BUSINESS AND CORPORATE LAWS

COURSE CODE: SGB24LW101MI

Minor Course - Law and Business

For FYUG Programmes (Honours)

Self Learning Material

SREENARAYANAGURU OPEN UNIVERSITY

The State University for Education, Training and Research in Blended Format, Kerala

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To increase access of potential learners of all categories to higher education, research and training, and ensure equity through delivery of high quality processes and outcomes fostering inclusive educational empowerment for social advancement.

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To be benchmarked as a model for conservation and dissemination of knowledge and skill on blended and virtual mode in education, training and research for normal, continuing, and adult learners.

Pathway

Access and Quality define Equity.

Business and Corporate Laws

Course Code: SGB24LW101MI

Semester - II

Minor Course - Law and Business
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Message from Vice Chancellor

Dear Learner,

It is with great pleasure that I welcome you to the Four Year UG Programme offered by Sreenarayanaguru Open University.

Established in September 2020, our university aims to provide high-quality higher education through open and distance learning. Our guiding principle, 'access and quality define equity', shapes our approach to education. We are committed to maintaining the highest standards in our academic offerings.

Our university proudly bears the name of Sreenarayanaguru, a prominent Renaissance thinker of modern India. His philosophy of social reform and educational empowerment serves as a constant reminder of our dedication to excellence in all our academic pursuits.

The course Business and Corporate Laws is offered as a Minor course for BCOM and BBA (Honours). It is designed to provide learners with a foundational understanding of legal frameworks governing businesses and corporate entities. Covering key aspects such as contract law, company law, and regulatory compliance, the course equips learners with essential legal knowledge relevant to the corporate world. Minor courses offer valuable supplementary knowledge that complements your major field of study. These allied subjects broaden your academic perspective, enhance interdisciplinary understanding, and develop versatile skills. By exploring related disciplines, you gain a more comprehensive education, preparing you for diverse career opportunities and fostering well-rounded intellectual growth throughout your academic journey.

Our teaching methodology combines three key elements: Self Learning Material, Classroom Counselling, and Virtual modes. This blended approach aims to provide a rich and engaging learning experience, overcoming the limitations often associated with distance education. We are confident that this programme will enhance your understanding of management principles, preparing you for various career paths and further academic pursuits.

Our learner support services are always available to address any concerns you may have during your time with us. We encourage you to reach out with any questions or feedback regarding the programme.

We wish you success in your academic journey with Sreenarayanaguru Open University.

Best regards,

Dr. Jagathy Raj V.P.
Vice Chancellor

01-01-2025

Contents

BLOCK 01

Introduction to Mercantile Law

Unit 1 Introduction to Mercantile Law

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ familiarize with the meaning of law of contract
- ◊ gain insights on the different types of contracts
- ◊ differentiate agreements from contracts

Prerequisite

Imagine a world without contracts where promises meant nothing and people could easily break their agreements. It would be a world of chaos and uncertainty, where business deals would be fragile and personal relationships would be unstable. Contracts, like sturdy pillars, provide the foundation for our world, ensuring that promises are kept and agreements are honored.

In today's dynamic world, where online transactions are common and global connections are the norm, contracts play a crucial role in maintaining order and stability. They form the foundation of trust, allowing individuals, businesses, and even governments can engage in collaborative ventures with confidence.

This unit explores into the complex world of contracts, unraveling the complexities of these legal agreements. We will explore the different types of contracts and how contracts provide a framework for smooth transactions, fostering trust and predictability in an ever-changing world.

Contracts are the invisible threads that bind our society together. They are the guardians of our promises, ensuring that we honor our commitments and that the world around us operates in harmony. By understanding the power of contracts, we empower ourselves to navigate through the complexities of modern life with confidence and integrity.

Keywords

Law, Mercantile law, Contract, Agreement, Kinds of contract

Discussion

1.1.1 Mercantile Law

Mercantile Law may be defined as that branch of law which prescribes a set of rules for the governance of certain transactions and relations between:

- ◊ Business persons themselves,
- ◊ Business persons and their customers, dealers, suppliers, etc., and
- ◊ Business persons and the state.

Mercantile law, a part of civil law, encompasses the legal framework governing commercial transactions and trade within a nation. It plays a crucial role in business operations, regulating aspects such as contracts, partnerships, corporations, negotiable instruments, insurance, carriage of goods, and arbitration.

The Indian mercantile law is deeply rooted in English law. Indian mercantile acts, while distinct in their own right, largely adhere to the principles and framework of English mercantile law. However, they incorporate certain modifications and adaptations to suit the unique socio-economic context of India.

The main sources of mercantile law in India are as follows:

- ◊ ***English Mercantile Law:*** Our laws are primarily based on the English laws which evolved through customs and usages of merchants or traders in England. These customs and usages governed these merchants in their interactions with each other. This law is also recognized as 'general law'. The most important part of mercantile law, namely, the law of contracts, is still a part of customary law in England.
- ◊ ***Indian Statute Law:*** The Acts passed through the Indian Legislatures are the main source of Indian mercantile law. The significant Acts passed through the Indian Legislatures are the Indian Contract Act 1872, the Negotiable Instruments Act 1881, the Sale of Goods Act 1930, the Indian Partnership Act 1932, the Companies Act 1956, and so on.
- ◊ ***Judicial Decisions:*** The past judicial decisions of courts are another significant source of law. They are usually followed through the courts while deciding alike cases before them. The past decisions have persuasive and guiding value. Wherever the law is silent on a point, the judge has to decide the case just as to the principle of equity, justice, and good conscience.
- ◊ ***Customs and Usages:*** The customs and usages of mercantile law are yet another significant source of Indian mercantile law. They play a significant role in regulating the dealings between the merchants. However, it is necessary that such customs or usages must be widely recognized, reasonable, and constant and must not be inconsistent with the law in force. The Indian Contract Act recognizes this principle by providing that 'nothing contained therein shall

affect any usage or custom of trade.' The Negotiable Instruments Act also makes a similar provision.

1.1.2 Law of Contract

Every day in life, we enter into many contracts knowingly and unknowingly. This may be hiring an auto for transportation, eating food from a restaurant, etc. When one hires an auto, the driver and the passenger implicitly enter into a contact where the driver offers the journey and passenger accepts it for a consideration called auto fare. In the same way, when we enter into a restaurant to have lunch, we take a ticket to see a cinema, we borrow a book from the college library, what we do is entering into a contract.

Arun enters in to an agreement either in spoken words or in writing with Sunil to buy some raw materials. Here Arun is the buyer and Sunil is the seller. When Arun agrees to buy the materials from Sunil at a price, an agreement comes in to being between them.

As this agreement satisfies all the essential elements of a contract (which we will study later) it becomes enforceable in a court of law. This is called a contract. A contract is an agreement to do or not to do something for a consideration. The Indian Contract Act 1872 is enacted to cover the laws relating to contracts.

