private company.
- 3. Number of directors.** A public company must have at least 3 directors whereas a private company must have at least 2 directors .
- 4. Restriction on appointment of directors.** In the case of a public company, the directors must file with the Register a consent to act as directors or sign an undertaking for their qualification shares. The directors of a private company need not do so (Sec 266)
- 5. Restriction on invitation to subscribe for shares.** A public company invites the general public to subscribe for shares. A public company invites the general public to subscribe for the shares or the debentures of the company. A private company by its Articles prohibits invitation to public to subscribe for its shares.
- 6. Name of the Company:** In a private company, the words "Private Limited" shall be added at the end of its name.
- 7. Public subscription:** A private company cannot invite the public to purchase its shares or debentures. A public company may do so.
- 8. Issue of prospectus:** Unlike a public company a private company is not expected to issue a prospectus or file a statement in lieu of prospectus with the Registrar before allotting shares.
- 9. Transferability of Shares.** In a public company, the shares are freely transferable (Sec. 82). In a private company the right to transfer shares is restricted by Articles.
- 10. Special Privileges.** A private company enjoys some special privileges. A public company enjoys no such privileges.
- 11. Quorum.** If the Articles of a company do not provide for a larger quorum. 5 members personally present in the case of a public company are quorum for a meeting of the company. It is 2 in the case of a private company (Sec. 174)
- 12. Managerial remuneration.** Total managerial remuneration in a public company cannot exceed 11 per cent of the net profits (Sec. 198). No such restriction applies to a private company.
- 13. Commencement of business.** A private company may commence its business immediately after obtaining a certificate of incorporation. A public company cannot commence its business until it is granted a "Certificate of Commencement of business".

#### **Special privileges of a Private Company**

Unlike a private a public company is subject to a number of regulations and restrictions as per the requirements of Companies Act, 1956. It is done to safeguard the interests of investors/shareholders of the public company. These privileges can be studied as follows :



1. a) Special privileges of all companies. The following privileges are available to every private company, including a private company which is subsidiary of a public company or deemed to be a public company
2. A private company may be formed with only two persons as member. It may commence allotment of shares even before the minimum subscription is subscribed for.
3. It is not required to either issue a prospectus to the public or file statement in lieu of a prospectus.
4. Restrictions imposed on public companies regarding further issue of capital do not apply on private companies.
5. Provisions of Sections 114 and 115 relating to share warrants shall not apply to it. (Sec. 14)
6. It need not keep an index of members.
7. It can commence its business after obtaining a certificate of incorporation. A certificate of commencement of business is not required.
8. It need not hold statutory meeting or file a statutory report
9. Unless the articles provide for a larger number, only two persons personally present shall form the quorum in case of a private company, while at least five member personally present form the quorum in case of a public company .
10. A director is not required to file consent to act as such with the Registrar. Similarly, the provisions of the Act regarding undertaking to take up qualification shares and pay for them are not applicable to directors of a private companies
11. Provisions in Section 284 regarding removal of directors by the company in general meeting shall not apply to a life director appointed by a private company .  
In case of a private company, poll can be demanded by one member if not more than seven members are present, and by two member if not more than seven member are present. In case of a public company, poll can be demanded by persons having not less than one-tenth of the total voting power in respect of the resolution or holding shares on which an aggregate sum of not less than fifty thousand rupees has been paid-up .It need not have more than two directors, while a public company must hav

### **MEMORANDUM OF ASSOCIATION**

The formation of a public company involves preparation and filing of several essential documents. Two of basic documents are :

1. Memorandum of Association
2. Articles of Association

**The preparation of Memorandum of Association** is the first step in the formation of a company. It is the main document of the company which defines its objects and lays down the fundamental conditions upon which alone the company is allowed to be formed. It is the charter of the company. governs the relationship of the company with the outside world and defines the scope of its activities. Its purpose is to enable shareholders, creditors and those who deal with the company to know what exactly is its permitted range of activities. It enables these parties to know the purpose, for which their money is going to be used by the company and the nature and extent of risk they are undertaking in making investment. Memorandum of Association enable the parties dealing with the company to know with certainty as whether the contractual relation to which they intend to enter with the company is within the objects of the company.

#### **Printing and signing of Memorandum (Sec. 15).**

The memorandum of Association of a company shall be

- (a) printed,
- (b) divided into paragraphs numbered consecutively, and
- (c) signed by prescribed number of subscribers (7 or more in the case of public company, two or more in the case of private company respectively). Each subscriber must sign for his/her name, address, description and occupation in the presence of at least one witness who shall attest the signature and shall likewise add his address, description and occupation, if any.

#### **Contents of Memorandum**

- I. Name clause
- II. Promoters of the company have to make an application to the registrar of Companies for the availability of name. The company can adopt any name if :
- III. There is no other company registered under the same or under an identical name;
- IV. The name should not be considered undesirable and prohibited by the Central Government (Sec. 20). A name which misrepresents the public is prohibited by the Government under the Emblems & Names (Prevention of Improper use) Act, 1950 for example, Indian National Flag, name pictorial representation of Mahatma Gandhi

and the Prime Minister of India, name and emblems of the U.N.O., and W.H.O., the official seal and Emblems of the Central Government and State Governments.

- V. Where the name of the company closely resembles the name of the company already registered, the Court may direct the change of the name of the company.
  - VI. Once the name has been approved and the company has been registered, then
  - VII. the name of the company with registered office shall be affixed on outside of the business premises;
  - VIII. if the liability of the members is limited the words "Limited" or "Private Limited" as the case may be, shall be added to the name;
  - IX. Omission of the word 'Limited' makes the name incorrect. Where the word 'Limited' forms part of a company's name, omission of this word shall make the name incorrect. If the company makes a contract without the use of the word "Limited", the officers of the company who make the contract would be deemed to be personally liable
- The omission to use the word 'Limited' as part of the name of a company must have been deliberate and not merely accidental. Note the following case in this regard:

(c) the name and address of the registered office shall be mentioned in all letterheads, business letters, notices and Common Seal of the Company.

name of a company is the symbol of its personal existence. The name should be properly and correctly mentioned. The Central Government may allow a company to drop the word "Limited" from its name.