The Law of Contract constitutes the most important branch of mercantile or commercial law. It affects everybody in trade, commerce and industry. The law relating to contract is governed by the Indian Contract Act, 1872. It came into force on September 1, 1872. The preamble to the Act says that, it is an Act "to define and amend certain parts of the law relating to contracts". It extends to the whole of India. The Act mostly deals with the general principles and rules governing contracts.

The Indian Contract Act is divisible into two parts. The first part (Section 1-75) deals with the general principles of the law of contract, and therefore applies to all contracts irrespective of their nature. The second part (Sections 124-238) deals with certain special kinds of contracts, e.g., Indemnity and guarantee, bailment, pledge, and agency. The Act basically identifies the ingredients of a legally enforceable valid contract in addition to dealing with certain special type of contractual relationships like indemnity, guarantee, bailment, pledge, quasi contracts, contingent contracts, etc. It basically defines the circumstances in which promises made by the parties to a contract shall be legally binding on them.

1.1.3 Contract

According to section 2(h) of the Indian Contract Act 1872, "an agreement enforceable by law is a contract". In the example given above, the agreement made between Arun and Sunil is legal and it is enforceable by law and thus became a contract. Thus, an agreement and its enforceability by law together constitute the basis for a contract.

Contract = Agreement + Enforceability by law

Agreement

According to section 2(e) of the Indian Contract Act, 1872, "Every promise and every set promises forming, the consideration for each other, is an agreement." Now the question arises, what is promise?

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

Agreement = Offer (or Proposal) + Acceptance of Offer (or Proposal)

Section 2(a) defined Proposal/ Offer as "When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal".

Example: Anil offers to sell his house to you for ₹50 lakhs and you agree to pay Anil ₹ 50 lakhs for the house. In this case Anil is the offeror and you are the offeree or acceptor.

It is to notice that every proposal is always to do or not to do an act or something. It may also be for stopping (abstain) somebody from doing an act or something. It is to be specifically noted that all contracts are agreements but all agreements are not contracts.

Proposal/ Offer ➡ Promise ➡ Agreement ➡ Contract

Table 1.1.1 Difference between Agreement and Contract

Basis of differences	Agreement	Contract
Meaning	Every promise and every set of promises, forming the considerationfor each other. (Offer + Acceptance)	Agreement enforceable by law.(Agreement + Legal enforceability)
Scope	It's a wider term including both legal and social agreement.	It is used in a narrow sense with the specification that contract is only legally enforceable agreement.
Legal obligation	It may not create legal obligation. An agreement does not always grant rights to the parties	Necessarily creates a legal obligation. A contract always grants certain rights to every party.
Nature	All agreements are not contracts.	All contracts are agreements.

1.1.4 Types of Contracts

There are different types of contracts that exist in business. These contracts are classified on the basis of their enforceability, formation and performance.

On the basis of enforceability

a. **Valid contract:** An agreement enforceable by law is a valid contract. It fulfills all essential criteria or elements of a contract (explained throughout this chapter).

   Example: X offers to marry Y. Y accepts X's offer. This is a valid contract.

b. **Void contract:** An agreement that does not fulfill all essential criteria of a contract is a void contract. In the strict sense they are not void contracts, but void agreements. This is because if all the essential elements of a valid contract are not present, they can never be called as contracts. However, in some situations a contract which is valid when entered into may become void subsequently. Such contracts cannot be enforced in a court of law. A contract may become void because of the following:

   i. Supervening impossibility

   ii. Subsequent illegality

   iii. Repudiation by one of the parties

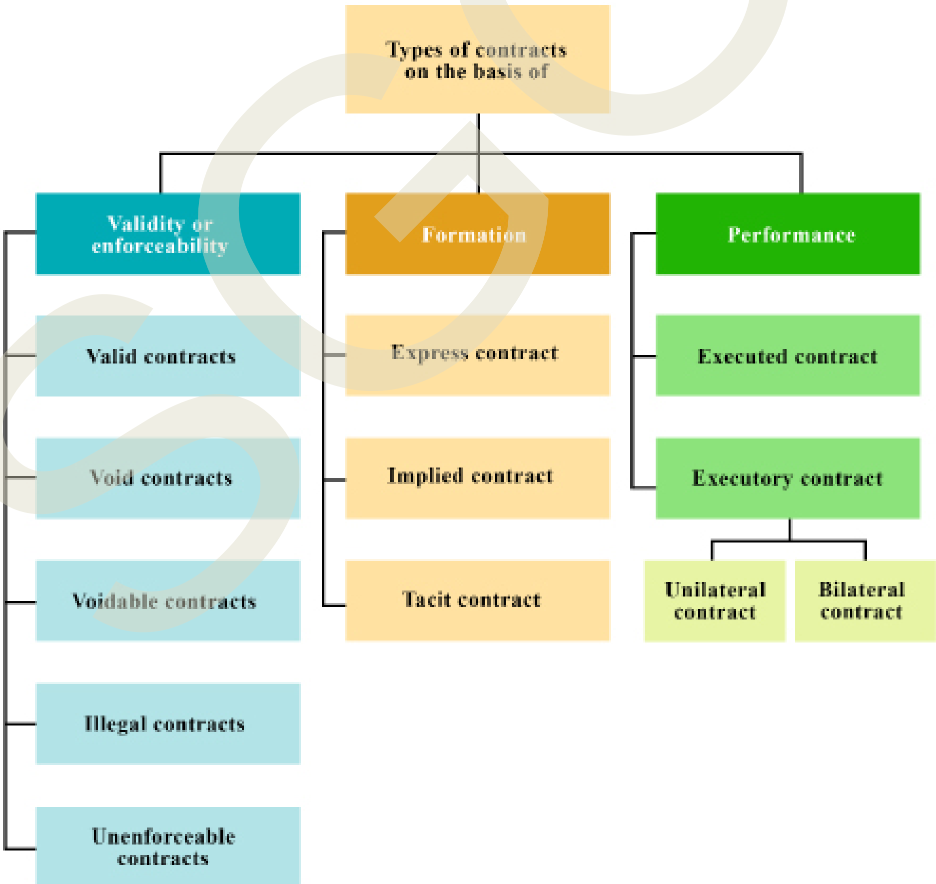

Figure 1.1.1 Types of Contract

iv. ***Supervening impossibility*** (subsequent impossibility) arises when a contract was capable of being performed when it was entered into, but subsequently it becomes impossible to perform or unlawful due to some reasons. Example: Anil entered into a contract with you to sell his house on December 24, 2020, but on December 10th it caught fire and damaged completely. Here the contract becomes void because of supervening impossibility.

v. ***Subsequent illegality:*** A valid contract becomes void by a change in certain circumstances like changes in law or similar other reasons. For example, the contract to buy or sell gold may become illegal if the government prohibits private dealings in gold subsequent to the date of contract.

vi. ***Repudiation by one of the parties:*** It means one party unconditionally refuses to perform the contract as promised by him. For example, a buyer and a seller enter into a contract for the sale of a house. The seller agrees to sell the house for ₹500,000, and the buyer agrees to pay the seller ₹500,000 for the house.