## **2. Registered Office Clause**

Memorandum of Association must state the name of the State in which the registered office of the company is to be situated. It will fix up the domicile of the company. Further, every company must have a registered office either from the day it begins to carry on business or within 30 days of its incorporation, whichever is earlier, to which all communications and notices may be addressed. Registered Office of a company is the place of its residence for the purpose of delivering or addressing any communication, service of any notice or process of court of law and for determining question of jurisdiction of courts in any action against the company. It is also the place for keeping statutory books of the company.

Notice of the situation of the registered office and every change shall be given to the Registrar within 30 days after the date of incorporation of the company or after the date of change. If default is made in complying with these requirements, the company and every officer of the company who is default shall be punishable with fine which may extend to Rs. 50 per day during which the default continues.

## **3. Object Clause**

This is the most important clause in the memorandum because it not only shows the object or objects for which the company is formed but also determines the extent of the powers which the company can exercise in order to achieve the object or objects. Stating the objects of the company in the Memorandum of Association is not a mere legal technicality but it is a necessity of great practical importance. It is essential that the public who purchase its shares should know clearly what are the objects for which they are paying.

In the case of companies which were in existence immediately before the commencement of the Companies (Amendment) Act. 1965, the object clause has simply to state the objects of the company. But in the case of a company to be registered after the amendment, the objects clause must state separately.

- i) **Main Objects** : This sub-clause has to state the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of main objects.
- ii) **Other objects**: This sub-clause shall state other objects which are not included in the above clause. Further, in case of a non-trading company, whose objects are not confined to one state, the objects clause must mention specifically the States to whose territories the objects extend. (Sec. 13)  
A company, which has a main object together with a number of subsidiary objects, cannot continue to pursue the subsidiary objects after the main object has come to an end.
- i) The objects of the company must not be illegal, e.g. to carry on lottery business.
- ii) The objects of the company must not be against the provisions of the Companies Act such as buying its own shares, declaring dividend out of capital etc. iii) The objects must not be against public, e.g. to carry on trade with an enemy country.
- iv) The objects must be stated clearly and definitely. An ambiguous statement like "Company may take up any work which it deems profitable" is meaningless.

- v) The objects must be quite elaborate also. Note only the main objects but the subsidiary or incidental objects too should be stated.

The narrower the objects expressed in the memorandum, the less is the subscriber's risk, but the wider such objects the greater is the security of those who transact business with the company.

#### **4. Capital Clause**

In case of a company having a share capital unless the company is an unlimited company, Memorandum shall also state the amount of share capital with which the company is to be registered and division thereof into shares of a fixed amount. The capital with which the company is registered is called the authorized or nominal share capital. The nominal capital is divided into classes of shares and their values are mentioned in the clause. The amount of nominal or authorized capital of the company would be normally, that which shall be required for the attainment of the main objects of the company. IN case of companies limited by guarantee, the amount promised by each member to be contributed by them in case of the winding up of the company is to be mentioned. No subscriber to the memorandum shall take less than one share. Each subscriber of the Memorandum shall write against his name the number of shares he takes.

#### **5. Liability Clause**

In the case of company limited by shares or by guarantee, Memorandum of Association must have a clause to the effect that the liability of the members is limited. It implies that a shareholder cannot be called upon to pay any time amount more than the unpaid portion on the shares held by him. He will no more be liable if once he has paid the full nominal value of the share.

The Memorandum of Association of a company limited by guarantee must further state that each member undertakes to contribute to the assets of the company if wound up, while he is a member or within one year after he ceased to be so, towards the debts and liabilities of the company as well as the costs and expenses of winding up and for the adjustment of the rights of the contributories among themselves not exceeding a specified amount.

Any alteration in the memorandum of association compelling a member to take up more shares, or which increases his liability, would be null and void. .

If a company carries on business for more than 6 months while the number of members is less than seven in the case of public company, and less than two in case of a private company, each member aware of this fact, is liable for all the debts contracted by the company after the period of 6 months has elapsed. .

#### **6 Association or Subscription Clause**

In this clause, the subscribers declare that they desire to be formed into a company and agree to take shares stated against their names. No subscriber will take less than one share. The memorandum has to be subscribed to by at least seven persons in the case of a public company and by at least two persons in the case of a private company. The signature of each subscriber must be attested by at least one witness who cannot be any of the subscribers. Each subscriber and his witness shall add his address, description and occupation, if any. This clause generally runs in this form : "we, the several person whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of the number of shares in the capital of the company, set opposite of our respective name".

After registration, no subscriber to the memorandum can withdraw his subscription on any ground.

#### **Alteration of Memorandums of Association**

Alteration of Memorandum of association involves compliance with detailed formalities and prescribed procedure. Alterations to the extent necessary for simple and fair working of the company would be permitted. Alterations should not be prejudicial to the members or creditors of the company and should not have the effect of increasing the liability of the members and the creditors.

Contents of the Memorandum of association can be altered as under :

##### **1.Change of name**

A company may change its name by special resolution and with the approval of the Central Government signified in writing . However, no such approval shall be required where the only change in the name of the company is the addition there to or the deletion there from, of the word "Private", consequent on the conversion of a public company into a private company or of a private company into a public company. By

ordinary resolution. If through inadvertence or otherwise, a company is registered by a name which, in the opinion of the Central Government, is identical with or too nearly resembles the name of an existing company, it may change its name by an ordinary resolution and with the previous approval of the Central Government signified in writing.

Registration of change of name. Within 30 days passing of the resolution, a copy of the order of the Central Government's approval shall also be filed with the Registrar within 3 months of the order. The Registrar shall enter the new name in the Register of Companies in place of the former name and shall issue a fresh certificate of incorporation with the necessary alterations. The change of name shall be complete and effective only on the issue of such certificate. The Registrar shall also make the necessary alteration in the company's memorandum of association

The change of name shall not affect any right or obligations of the company or render defective any legal proceeding by or against it. (Sec. 23).