The seller then decides that he do not want to sell the house for ₹500,000 anymore. The seller calls the buyer and tells that he will not sell the house for less than ₹600,000.

Because the seller has repudiated the contract, the contract is now void. The buyer is not obligated to pay the seller ₹500,000.

c. **Voidable contract:** A voidable contract is one which is enforceable at the option of one of the parties of the contract. If that party does not get it enforced, it becomes void. As per Section 2(i) "An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others is a voidable contract"

Example: Anil, a person of weak intelligence made a gift of his entire property to Sunil, who was in a position to dominate him. The gift having been obtained by undue influence is voidable at the option of Anil.

A contract may be rendered voidable if:

◊ Any party was under duress, undue influence, or was being intimidated, coerced, or threatened when entering into the agreement;

◊ Any party was mentally incompetent (i.e., mentally ill, below the age of majority) at the time that the contract was entered;

◊ Any party made a mistake as to their interpretation of the contract terms; or

◊ There was fraud or misrepresentation of material facts involved.

Table 1.1.2 Difference between Void Contract and Voidable Contract

Basis	Void Contract	Voidable Contract
Meaning	A Contract that ceases to be enforceable by law becomes void.	An agreement which is enforceable by law at the option of one or more ofthe parties thereto, but not at the option of the other or others, is a voidable contract.
Enforceability	A void contract cannot be enforced at all.	It is enforceable only at the option of aggrieved party and not at the option of other party.
Cause	A contract becomes void due to change in law or change in circumstances beyond the contemplation of parties.	A contract becomes a voidable contract if the consent of a party was not free.
Performance of contract	A void contract cannot be performed.	If the aggrieved party does not, within reasonable time, exercise his right to avoid the contract, any party can sue the other for claiming the performance of the contract.
Rights	A void contract does not grant any legal remedy to any party.	The party whose consent was not free has the right to rescind the contract within a reasonable time. If rescinded it becomes a void contract. If it is not rescinded it becomes a valid contract.

d. **Illegal Agreement:** An agreement which is criminal in nature or which is immoral or is against public policy is an illegal agreement. Example, a contract to sell barn owl (silver owl).

Illegal and Void Agreements

Sections 25 to 30 address cases where the agreement is only void. Section 23 specifies the instances where the purpose or consideration of an agreement is illegal, rendering the agreement void. An illegal agreement in contract law is one that the court will not uphold because it aims to achieve an unlawful outcome. The unlawful outcome must stem from the fulfillment of the contract itself. A classic example of such an agreement is a contract for committing murder. Consequently, every illegal agreement is void, but not every void agreement constitutes an illegal agreement

e. **Unenforceable contract**: These are not enforceable in a court due to certain technical deficiencies, such as the absence of evidence or non-compliance with legal requirements, such as oral contract, contract beyond the limitation period, or a written contract lacking the required revenue stamp. For example, an unenforceable contract may arise from an agreement mandatorily requiring a stamp but lacking the stamp entirely or having insufficient stamps. In such cases, if the stamp is merely for revenue purposes, such as a receipt for cash payment, the required stamp can be affixed upon payment of a penalty, rectifying the deficiency and restoring the contract's enforceability. However, if the technical deficiency cannot be remedied, such as an unstamped bill of exchange or promissory note, the contract remains unenforceable. Nevertheless, the parties concerned may still carry out the contract. However, in the event of a breach or repudiation, the non-breaching party will not be entitled to legal remedies.

On the basis of formation

g. **Express contract**: When parties enter into contract either orally or in writing. Example: Anil agrees to sell his motor bike to you for ₹10000 and agreement is written as sale document. It is an express contract.

h. **Implied contract**: The behaviour and attitude of the parties will lead to an inference that they intended to enter into contract. For example, you employ a worker for one day to clean the surroundings of your house. As per law of contract, it is implied that you are liable to pay his wage at the end of the day for the work done by him.

i. **Tacit contract:** A tacit contract is one which is inferred from the conduct of parties. Example: Withdrawing cash through ATM

On the basis of performance

a. **Executed contract:** It is a contract where both the parties have performed their obligation or carried out the terms of the contract. It is a completed contract.

   Example: Anil offered to sell his car to Sunil for ₹250000. Sunil accepts Anil's Offer. Anil delivers the car to Sunil and Sunil pays ₹250000 to Anil.

b. **Executory contract:** This contract is not yet completed or either of the parties yet to have perform their obligation. In an executory contract, the consideration is either the promise of performance or an obligation. In such contracts, the consideration can only be performed sometime in the future, hence the name executory contract. Here the promises of consideration simply cannot be performed immediately. The best example of an executory contract is that of a lease. All the conditions of a lease cannot be fulfilled immediately. They are performed over time. Similarly, say Alex decides to tutor some students in Physics. They pay him ₹2500 at the start of the month. But here the contract isn't executed since Alex has to still carry out his promise. So, such a contract is an executory contract. Now even in executory contracts there are two types, namely, unilateral contracts and bilateral contracts.

i. Unilateral Contracts

As the name suggests these are one-sided contracts. It usually comes into existence when only one party makes a promise, which is open and available to anyone who wishes to or can fulfil the said promise. The contract will only be fulfilled once someone fulfils the promise. Let us see an example. Alex lost his bag on the metro. So, he decided to announce a reward of ₹1000 to anyone who finds and returns his bag with all its contents. Here he is only one party to the contract, namely Alex. If someone finds and returns his bag, he is obligated to pay the reward. This is a unilateral contract.

ii. Bilateral Contracts

A bilateral contract is one in which both the parties have to perform their respective promises or obligations to do or forbear. Here both parties agree to the terms of the agreement and thus enter into a contract. Hence it is also known as a reciprocal contract. In bilateral contracts, both parties have usually agreed to a time frame to carry out the said contract. Example, the contract of sale of a house. The buyer pays a down payment and agrees to pay the balance at a future date. The seller gives possession of the house to the buyer and agrees to deliver the title against the specified sale price. This is a bilateral contract.

Recap

- **Contract - agreement enforceable by law**
- **Indian Contract Act 1872 - details relating to contracts in India**
- **Agreement - every promise or set promises forming consideration for each other.**
- **Promise – accepted proposal**
- **Valid contract - satisfies all the conditions prescribed by Law**
- **Void contract – an agreement not enforceable by Law**
- **Voidable contract – an agreement which is enforceable by law at the option of one or more of the parties but not at the option of the other or others**
- **Illegal agreement – the object or consideration of which is unlawful**
- **Unenforceable contract– a contract which is actually valid but cannot be enforced due to some technical defect**
- **Express contract – one which is made by words spoken or written**

- **Implied contract – one which is made otherwise than by words spoken or written**
- **Tacit contract – one which is inferred from the conduct of parties or circumstances of the case**
- **Executed contract - where both the parties to the contract have performed their respective obligations**
- **Executory contract – where both the parties to the contract have still to perform their respective obligations**
- **Unilateral contract – one in which only one party has to perform his promise or obligation to do or forebear**
- **Bilateral contract – one in which both parties have to perform their respective obligations**

Objective Questions

1. In which year the Indian Contract Act came into force?
2. What is an agreement enforceable by law called?
3. Which contract is enforceable at the option of one of the parties to the contract?
4. What is an executed contract?
5. Identify the type of the contract in which both the parties to the contract have still to perform their respective obligations.
6. What is an illegal contract?
7. Identify the contract in which only one party has to perform his promise or obligation to do or forebear
8. A proposal when accepted is called?
9. Every promise or set promises forming consideration for each other is commonly known as?

Answers

1. 1872
2. Contract
3. Voidable
4. Both the parties have performed their obligation
5. Executory contract
6. One the object or consideration of which is unlawful
7. Unilateral contract
8. Promise
9. Agreement

Self-Assessment Questions

1. When does an agreement become contract?
2. Differentiate void contract and voidable contract.
3. Differentiate void contract and illegal contract.
4. What are the types of contracts on the basis of enforceability?
5. Differentiate executed contract and executory contract.
6. What is promise?
7. What is tacit contract?

Assignments

1. Differentiate between express and implied contracts, providing examples of each.

2. Explain the concept of voidable contracts and the circumstances that can lead to their voidability.
3. Contrast unilateral and bilateral contracts, providing specific examples of each type.
4. Elaborate on the concept of illegal contracts and the legal consequences of entering into such agreements.
5. Discuss the importance of contract formalities and how they can affect the enforceability of a contract.
6. Analyze the concept of voidable contracts. Describe the conditions under which a voidable contract can be set aside and the remedies available to the parties involved.

Suggested Reading

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Unit 2
Essentials of a Valid Contract

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ familiarise with the essential elements of a valid contract
- ◊ identify the role of consideration in a contract
- ◊ gain an insight on the importance of free consent in a contract
- ◊ know about the capacity to enter into a contract
- ◊ differentiate fraud and misrepresentation

Prerequisite

In our previous unit, we discussed contracts and their various types. Recall that an agreement that is legally enforceable is considered a contract. Consider a scenario where you enter into an agreement to sell your house to someone. However, the truth is that you were forced into this agreement under duress from that person, compelling you to sign the contract. Would this be a valid contract? Certainly not. A mere agreement is insufficient to constitute a valid contract. There are essential elements that must be present for a contract to be enforceable, and their absence renders the contract void. This unit will delve into the essential elements of a valid contract.

Keywords

Valid contract, Essential elements, Offer and acceptance, Free consent

Discussion

1.2.1 Essential Elements

The essential elements of a contract are depicted in the following figure:

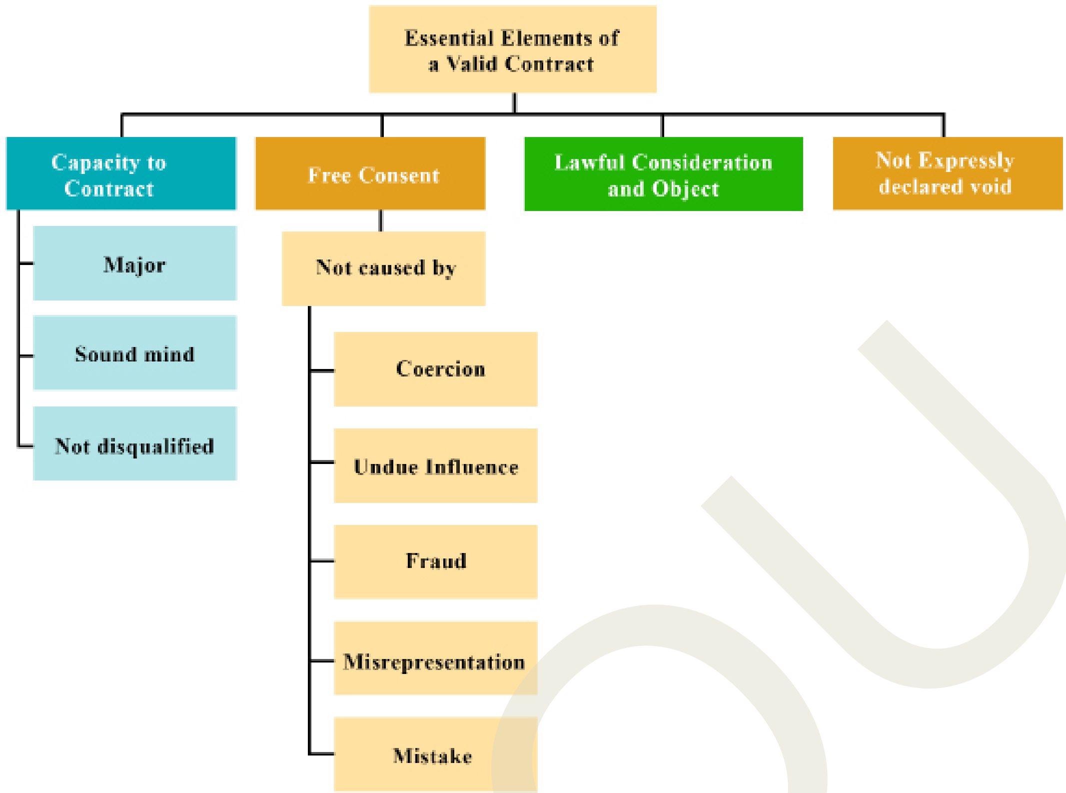

Figure 1.2.1 Essential Elements of a Valid Contract

Section 10 of the Indian Contract Act, 1872 provides that an agreement in order to be a contract must satisfy the following conditions:

◊ The parties must be competent to contract;

◊ It must be made by the free consent of the parties;

◊ It must be made for a lawful consideration and with a lawful object

◊ It should not have been expressly declared as void by law

The essential elements of a valid contract can be summarized as follows:

i. Offer and acceptance

Offer and Acceptance are the key parts of any agreement. Offer when accepted, becomes a contract. So, agreement involves valid offer by one party and valid acceptance by another. Agreement is defined in Contract Act Section 2(e) as "every promise and every set promises, forming consideration for each other." Therefore, for a valid contract, a valid agreement is essential. For example, a retailer might *offer* a men's watch for ₹2000, meaning that the retailer will sell the watch for that amount. However, a customer might come into the store and offer ₹1500 for the watch, meaning that the customer is expressing an interest in buying the watch for that amount.

ii. Legal relationship

There must be an intention among the parties to create a legal relationship. In case of social or domestic agreements, the usual presumption is that the parties do not intend to create legal relationship but in commercial or business agreements, the usual presumption is that the parties intend to create legal relationship unless otherwise agreed upon.