## **2.Change of Registered Office**

This may involve :

- a) Change of registered office from one place to another place in the same city, town or village. In this case, a notice is to be given within 30 days after the date of change to the Registrar who shall record the same.
- b) Change of registered office from one town to another town in the same State. In this case, a special resolution is required to be passed at a general meeting of the shareholders and a copy of it is to be filed with the Registrar within 30 days. The within 30 days of the removal of the office. A notice has to be given to the Registrar of the new location of the office.
- c) Change of Registered Office from one State to another State to another State.

Section 17 of the Act deals with the change of place of registered office from one State to another State. According to it, a company may alter the provision of its memorandum so as to change the place of its registered office from one State to another State for certain purposes referred to in Sec 17(1) of the Act. In addition the following steps will be taken.

### **Special Resolution**

For effecting this change a special resolution must be passed and a copy thereof must be filed with the Registrar within thirty days. Special resolution must be passed in a duly convened meeting.

### **Confirmation by Central Government**

The alteration shall not take effect unless the resolution is confirmed by the Central Government.

The Central Government before confirming or refusing to confirm the change will consider primarily the interests of the company and its shareholders and also whether the change is bonafide and not against the public interest. The Central Government may then issue the confirmation order on such terms and conditions as it may think fit.

## **3.Alteration of the Object Clause**

The Company may alter its objects on any of the grounds (I) to (vii) mentioned in Section 17 of the Act.

The alteration shall be effective only after it is approved by special resolution of the members in general meeting with the Companies Amendment Act, 1996, for alteration of the objects clause in Memorandum of Associations sanction of Central Government is dispensed with.

### **Limits of alteration of the Object Clause**

The limits imposed upon the power of alteration are substantive and procedural. Substantive limits are provided by Section 17 which provides that a company may change its objects only in so far as the alteration is necessary for any of the following purposes:

- i) to enable the company to carry on its business more economically or more effectively;
- ii) to enable the company to attain its main purpose by new or improved means;
- iii) to enlarge or change the local area of the company's operation
- iv) to carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company;

Alterations in the objects is to be confined within the above limits for otherwise alteration in excess of the

above limitations shall be void.

A company shall file with the registrar a special resolution within one month from the date of such resolution together with a printed copy of the memorandum as altered. Registrar shall register the same and certify the registration. [Sec. 18].

#### **Effect of non Registration with Registrar**

Any alteration, if not registered shall have no effect. If the documents required to be filed with the Registrar are not filed within one month, such alteration and the order of the Central Government and all proceedings connected therewith shall at the expiry of such period become void and inoperative. The Central Government may, on sufficient cause show, revive the order on application made within a further period of one month [Sec. 19]

#### **4.Alteration of Capital Clause**

The procedure for the alteration of share capital and the power to make such alteration are generally provided in the Articles of Association. If the procedure and power are not given in the Articles of Association, the company must change the articles of association by passing a special resolution. If the alteration is authorized by the Articles, the following changes in share capital may take place :

- a) Alteration of share capital [Section 94-95]
- b) Reduction of capital [Section 100-105]
- c) Reserve share capital or reserve liability [Section 99]
- d) Variation of the rights of shareholders [Section 106-107]
- e) Reorganization of capital [Section 390-391]

#### **5.Alteration of Liability Clause**

Ordinarily the liability clause cannot be altered so as to make the liability of members unlimited. And the liability of the members cannot be increased without their consent. It lays down that a member cannot by changing the memorandum or articles, be made to take more shares or to pay more the shares already taken unless he agrees to do so in writing either before or after the change.

A company, if authorized by its Articles, may alter its memorandum to make the liability directors or manager unlimited by passing a special resolution.

#### **ARTICLES OF ASSOCIATION**

Every company is required to file Articles of Association along with the Memorandum of Association with the Registrar at the time of its registration. Companies Act defines 'Articles as Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies Acts. They also include, so far as they apply to the company, those in the Table A in Schedule I annexed to the Act or corresponding provisions in earlier Acts.

Articles of Association are the rules, regulations and bye-laws for governing the internal affairs of the company. They may be described as the 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 the shareholders. They lay down the mode and the manner in which the business of the company is to be conducted.

In framing Articles of Association care must be taken to see that regulations framed do not go beyond the powers of the company itself as contemplated by the Memorandum of Association nor should they be such as would violate any of the requirements of the companies Act, itself. All clauses in the Articles ultra vires the Memorandum or the Act shall be null and void.

Article of Association are to be printed, divided into paragraphs, serially numbered and signed by each subscriber to Memorandum with the address, description and occupation. Each subscriber shall sign in the presence of at least one witness who shall attest the signatures and also mention his own address and occupation.

#### **Contents of Articles of Association**

**Articles generally contain provision relating to the following matters;**

- (1) the exclusion, whole or in part of Table A;

- (2) share capital different classes of shares of shareholders and variations of these rights
- (3) execution or adoption of preliminary agreements, if any;
- (4) allotment of shares;
- (5) lien on shares
- (6) calls on shares;
- (7) forfeiture of shares;
- (8) issue of share certificates;
- (9) issue of share warrants; of shares; transmission of shares; alteration of share capital; borrowing power of the company;
- (10) rules regarding meetings;
- (11) voting rights of members;
- (12) notice to members;
- (13) dividends and reserves;
- (14) accounts and audit;
- (15) arbitration provision, if any;
  - a. directors, their appointment and remuneration;
  - b. the appointment and reappointment of the managing director, manager and secretary;
- (16) fixing limits of the number of directors
- (17) payment of interest out of capital; common seal; and
- (18) winding up.

### **Model form of Articles**

Different model forms of memorandum of association and Articles of Association of various types of companies are specified in Schedule I to the Act. The schedule is divided into following tables.

**Table A** deals with regulations for management of a company limited by shares.

**Table B** contains a model form of Memorandum of Association of a company limited by shares.

**Table C** gives model forms of Memorandum and Articles of Association of a company limited by guarantee and not having a share capital.

**Table D** gives model forms of Memorandum and Articles of Association of a company limited by guarantee and having a share capital. The Articles of such a company contain in addition to the information about the number of members with which the company proposes to be registered, all other provisions of Table A.