Example: Where a father fails to pay his son the promised pocket money, the son cannot sue the father because it was purely a domestic arrangement.

But even a business agreement may not be enforceable by law where the agreement so provides e.g., in Rose & Frank Co. v. Crompton Bros. (1925) A.C. 445, the agreement entered into stated that it will not be subject to legal jurisdiction in the law courts, the agreement was not enforceable by law as the parties never agreed to create legal obligations despite being a business agreement.

iii. Consensus ad idem

The minds of both the parties must be ad idem. In other words, the two parties must have agreed about the subject matter of the contract at the same time and in the same sense. For instance, if A who owns two cars, one Toyota and the other Honda, offers to sell B one car, A intending it to be the Toyota, B accepts the offer thinking that it is the Honda, there is no consensus and hence no contract.

iv. Competency of parties

The parties to the agreement must be competent to contract. If either of the parties to the contract is not competent to contract, the contract is not valid. According to section 11, the following are the persons who are competent to contract:

a. who are of the age of majority according to the law to which they are subject;

b. who are of sound mind;

c. who are not disqualified from contracting by any law to which they are subject.

v. Free consent

An agreement must have been made by free consent of the parties. A consent may not be free either on account of mistake in the minds of the parties or on account of the consent being obtained by some unfair means like coercion, fraud, misrepresentation or undue influence. In case of mutual mistakes, the contract would be void, while in case the consent is obtained by unfair means, the contract would be voidable (explained in detail later).

vi. Lawful consideration

All contracts must be supported by consideration. Gratuitous promises are not enforceable at law. An agreement made for an unlawful consideration is void.

Lawful consideration requires both the presence of consideration and the lawfulness of consideration.

Example: A promises to obtain for B an employment in government service and B promises to pay ₹ 1000 to A. The agreement is void as the consideration for it is unlawful.

vii. Lawful object

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

a. it is forbidden by law;

b. it is of such nature that if permitted it would defeat the provisions of any law;

c. it is fraudulent;

d. it involves or implies injury to the person or property of another;

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

viii. Not declared to be void

The agreement must not have been declared to be expressly void. Agreements mentioned in sections 24 to 30 have been expressly declared to be void. They include, Agreement in restraint of Marriage, Agreement in restraint of trade, Agreements in restraint of legal proceedings, Agreements void for uncertainty, Agreements by way of wager, Agreement to do impossible act, etc.

Example: X and Y carried on business in Mumbai. X promised to stop business in that locality if Y paid ₹500000. X stopped his business but Y did not pay him the promised money. It was held that X was not entitled to recover anything because the agreement was in restraint of trade and as such void.

ix. Certainty and possibility of performance

The terms of the contract must be precise and certain. It cannot be left vague. The terms of the agreement must also be capable of performance. An agreement to do an impossible act cannot be enforced.

Example. An agreement to discover treasure by magic is void as it is impossible to perform.

x. Legal formalities

An oral contract is a perfectly valid contract, except in those cases where writing, registration etc. is required by some statute. In India writing is required in cases of sale, mortgage, lease and gift of immovable property, negotiable instruments; memorandum and articles of association of a company, etc.

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

1.2.2 Offer and Acceptance

Offer or Proposal: It is an expression of willingness to do or not to do something; made to another person; with the object of gaining the consent of the other person to such act or abstinence. For example, Anil offers to sell his car to Sunil for ₹50000, is an offer.

The person making the proposal is called the 'offeror' or 'proposer'. The person to whom the proposal is made is called the 'offeree' or 'proposee'.

Essentials/Rules regarding a valid offer

◊ **It must be capable of creating legal relations:**

The person who offers something (known as offeror) must intend that if his offer is accepted, a legally binding agreement shall result. Once the offeree accepts the offer, the offeror can't reverse his offer and is liable to perform his part. If the offeror does not have an intention to create a legal relationship, it is not a valid offer. For example, Anil inviting his friend Sunil for a dinner is not an offer as the invitation is not capable of creating a legal relationship.

A leading case in this case is Balfour Vs Balfour. Mr. Balfour was employed in Ceylon. Mrs. Balfour owing to ill health, had to stay in England and could not accompany him to Ceylon. On the occasion of leaving her in England for medical treatment Mr. Balfour promised to send her £ 30 per month while he was abroad. But Mr. Balfour failed to pay that amount. So, Mrs. Balfour filed a suit against her husband for recovering the said amount. The court held that it was a mere domestic agreement and that the promise made by the husband in this case was not intended to be a legal obligation. Hence the suit filed by Mrs. Balfour was dismissed since there was no contract enforceable in a court of law.

◊ **Offer must be certain and definite:**

The terms in the offer should be very specific and not vague. Both the parties should understand the meaning and be clear about the legal consequences arising out of the offer. For example, an offer should not use terms like reasonable profit, certain sum of money, etc. Instead, it should write as 10% profit, ₹100000, etc.

Example: A agreed to take B's house on rent for three years at a rent of ₹100000 per annum provided the house was put into thorough repair and drawing rooms were decorated "according to present style". It is a vague term, because the term "present style" may mean one thing to A and another thing to B. Hence the agreement was void on the ground that the terms of offer were vague and uncertain.

◊ **Offer must be communicated to the offeree:**

There can be no offer by a person to himself, there must be always an offeree and offer should be properly communicated to him. No communication of offer leads to no acceptance of the same. Also, a person cannot accept an offer which he is not aware of.

Case: Lalman Shukla V /s Gauri Dutt (1913)

The master sent his servant to trace his missing nephew. The servant went in search of the boy, in the meantime the master announced a reward for providing information about the missing boy. The servant, in ignorance of the announcement traced the boy and informed the master. The servant later on came to know of the reward and he claimed it. His claim was dismissed on the ground that he was ignorant of the offer at the time of performance. It was further held that it was the duty of the servant to search for the boy.

◊ **Offer must be made with a view to obtaining the assent of the other party:**

An offer must be distinguished from mere expression of intention.

Case: Harris V/s Nickerson 1873

X advertised in the newspaper to effect sale of his goods on a particular day at a particular place. Y travelled a long distance to bid for the sale. On arrival, he found that the sale was cancelled. He sued X for breach of contract. It was held that the advertisement was merely expression of an intention and not an offer.

◊ **An offer may be conditional:**

An offer can be made subject to a condition. In that case it can be accepted by the offeree only subject to that condition. For example, Anil offers his car for sale at ₹ 50000 provided the buyer should furnish an advance of ₹10,000 within 24 hours. If anyone accepts the offer without furnishing advance there is no contract.

◊ **Lapse of an offer:**

An offer lapses:

a. If either offeror or offeree or both dies before acceptance;

b. If it is not accepted within specified time;

c. lapse by revocation (cancellation of offer by offeror); or

d. if offeree does not make a valid acceptance.

Kinds of Offers

Based on the nature, offers can be classified as follows:

i. **Express Offer:**

When an offer is made by words spoken or written, it is called an express offer. For example, through a telephone call, Anil offers to sell his car to Sunil for ₹50000.

ii. **Implied Offer:**

When an offer is implied by conduct of parties or circumstances of the case it is called an implied offer. For example, Anil enters a bus to travel from his village to the city.

iii. **General Offer:**

When an offer is made to the public at large it is called a general offer. This offer may be accepted by anyone. For example, an offer to give reward to anybody who finds the lost horse is a general offer. Though the general offer is made to the public at large, the contract in this case comes to an end when any person acts upon the conditions of the offer.

Case: Carlill v Carbolic Smoke Ball Co [1893]

The defendant, the Carbolic Smoke Ball Company, placed an advertisement in a newspaper for their products, stating that any person who purchased and used their product but still contracted influenza despite properly following the instructions would be entitled to a £100 reward. The advert further stated that the company had demonstrated its sincerity by placing £1000 in a bank account to act as the reward. The claimant, Mrs. Carlill, thus purchased some smoke balls and, despite proper use, contracted influenza and attempted to claim the £100 reward from the defendants. The defendants contended that they could not be bound by the advert as it was an invitation to treat rather than an offer. However, the court held that what the company made was a general offer and Mrs. Carlill accepted it by using the smokeballs and hence the company is liable to pay compensation.

iv. **Specific Offer:**

Specific offer is an offer, which is made to a specific or an ascertained person. In this case, the person to whom the offer is made is only liable to accept the offer. For example, Anil offers to sell his car to Sunil. Only Sunil can accept the offer and no one else.

v. **Counter Offer:**

Counter offer by the offeree terminates the original offer. When in place of accepting the terms of an offer as they are, the offeree accepts the same, subject to certain condition or qualification, then a counter offer is said to be made. For example, Anil offers to sell his car to Sunil at ₹50,000. In return, Sunil offers to buy the car at ₹40,000. In this case both are counter offers.

vi. **Cross Offer:**

Where two parties make identical offer to each other, in ignorance of each other's offer, this offer is termed as cross offer. In this case, there is no contract because out of the two parties no one can be called for acceptance. For example, Anil offers to sell his car to Sunil for ₹50000 by an e mail. At the same time Sunil offers to buy the car of Anil for ₹45000. Both persons do not know about the others offer at the time of making their offers. These are cross offers.

vii. **Standing Offer:**

When an offer is allowed to remain open for acceptance over a period of time, it is called standing, open or continuing offer. Tenders are the example of standing offer. For example, a bottle water company offers to supply bottled water to the railway company for 5 years.

Differences Between Offer and Invitation to Offer

An offer is to be distinguished from an invitation to offer. A prospective shareholder by filling up a share application form, usually attached to the prospectus, is making the offer. An auctioneer at the time of auction, inviting offers from the bidders is not making an offer. The price lists, catalogues and inviting tenders and quotations are mere invitations to offer. Likewise, a display of goods with a price tag on them in a shop window is construed as an invitation to offer and not an offer to sell.

For example, in a departmental store, there is self-service. The customers pick up articles and take to the cashier's desk to pay. The customer's action in picking up a particular article is an offer to buy. As soon as the cashier accepts payment, a contract is entered into. However, there are certain exceptions to this. Where a store advertises that it will give a free gift or a special discount to "the first 100 customers" or something like that, it may be anything that requires special effort on the part of the customer. If so, the store has made an offer which he may accept by being among the 100 customers. Similarly, sale promotion schemes requiring customers to do anything special are offers.

In terms of Section 2 (a) of the Act, an offer is the final expression of willingness by the offeror to be bound by the offer should the other party chooses to accept it. On the other hand, offers made with the intention to negotiate, or offers to receive offers are known as invitation to offer. Thus, where a party without expressing his final willingness, proposes certain terms on which he is willing to negotiate he does not make an offer, but only invites the other party to make an offer on those terms. Hence the only thing that is required is the willingness of the offeree to abide by the terms of offer.

In order to ascertain whether a particular statement amounts to an offer or an invitation to offer, the test would be the intention with which such statement is made. The mere statement of the lowest price at which the vendor would sell contains no implied contract to sell at that price to the person making the inquiry.

If a person who makes the statement has the intention to be bound by it as soon as the other accepts, he is making an offer. Thus, the intention to be bound is an important factor to be considered in deciding whether a statement is an 'offer' or 'invitation to offer.'

Following are instances of invitation to offer to buy or sell:

- ◊ An invitation by a company to the public to subscribe for its shares.
- ◊ Display of goods for sale in shop windows.
- ◊ Advertising auction sales and
- ◊ Quotation of prices sent in reply to a query regarding price.

When Communication of offer is Complete?

Section 4 of the Contract Act says, the communication of an offer is complete when it comes to the knowledge of the person to whom it is made i.e., when the letter containing the offer reaches the offeree. For instance, Anil of Delhi sends a letter through post to Sunil of Bombay offering to sell his home for ₹10 lakhs. The letter is posted on April 5, and this letter reaches Sunil on April 7. The communication of the offer is complete on April 7 when Sunil comes to know about the offer through the letter. In the instance, if the letter containing the offer never reaches Sunil, but Sunil comes to know in relation to the proposal from some other source and sends his acceptance, it will not amount to proper communication of the offer and so no contract will arise.

Acceptance

When the person to whom the proposal is made signifies his assent, it is an acceptance of the proposal. An acceptance must be communicated to the offeror in order to complete the acceptance. The acceptor should do something to signify his intention to accept.

Essentials of valid Acceptance

i. It must be given by the Offeree

An offer can be accepted only by the person to whom it is made. It cannot be accepted by another person without the consent of offeror. If anyone attempted to accept it no contract with that person arises.

Example: A sold his business to B without disclosing the fact to his customers. J sent an order for the supply of goods to A by name. B received the order and executed the same. It was held that there was no contract between B and J because J never made any offer to B.

ii. It must be Absolute & Unconditional

In order to convert the offer into an agreement the acceptance must be absolute and unconditional. If the offeree imposes any condition in his acceptance, it is not a valid acceptance but a counter offer.