**Table E** contains the model forms of memorandum and Articles of Association of an unlimited company. A Public Company may have its own Article of Association.

### **Alteration of Articles**

Company law 2013 grant power to every company to alter its articles whenever it desires by passing a special resolution and filing a copy of altered Articles with the Registrar. An alteration is not invalid simply because it changes the company's constitution. Thus, A company was allowed by changing articles to issue preference shares when its memorandum was silent on the point.

### **. Distinctions between Memorandum of Association and Articles of Association**

| <b>Memorandum of Association</b>  | <b>Articles of Association</b>   |
|---|--|
| It is character of company indicating nature of business & capital. It also defines the company's relationship with outside world | They are the regulation for the internal management of the company and are subsidiary to the memorandum. |
| It defines the scope of the activities of the company, or the area beyond which the actions of the company cannot go.             | They are the rules for carrying out the objects of the company as set out in the Memorandum.             |
| It, being the charter of the company, is the supreme  | They are subordinate to the Memorandum. If there   |



|  |  |
|--|--|
| document.  | is a conflict between the Articles and the Memorandum, the act of the company  |
| Any act of the company which is ultra vires the Memorandum is wholly void and cannot be ratified even by the whole body of shareholders.                                       | Any act of the company which is ultra vires the Memorandum is wholly void and cannot be ratified even by the whole body of shareholders. |
| Every company must have its own Memorandum   | A company limited by Shares need not have Articles of its own. In such A case, Table A Applies.  |
| There are strict restrictions on its alteration. Some of the conditions of incorporation contained in it cannot be altered except with the sanction of the Central Government. | They can be altered by a special resolution, to any extent, provided they do not conflict with the Memorandum and the Companies Act.     |

## Doctrine of Ultra Vires

Objects clause is contained in the memorandum of association and sets out the powers of the directors in running the company. Traditionally, each power of the company had to be enumerated, which resulted in detailed statements as to the powers of the company. Companies are now able to use the phrase 'to carry on the business of a general commercial company' rather than use exhaustive lists of enumerated powers.

### The Introduction to Doctrine of Ultra Vires

The object clause of the memorandum of the company contains the object for which the company is formed. An act of the company must not be beyond the object clause otherwise it will be ultra vires and therefore, void and cannot be ratified even if all the member wish to ratify. This is called the doctrine of ultra vires. The expression "ultra vires" consists of two words: 'ultra' and 'vires'. 'Ultra' means beyond and 'Vires' means powers. Thus, the expression ultra vires means an act beyond the powers. Here the expression ultra vires is used to indicate an act of the company, which is beyond the powers conferred on the company by the objects clause of its memorandum. An ultra vires act is void and cannot be ratified even if all the directors wish to ratify it. Sometimes the expression ultra vires is used to describe the situation when the directors of a company have exceeded the powers delegated to them. Where accompany exceeds its power as conferred on it by the objects clause of its memorandum, it's not bound by it because it lacks legal capacity to incur responsibility for the action, but when the directors of a company have exceeded the powers delegated to them. This use must be avoided for it is apt to cause confusion between two entirely distinct legal principles. Consequently, here are restricting the meaning of ultra vires objects clause of the company's memorandum.

### Protection Of Creditors And Investors

Doctrine of ultra vires has been developed to protect the investors and creditors of the company. This doctrine prevents a company to employ the money of the investors for a purpose other than those stated in the objects clause of its memorandum. Thus, the investors and the company may be assured by this rule that their investment will not be employed for the objects or activities which they did not have in contemplation at the time of investing their money in the company. It enables the investors to know the objects in which their money is to be employed. This doctrine protects the creditors of the company by ensuring them that the funds of the company to which they must look for payment are not dissipated in unauthorized activities. The wrongful application of the company's assets may result in the insolvency of the company, a situation when the creditors of the company cannot be paid. This doctrine prevents the wrongful application of the company's assets likely to result in the insolvency of the company and thereby protects creditors. Besides the doctrine of ultra vires prevents directors from departing the object for which the company has been formed and, thus, puts a check over the activities of the directions. It enables the directors to know within what lines of business they are authorized to act .

### Lifting of the 'Corporate Veil'

It means looking behind the company as a legal person and paying regard to its corporate identity and find out the real life behind the company. In such circumstances ,the Courts ignore the company as legal entity and verify directly with the management of company by members or managers ,thus, the corporate veil may be said to have been lifted. Only in appropriate circumstances, the Courts are willing to lift the corporate veil

and that too, when questions of control are involved .

The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

- (a) In the law relating to trading with the enemy where the test of control is adopted.
- (b) In certain matters concerning the law of taxes, duties and stamps particularly where question of the controlling interest is in issue.
- (c) Where companies form other companies as their subsidiaries to act as their agent. The application of the doctrine may operate in favor of such companies depending upon the facts of a particular case. Suppose, a company acquires a partnership concern and registers it as a company, which becomes subsidiary of the acquiring company. In an action for compulsory acquisition of the business premises of the subsidiary, it was held that the parent company (which through itself and nominees held all the shares) was entitled to compensation, maintain action for the same . Where the courts find that there is avoidance of welfare legislation, it will be free to lift the corporate veil.
- (d) The Courts invariably lift the corporate veil or a disregard the corporate personality of a company to protect the public policy and prevent transactions contrary to public policy.
- (e) Under the law relating to exchange control. The courts pierce the corporate veil in quasi-criminal cases in order to look behind the legal person and punish the real persons who have violated the law.
- (e) Where the use of an incorporated company is being made to avoid legal obligations, the Court may disregard the legal personality of the company and proceed on the assumption as if no company existed.

### **DOCTRINE OF CONSTRUCTIVE NOTICE OR DOCTRINE OF INDOOR MANAGERMENTS**

The Memorandum and Articles of a company are registered with the Registrar. These are the public documents and open to public inspection,. Every person contracting with the company must acquaint himself with their contents and must make sure that his contract is in accordance with them, otherwise he cannot sue the company.

On registration the memorandum and articles of association become public documents. These documents are available for public inspection either in the office of the company or in the office of the Registrar of Companies on payment of one rupee for each inspection and can be copied (Sec. 610).

Every person who deals with the company, whether shareholder or an outsider is presumed to have read the memorandum and articles of association of the company and is deemed to know the contents of these document. Therefore, the knowledge of these documents and their contents is known as the constructive notice of memorandum and articles of association.

It is presumed that persons dealing with the company have not only read these documents but they have also understood their proper meaning.

Where a person deals with the company in a manner, which is inconsistent with the provisions of memorandum or articles, or enters into a transaction which is beyond the powers of the company, shall be personally liable to bear the consequences regarding such dealings.

## MANAGEMENT OF COMPANY

### Concept of Director

The Board of directors of a company is a nucleus, selected according to the procedure prescribed in the Act and the Articles of Association. Members of the Board of directors are known as directors, who unless especially authorised by the Board of directors of the Company, do not possess any power of management of the affairs of the company. Acting collectively as a Board of directors, they can exercise all the powers of the company except those, which are prescribed by the Act to be specifically exercised by the company in general meeting.

The directors of a company are its eyes, ears, brain, hands, nerves and other essential limbs, upon whose efficient functioning depends the success of the company. The directors formulate policies and establish organisational set up for implementing those policies and to achieve the objectives as contained in the Memorandum, muster resources for achieving the company objectives and control, guide, direct and manage the affairs of the company

### Position of Director

The position that the directors occupy in a corporate enterprise is not easy to explain. They are professional men hired by the company to direct its affairs. Yet they are not the servants of the company. They are rather the officers of the company. 'A director is not a servant of any master. He cannot be described as a servant of the company or of anyone'. 'A director is in fact a director or controller of the company's affairs'. A director may, however, work as an employee in a different capacity.

### Company to have Board of Directors (Section 149)

- This section provides for the provisions for companies to have a duly constituted Board of Directors. According to this section:

#### Number of Directors

According to section 149 (1) of the Companies Act, 2013, every company shall have a Board of Directors consisting of individuals as directors and shall have:

#### Minimum number of directors

- in the case of Public company - 3,
- in the case of Private Company - 2, and
- in case of One person company (OPC) – 1

#### Maximum number of directors

:If the company wants to appoint more than 15 directors, it can do so after passing a special resolution. [Every special resolution is required to be filed in form No. MGT – 14 as per Section 117(3)(a)].

As per the Notification G.S.R. 463(E) dated 5th June, 2015, the limit of maximum of 15 directors and their increase in limit by special resolution shall not apply to Government Company.

#### Women director

At least one woman director shall be on the Board of such class or classes of companies as may be prescribed. [Second proviso to section 149(1)]

Rule 3 of the Companies (Appointment and Qualification of Directors) Rules, 2014 provides that the following class of companies shall appoint at least one woman director:

- every listed company.
- every other public company having;--

**paid-up share capital of one hundred crore rupees or more; or  
turnover of three hundred crore rupees or more.**

A company, shall comply with such provisions within **a period of six months** from the date of its incorporation. Further, any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than **immediate next Board meeting or three months from the date of such vacancy whichever is later.**

### **Independents Director**

Every listed public company shall have at least one-third of the total number of directors as independent directors [Section 149(4)].

According to the Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the following class or classes of companies shall have at least 2 directors as independent directors:

**----the Public Companies having paid up share capital of ` 10 crore or more, or**

**----the Public Companies having turnover of ` 100 crore or more, or**

**----the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding ` 50 crore.**

### **Additional Director [Section 161 (1)]**

Section 161(1) of the Companies Act, 2013 provides for appointment of additional director. According to this section:

---The articles of a company may confer on its Board of Directors the power to appoint any person as an additional director at any time.

---A person, who fails to get appointed as a director in a general meeting, cannot be appointed as an additional director.

---Additional director shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

### **Alternate Director [Section 161 (2)]**

Section 161(2) of the Companies Act, 2013 provides for appointment of Alternate director. According to this section:

---The Board of Directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint a person to act as an alternate director in place of another director (original director) during his absence for a period of not less than 3 months from India.

---A person who is holding any alternate directorship for any other director in the company cannot be considered for appointment as above.

### **Nominee Director [Section 161 (3)]**

Section 161(3) of the Companies Act, 2013 provides for appointment of Nominee director. According to this section:

Subject to the articles of a company, the Board may appoint any person as a director nominated by any

institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its shareholding in a Government company.

### **Director in Casual Vacancy [Section 161 (4)]**

Section 161 (4) of the Companies Act, 2013 provides for appointment of director in casual vacancy. According to this section:

--In the case of a public company, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board.

--Any person so appointed shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.

### **Appointment of Directors elected by Small shareholders (Section 151)**

According to section 151 of the Companies Act, 2013:

---A listed company may have one director elected by such small shareholders in such manner and on such terms and conditions as may be prescribed.

---Here, "Small Shareholders" means a shareholder holding shares of nominal value of not more than ` 20,000 or such other sum as may be prescribed.

### **Appointment of Directors (Section 152)**

Where no provision is made in the articles of a company for the appointment of the first director, the subscribers to the memorandums who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed. [Section 152 (1)]

-In case of a One Person Company, an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section. [Section 152 (1)]

-Save as otherwise expressly provided in this Act, every director shall be appointed by the company in general meeting. [Section 152 (2)].

-No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number (DIN) under section 154. [Section 152 (3)].

-Every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number (DIN) and a declaration that he is not disqualified to become a director under this Act. [Section 152 (4)].

-A person appointed as a director shall not act as a director unless he gives his consent to hold the office as director and such consent has been filed with the Registrar within 30 days of his appointment in Form DIR-12 along with the fee as prescribed [Section 152 (5)].

### **Retirement by rotation [Section 152 (6)]**

Unless the articles provide for the retirement of all directors at every annual general meeting, not less than two-thirds of the total number of directors of a public company shall:

-be persons whose period of office is liable to determination by retirement of directors by rotation, and

-be appointed by the company in general meeting.

-The remaining directors in the case of any such company shall also be appointed by the company in general meeting.