Example: A offers to sell his watch to B for ₹500 and B replies that he can buy it only for ₹300, there is a material variation in the acceptance. Therefore, there is no contract as the acceptance is not absolute and unconditional.

iii. It must be in a Prescribed Manner

If the offeror in his offer has prescribed any particular manner of acceptance it must be given according to that particular manner. If no particular manner is prescribed in the offer, then acceptance should be made in a reasonable manner.

Example: A makes an offer to B and writes "if you accept the offer send your acceptance by telegram." B sends his acceptance by registered post. It is not a valid acceptance. But A should inform B that it is rejected because it is not in the prescribed manner.

iv. It must be Communicated to the Offeror

In order to form a contract, the acceptance must be communicated to the offeror in a clear manner by the offeree or his authorized agent. Mere expression of intention to accept an offer is not a valid acceptance.

Example: A proposes by letter to purchase B's house. B expresses his intention to sell it to A but does not send a reply to him. The house is sold to C despite B's intention. A has no legal remedy against B.

v. It may be Express or Implied

When an acceptance is given by words spoken or written, it is called express acceptance. When it is given by conduct, it is called implied acceptance. Sometimes the proposal instead of being made to a definite person is made to the public.

Example: A wrote a letter to B to sell his cycle for ₹2,000. B accepted his offer and sent a letter of acceptance to A. It is an express acceptance.

An implied acceptance occurs when a shopper selects an item in a supermarket and pays cashier for it. The shopper's conduct indicates that he or she has agreed to the supermarket owner's offer to sell the item for the price stated on it.

vi. Acceptance must be made within the stipulated time.

If the time with in which the offeree should accept the offer is specified in the offer, the acceptance should be done within such time. If no time is specified for acceptance, it shall be made within a reasonable time.

vii. The acceptor must be aware of the proposal at the time of the offer.

At the time of acceptance, the offeree should have knowledge about the offer. Example: **Case: Lalman Shukla V /s Gauri Dutt (1913)**

The master sent his servant to trace his missing nephew. The servant went in search of the boy in the meantime the master announced a reward for providing information about the missing boy. The servant, in ignorance of the announcement traced the boy and informed the master. The servant later on came to know of the reward and he claimed it. His claim was dismissed on the ground that he was ignorant of the offer at the time of performance. It was further held that it was the duty of the servant to search for the boy.

viii. **Acceptance must be given before the offer lapses or before the offer is revoked.**

The offeree should accept the offer before the same is revoked or withdrawn by the offeror not afterwards.

ix. **Acceptance cannot be implied from silence.**

The general rule is that silence cannot amount to acceptance. The rationale behind this is based on the idea that acceptance must take some form of objective manifestation of the intention of the offeree (i.e., the party to which an offer has been made) to accept the terms of the contract. Such intention is usually best expressed though some form of positive action. This is so, in order to ensure that no one can enforce a contract upon an unwilling party. For instance, A writes to B that "If I do not hear from you, I will assume that you have sold your horse to me for ₹6000". The courts will not find that B has accepted the offer unless he does a positive act towards this direction. However, there are exceptions to this, whereby silence may amount to acceptance of the contract. For example, A leaves some goods with B asking him to return the same if he does not want them. But instead of returning, B started using the goods. It is an implied acceptance though B kept silence in the matter.

Who may accept an offer?

An offer can be accepted only by the person to whom it is made. It means that the person to whom the offer is made can alone accept it. It cannot be accepted by another without the consent of the person making it. Thus, where offer is made by A to B, the acceptance by C would be inoperative. However, a general offer can be accepted by any person who come to know about the offer. Example: Carlill Vs Carbolic Smokeball Company.

Communication of Acceptance

The rules concerning communication of acceptance have to be studied from the point of view of offeror as well as the offeree because the communication of acceptance is complete at dissimilar times for the offeror and the offeree. As per Section 4 of the Contract Act, "the communication of acceptance is complete:

◊ As against the proposer, when it is put in a course of transmission to him, so as to be out of the power of the acceptor, and

◊ As against the acceptor, when it comes to the knowledge of the proposer.

Therefore, the offeror becomes bound through the acceptance as soon as the letter of acceptance is duly posted by the acceptor, but the acceptor is bound through his acceptance only when the letter of acceptance reaches the offeror. It is important to note that a valid contract arises even if the letter of acceptance is lost in transit or is delayed. The offeror will be bound through the acceptance only when the letter of acceptance was correctly addressed, properly stamped, and actually posted. Therefore, if the acceptance letter is not correctly addressed, it will not be binding upon the offeror.

In the example given above if Sunil of Bombay sends his acceptance through post on April 10 and the communication of acceptance is complete against Anil on April 10, i.e., when the letter of acceptance is posted, but the communication of acceptance shall be complete as against Sunil only when this letter reaches Anil. Suppose Anil receives the letter of acceptance on April 12, at 11 a.m. then Sunil will be bound through his acceptance on April 12 only. In other words, the law has given a chance to the acceptor to withdraw his acceptance.

Modes of Communication of Acceptance

Section 3 of the Act prescribes in general terms two modes of communication namely, (a) by any act and (b) by omission, intending thereby, to communicate to the other or which has the effect of communicating it to the other.

◊ **Communication by act** would include any expression of words whether written or oral. Written words will include letters, telegrams, faxes, emails and even advertisements. Oral words will include telephone calls. Again, communication would include any conduct intended to communicate like positive acts or signs so that the other person understands what the person 'acting 'or 'making signs' means to say or convey.

◊ **Communication of acceptance by 'omission' to do something**. Such omission is conveyed by a conduct or by forbearance on the part of one person to convey his willingness or assent. However, silence would not be treated as communication by 'omission'. For example, Anil offers ₹50,000 to Sunil if he does not arrive before the court of law as evidence to the case. Sunil does not arrive on the date of hearing, to the court. Here omission of doing an act amounts to acceptance.

◊ **Communication of acceptance by conduct.** For instance, delivery of goods at a price by a seller to a willing buyer will be understood as a communication by conduct to convey acceptance. Similarly, one need not explain why one boards a public bus or drop a coin in a weighing machine. The first act is a conduct of acceptance against its communication to the offer by the public transport authority to carry any passenger. The second act is again a conduct conveying acceptance to use the weighing machine kept by the vending company as an offer to render that service for a consideration.

Another issue in communication of acceptance is about the effect of act or omission or conduct. These indirect efforts must result in effectively communicating its acceptance or non-acceptance. If it has no such effect, there is no communication regardless of which the acceptor thinks about the offer within himself. Thus, a mere mental unilateral assent in one's own mind would not amount to communication. Where a resolution passed by a bank to sell land to 'A' remained uncommunicated to 'A', it was held that there was no communication and hence no contract. [Central Bank Yeotmal vs Vyankatesh (1949)].