-At the first annual general meeting of a public company held next after the date of the general meeting at which the first directors are appointed and at every subsequent annual general meeting, one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office.

-The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall be determined by lot.

---At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto.

For the purposes of the above provisions: total number of directors shall not include independent directors, whether appointed under this Act or any other law for the time being in force, on the Board of a company.

### **Removal of Directors (Section 169)**

section 169 of the Companies Act, 2013 came into force partially 4 from 1st April, 2014 which provides the provisions for removal of directors. According to this section:

---A company may, by ordinary resolution, remove a director before the expiry of the period of his office after giving him a reasonable opportunity of being heard. [Section 169(1)].

---It is further provided that the directors appointed on the principle of proportional representation under section 163 cannot be removed by an ordinary resolution as aforesaid. {Proviso to section 169(1)}.

---A special notice shall be required of any resolution, to remove a director under section 169 or to appoint somebody in place of a director so removed, at the meeting at which he is removed. [Section 169 (2)].

On receipt of the notice of a resolution to remove a director under section 169, the company shall forthwith send a copy thereof to the director concerned, and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting. [Section 169(3)].

---The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall be determined by lot.

---At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto.

For the purposes of the above provisions: total number of directors shall not include independent directors, whether appointed under this Act or any other law for the time being in force, on the Board of a company.

--On receipt of the notice of a resolution to remove a director under section 169, the company shall forthwith send a copy thereof to the director concerned, and the director, whether or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting. [Section 169(3)].

--The vacancy resulting from the aforesaid removal if he had been appointed by the company in general meeting or by the Board, may be filled in by the appointment of another director at the same meeting at which the director is removed, provided special notice of the proposed appointment has been given under section 169(2). [Section 169(5)].



--A director so appointed shall hold office for the remaining period for which the director who has been removed would have held office if he had not been removed. [Section 169(6)].

--If the vacancy is not filled in the same meeting as above, then it may be filled as a casual vacancy in accordance with the provisions of this Act provided that the director who was so removed from office shall not be reappointed as a director. [Section 169(7)].

- ---Nothing in this section shall be taken to deprive a person removed under this section of his rights to compensation or damages payable to him in respect of the premature termination of the directorship, or terms of his appointment as director or of any appointment terminating with that as a director. [Section 169(8)(a)].

### **Duties of directors (section 166)**

Duties of directors has been defined in the company Law for the first time under section 166 of the Companies Act, 2013. The following duties have been prescribed for a director under the said section:

**1-**He shall act in accordance with the articles of the company, subject to the provisions of this Act.

**2-**He shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

**3-**He shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

**4-**He shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

**5-**He shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

**6-**He shall not assign his office and if any assignment so made, it shall be void.

If a director of the company contravenes the provisions of this section, such director shall be punishable with fine which shall not be less than ` 1,00,000 but which may extend to ` 5,00,000.

### **Liabilities of directors**

The liabilities of the directors may be grouped under certain heads for convenience of consideration and discussion. They are:

#### **1 Liability to outsiders**

Directors of a company may personally become liable to outside parties in the following cases:

A-When they enter into contracts on behalf of the company:

--if the contracts are ultra vires the company;

--if they act outside the scope of their own authority;

--if they act in their own name and not for and on behalf of the company;

--When they issue a prospectus; in violation of the provisions of the Companies Act, 2013 and the SEBI (ICDR) Regulations which contains mis-statements(s).

--When they are found guilty of fraud.

--When they allot shares in an irregular manner.

--When the Court orders that the directors are personally liable for all or any of the debts or liabilities of the company for fraudulent trading on the part of the company.

## **2 Liability to the company**

The directors are liable to the company in the following cases:

--When they are negligent in the performance of their duty as directors and the company suffers loss, etc.

--When they commit an act which is ultra vires their powers or ultra vires the company.

--When any illegal act or breach of trust is committed by them.

## **3 Liability to the shareholders**

The position of the directors in respect of the company's properties and the rights conferred upon them to be exercised as directors is that of **a trustee**.

--If they commit any breach of trust or indulge in wrongful uses of their rights and the company suffers loss, they have to make good the loss.

--Similarly, if shareholders suffer loss due to the negligence of the directors they are personally liable for the loss.

## **4 -Liability for statutory defaulter and violation**

Under the Companies Act, 2013 the directors are required to ensure compliance with the several provisions of the Act and penalties have been prescribed for defaults and/or non-compliance. The directors are liable for consequences.

## **Meetings of company**

### **1-Board meeting**

Section 173 of the Act provides for Meetings of Board. According to this section:

#### **Frequency of Board Meetings [Section 173 (1)]**

**First Board meeting:** Every company shall hold the first meeting of the Board of Directors within 30 days of the date of its Incorporation.

**Subsequent Board meetings:** Every company shall hold minimum of 4 meetings every year provided that the gap between two consecutive board meetings shall not be more than 120 days.

However, the Central Government may by notification, direct that these provisions will not apply in relation to any class or descriptions of companies or will apply in relation thereto subject to such exceptions, modifications or conditions as may be specified in the notification.

#### **Exceptions:**

---A one person company, small company and dormant company shall be deemed to have complied with the provisions of section 173, if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than 90 days.

--Provided that, a one person company in which there is only one director on its Board of Directors shall not be required to hold at least one Board meeting in each half of a calendar year. Thus, it is exempt from following the provisions of section 173(5).

#### **Participation in Board meeting [Section 173 (2)]**

**(a)** Sub section (2) of section 173 allows directors to attend Board meetings:

- 1-in person, or,
- 2-through video conferencing, or,
- 3-other audio visual means as may be prescribed.

**(b)** Such audio visual means should be capable of recording and recognising the participation of the directors and of recording and storing the proceedings of such meetings along with date and time.

**(c)** Matters not to be dealt with in a meeting through video conferencing or other audio-visual means:-The following matters shall not be dealt with in any meeting held through video conferencing or other audiovisual means, as provided in Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014:

- 1-the approval of annual financial statements;
  - 2-the approval of the Board's report;
  - 3-the approval of the prospectus;
  - 4-the Audit Committee Meetings for consideration of financial statement including consolidated financial statement, if any to be approved by the Board; and
- the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover

### **Notice of the Meeting [Section 173 (3)]**

According to section 173(3), every board meeting shall be called by giving at least 7 days notice in writing to all the directors at their registered address (whether in India or outside India). The notice may be sent by hand delivery or by post or by electronic means.

Provided that a meeting of the Board of Directors may be called on a shorter notice (than 7 days)

--in order to transact an urgent business, subject to the condition that at least one independent director, if any, shall be present at the meeting.

---If no independent director is present at such a meeting of the Board then the decisions taken at such a meeting shall be circulated to all the directors and shall be final only on ratification thereof by at least one independent director, if any.

### **Penalty for failure to give notice [Section 173(4)]**

The Act under section 173(4) has prescribed a penalty of ` 25,000 on every officer of the Company whose duty is to give notice under this section and who has failed to do so.

### **Quorum for meetings of Board (Section 174)**

A quorum is the minimum number of qualified persons who must attend in order to transact business at a duly convened Board meeting. A meeting shall not be deemed to have been properly held unless the quorum was present at that meeting.

### **Rules of quorum**

--The companies covered under section 8 of the Act shall constitute quorum for the Board meeting, either eight members or 25% of its total strength whichever is less. Provided that quorum shall not be less than two members.

--The provisions of section 174 are not applicable to one person company in which there is only one director on its Board of directors.

--For the purpose of calculating quorum, any fraction of a number shall be rounded off as one.

--Total strength shall not include directors whose places are vacant.

**Quorum shall be present throughout the meeting**

**Meetings of Members:**

These are meetings where the members / shareholders of the company meet and discuss various matters. Member's meetings are of the following types :-

**A. Statutory Meeting :**

A public company limited by shares or a guarantee company having share capital is required to hold a statutory meeting. Such a statutory meeting is held only once in the lifetime of the company. Such a meeting must be held within a period of not less than one month or within a period not more than six months from the date on which it is entitled to commence business i.e. it obtains certificate of commencement of business. In a statutory meeting, the following matters only can be discussed :-

- Floatation of shares / debentures by the company
- Modification to contracts mentioned in the prospectus

A notice of at least 21 days before the meeting must be given to members unless consent is accorded to a shorter notice by members, holding not less than 95% of voting rights in the company.

A statutory meeting may be adjourned from time to time by the members present at the meeting.

The Board of Directors must prepare and send to every member a report called the "Statutory Report" at least 21 days before the day on which the meeting is to be held. But if all the members entitled to attend and vote at the meeting agree, the report could be forwarded later also.

The report should be certified as correct by at least two directors, one of whom must be the managing director, where there is one, and must also be certified as correct by the auditors of the company with respect to the shares allotted by the company, the cash received in respect of such shares and the receipts and payments of the company.

A certified copy of the report must be sent to the Registrar for registration immediately after copies have been sent to the members of the company.

**B. Annual General Meeting**

Annual General Meeting must be held by every type of company, public or private, limited by shares or by guarantee, with or without share capital or unlimited company, once a year. Every company must in each year hold an annual general meeting. Not more than 15 months must elapse between two annual general meetings. However, a company may hold its first annual general meeting within 18 months from the date of its incorporation. In such a case, it need not hold any annual general meeting in the year of its incorporation as well as in the following year only.

In the case there is any difficulty in holding any annual general meeting (except the first annual meeting), the Registrar may, for any special reasons shown, grant an extension of time for holding the meeting by a period not exceeding 3 months provided the application for the purpose is made before the due date of the annual general meeting..

A notice of at least 21 days before the meeting must be given to members of company. The notice must state that the meeting is an annual general meeting. The time, date and place of the meeting must be mentioned in the notice.

**C. Extraordinary General Meeting on Requisition :**

The members of a company have the right to require the calling of an extraordinary general meeting by the directors. The board of directors of a company must call an extraordinary general meeting if required to do so by the following number of members :-

- members of the company holding at the date of making the demand for an EGM not less than one-tenth of such of the voting rights in regard to the matter to be discussed at the meeting ; or
- if the company has no share capital, the members representing not less than one-tenth of the total voting rights at that date in regard to the said matter.
- A requisition is required to be submitted by member intend to call EGM .

The requisition must state the objects of the meetings and must be signed by the requisitioning members.

--The requisition must be deposited at the company's registered office. When the requisition is deposited at the registered office of the company, the directors should within 21 days, move to call a meeting and the meeting should be actually held within 45 days from the date of the lodgement of the requisition. If the directors fail to call and hold the meeting as aforesaid

#### **D. CLASS MEETINGS**

Class meetings are the meetings of the shareholders and the creditors. Class meetings are held to pass resolutions which will bind only the members of the particular class concerned. It can be done with the consent of the holders of 3/4 of the issued shares of that class in a separate meeting of that class of holders. Class meetings can only be attended by the members of that class. Whenever it is necessary to alter or change the rights or privileges of a class as provided by the Articles, a class meeting must be called.

##### **Resolutions**

A resolution is a legally binding decision made by limited company directors or shareholders. If a majority vote is achieved in favour of the decision, a resolution is 'passed'. Shareholders can pass resolutions or special resolutions at general meetings, or they can pass written resolutions. All ordinary types of collective decisions of directors are simply referred to as 'resolutions'. These decisions can be made at board meetings or in writing.

##### **Types of resolutions**

There are 3 types of resolutions available to limited company shareholders:

- **Ordinary resolutions**– Passed by a simple majority of shareholders' votes. Used for all matters, unless the Companies Act, the articles of association, and/or a shareholders' agreement stipulates the need for a special resolution. The majority of ordinary resolutions must be filed with Companies House.
- **Special resolutions**– Passed by a 75% majority of shareholders' votes at a general meeting. Used for extraordinary matters that cannot be passed by an ordinary resolution.
- **Written resolutions**– Used when a general meeting is not required to pass an ordinary resolution or special resolution. Any written ordinary resolution must be passed by a simple majority of shareholders' votes; written special resolutions require a 75% majority vote. Shareholders must sign a written resolution to cast their votes.

##### **What decisions require an ordinary resolution?**

An ordinary resolution is passed if a simple majority (above 50%) of the votes cast are in favour of the resolution. This type of resolution can be used by shareholders and directors for all day-to-day matters, such as:

- Appointing and removing directors.
- Appointing and removing secretaries.
- Matters pertaining to directors' employment contracts.
- Amending directors' powers.
- Approving dividend payments.
- Authorizing directors' loans.
- Authorizing the transfer of shares.

The types of decisions that company directors can make will depend on the powers they are granted by the shareholders. Their rights and powers will be outlined in the articles of association and shareholders' agreement.

##### **What decisions require special resolution?**

In the context of limited companies, a special resolution is a motion or proposal that requires approval of at least 75% of shareholder votes. This kind of resolution is reserved for important and rare decisions, such as:

- Changing a company name.
- Reducing share capital.
- Allotting more shares.
- Issuing different share classes.
- Altering the articles of association.
- Removing pre-emption rights.
- Re-registering a company.

- Changing a private company to a public company, or vice versa.
- Winding up a company by members' voluntary liquidation.

The Companies Act 2006 specifies the types of decisions requiring a special resolution. Where no type of resolution is specified, shareholders may pass an ordinary resolution with a simple majority of 50.01% of the votes.

#### **How to pass a special resolution**

**IN** order to pass a special resolution, 14 days' notice must be given to all shareholders (members) about the proposed resolution and its intention, unless the Articles states otherwise. If a general meeting is held, a vote will be taken by a show of hands or using a poll. Alternatively, these decisions can be passed by written resolution. If 75% of the shareholders agree to pass a proposed resolution, the decision is legally binding in accordance with the Companies Act 2006.

Special resolutions must be delivered to Companies House by post within 15 days of being passed. A copy must also be given to all shareholders and the company auditor. Furthermore, a company must keep a copy of all resolutions at its registered office address or SAIL address for a minimum period of 10 years.

### **CORPORATE WINDING UP AND DISSOLUTION**

The Companies Act, 2013, provides various strategies to deal with such business failures such as arrangement, reconstruction, amalgamation and winding-up. Winding-up of a company is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such dissolution its assets are collected, its debts are paid off out of the assets of the company or from contributions by its members, if necessary. If any surplus is left, it is distributed among the members in accordance with their rights.

**Under Companies Act 2013, the Company may be wound up in any of the following modes:**

- By National Company Law Tribunal (the Tribunal).
- Voluntary winding up

#### **Circumstances in which company may be wound up by Tribunal (Section 271)**

Grounds on which a Company may be wound up by the Tribunal A company under Section 271(1) may be wound up by the tribunal if:

- if the company is unable to pay its debts.
- if the company has, by special resolution, resolved that the company be wound up by the Tribunal.
- if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality. –
- if the Tribunal has ordered the winding up of the company under Chapter XIX(i.e., Revival and Rehabilitation of Sick Companies).
- if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.
- if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years, or
- if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

#### **Petition for winding up (Section 272)**



An application for the winding up of a company has to be made by way of petition to the Court. A petition may be presented under Section 272 by any of the following persons:

- i** the company, or
- ii** Any creditor or creditors, including any contingent or prospective creditor or creditors.
- iii** Any contributory or contributories.
- iv** All or any of the parties specified above in clauses (a), (b), (c) together (e) the Registrar.
- v** Any person authorized by the Central Government in that behalf.
- vi** By the Central Government or State Government in case falling under clause (c) of Section 271 (1) i.e., Company acting against the interest of the sovereignty and integrity of India.

#### **Final Meeting and dissolution (Section 318)**

Section 318 (1) states that as soon as the affairs of a company are fully wound up, the Company Liquidator shall prepare a report of the winding up showing that the property and assets of the company have been disposed of and its debt fully discharged or discharged to the satisfaction of the creditors and thereafter call a general meeting of the company for the purpose of laying the final winding up accounts before it and giving any explanation there for.

#### **VOLUNTARY WINDING UP (SECTION 304 TO 323)**

##### **Circumstances in which a company may be wound up voluntarily (Section**

As per Section 304 (1), a company may be wound up voluntarily:

if the company in general meeting passes a resolution requiring the company to be wound up voluntarily as a result of the expiry of the period for its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company should be dissolved, or

if the company passes a special resolution that the company be wound up voluntarily.

##### **Procedures for voluntary winding -up**

- Declaration of Solvency in case of proposal to wind up voluntarily (Section 305)
- Meeting of Creditors (Section 306)
  - As per Section 306 (1) the company shall call a meeting of its creditors either on the same day on which resolution is passed for winding up or on the next day and
  - serve a notice of such meeting by registered post to the creditors.
  - The declaration by affidavit to be made by directors or
  - In case the company has more than two director, they have to make a full inquiry into the affairs of the company and give opinion that the company has no debt and it will be able to pay its debt in full from the proceeds of asset sold.
- Commencement of voluntary winding up (Section 308)

voluntary winding up shall be deemed to commence on the date of passing of the resolution for voluntary winding up or resolution on the expiry of period fixed by its articles or on occurrence of any event in respect of which the articles provide that the company should be dissolved.

- Publication of resolution

when a company has passed a resolution for voluntary winding up and a resolution is passed, it shall within fourteen days of the passing of the resolution give notice of the resolution by advertisement in the Official Gazette and also in a newspaper which is in circulation in the district where the registered office or the principal office of the company is situated.

- Appointment of Company Liquidator (Section 310)

The company in its general meeting, where a resolution of voluntary winding up is passed, shall appoint a liquidator under Section 310, the manner specified in that Section and submit copy of resolution to Registrar.

➤ Final Meeting and dissolution (Section 318)

Section 318 (1) states that as soon as the affairs of a company are fully wound up, the Company Liquidator shall prepare a report of the winding up showing that the property and assets of the company have been disposed of and its debt fully discharged or discharged to the satisfaction of the creditors and thereafter call a general meeting of the company for the purpose of laying the final winding up accounts before it and giving any explanation there for