◊ **Where a proposal is accepted by a letter sent by the post**, the communication of acceptance will be complete as against the proposer when the letter of acceptance is posted and as against the acceptor when the letter reaches the proposer.

◊ **Acceptance over telephone or telex or fax**: When an offer is made of instantaneous communication like telex, telephone, fax or through e-mail, the contract is only complete when the acceptance is received by the offeror, and the contract is made at the place where the acceptance is received (Entores Ltd. v. Miles Far East Corporation). However, in case of call drops and disturbances in the line, there may not be a valid contract.

1.2.3 Revocation of Offer and Acceptance

The term 'revocation' basically means 'taking back' or 'withdrawing'. Both offer and acceptance can be revoked or withdrawn. But it is possible only up to a certain stage.

1.2.3.1 Revocation of Offer

As per Section 5 of the Contract Act "a proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards." The communication of acceptance is complete as against the offeror when it is put in a course of transmission. Hence, an offer can be revoked at any time before the letter of acceptance has been posted.

For example, Aman offers through letter to sell his car to Mithun at a sure price. Aman may revoke his offer at any time before Mithun posts his letter of acceptance, but not afterwards. Once the letter of acceptance has been posted, the offer cannot be revoked. So, when the offeror wishes to revoke his offer, he has to do so through a speedier mode of communication so that the revocation notice reaches the offeree before he posts his letter of acceptance. Revocation shall always be expressed and move from the offeror himself or a duly authorized agent. Notice of revocation of a 'common offer' is given through the similar channel through which the original offer was made.

Modes of Revocation of Offer

◊ **By notice of revocation**: Anil offered Binu to sell goods at ₹5000 through a post but before Binu could accept the offer Anil received a higher bid for the goods from Vinay. So, Anil revoked the offer to Binu by informing Binu over the telephone and sold goods to Vinay.

◊ **By lapse of time**: The time for acceptance can lapse if the acceptance is not given within the specified time and where no time is specified, then within a reasonable time. This is for the reason that proposer should not be made to wait indefinitely. It was held in Ramsgate Victoria Hotel Co. Vs Montefiore (1866 L.R.Z. Ex 109), that a person who applied for shares in June was not bound by an allotment made in November. This decision was also followed in India Cooperative Navigation and Trading Co. Ltd. Vs Padamsey Prem Ji. However, these decisions now will have no relevance in the context of allotment of shares since the Companies Act, 2013 has several provisions specifically covering these issues.

◊ **By non-fulfilment of condition precedent**: Where the acceptor fails to fulfill a condition precedent to acceptance, the proposal gets revoked. This principle is laid down in Section 6 of the Act. The offeror for instance may impose certain conditions such as executing a certain document or depositing certain amount as earnest money. Failure to satisfy any such condition will result in the lapse of the proposal. As stated earlier 'condition precedent' to acceptance prevents an obligation from coming into existence until the condition is satisfied. Suppose where 'Ajay' proposes to sell his house to 'Binoy' for ₹5 lakhs, provided 'Binoy' leases his land to 'Ajay'. If 'Binoy' refuses to lease the land, the offer of 'Ajay' is revoked automatically.

◊ **By death or insanity:** Death or insanity of the proposer would result in automatic revocation of the proposal but only if the fact of death or insanity comes to the knowledge of the acceptor.

◊ **By counter offer:** When the offeree to an offer makes a counter offer, instead of accepting the former, the original offer will stand revoked.

◊ **By subsequent illegality**: An offer which was legal when made, may become illegal before acceptance, in which case the offer will stand revoked.

1.2.3.2 Revocation of Acceptance

Section 5 of the Contract Act further gives that an acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards. It is already discussed that the communication of acceptance is complete as against the acceptor when it comes to the knowledge of the offeror. Hence, the acceptor can revoke his acceptance at any time before his letter accepting the offer reaches the offeror. Once the letter of acceptance reaches the offeror, the acceptance cannot be revoked. Therefore, for effective revocation of acceptance it is necessary that the acceptor should adopt some speedier mode of communication so that his revocation reaches the offeror before the letter of acceptance. For example, Aman offers through a letter dated February 2, sent through post, to sell his home to Mithun at a sure price. Mithun accepts the offer on February 6 through a letter sent through post. The letter reaches Aman on February 8 at 2 p.m. Here Mithun may revoke his acceptance at any time before 2 p.m. on February 8, but not afterwards. Sometimes, confusing situation may arise. The letter of acceptance and the telegram containing revocation of acceptance may be delivered to the offeror at the same time. In such a situation, the formation of a contract is a matter of chance. Which one is opened first by the offeror will decide the issue. Usually, it is presumed that a man of ordinary prudence will first read the telegram. Hence, the revocation will be quite effective. When the parties at distant spaces communicate in excess of telephone or telex, the question of revocation does not arise because there is instantaneous communication of the offer and its acceptance. The offer is made and accepted at the similar time. In brief, an offer can be revoked at any time before the letter of acceptance is posted and an acceptance can be revoked before it reaches the offeror.

Communication of Revocation

The communication of revocation is complete at dissimilar times for the person who creates it and the person to whom it is made. Just as to Section 4 the communication of revocation is complete:

◊ As against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it.

◊ As against the person to whom it is made, when it comes to the knowledge of the proposer.

For example, Anil proposes through letter to sell his home to Sunil at a sure price. Sunil accepts the proposal through a letter sent through post. If Anil revokes his offer through telegram, then revocation of offer is complete as against Anil, when the telegram is sent and for Sunil it is complete when Sunil receives the telegram. If Sunil revokes his acceptance through telegram the revocation of acceptance is complete for Sunil when the telegram is sent and as against Anil, when it reaches him.

1.2.4 Consideration

Consideration means something in return. An agreement must involve exchange of benefit from both sides. If you agree to sell your car to Arun for ₹ 300000 and Arun promised to pay you ₹ 300000. Here Arun's promise to pay the sum of ₹300000 is the consideration for your promise to sell the car. Your promise to sell the car is the consideration for Arun's promise to pay the sum of ₹ 300000.

Meaning and Definition:

Consideration is the benefit that each party receives, or expects to receive, when entering into a contract. Consideration is often monetary, but it can be a promise to perform a specific act, or a promise to refrain from doing something. In order for a contract or agreement to be legally binding, every party to the contract must receive some type of consideration. In other words, a contract is a two-way street, so each party must receive something of value from the other party or parties. Illegal or immoral acts are not legally considered to serve as consideration. To explore this concept, consider the following definition:

Section 2(d) of the Indian Contract Act 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 act, or abstinence or promise is called a consideration for the promise"

Consideration is a benefit to the party, which can be in any form like cash/kind/goods/service/tangible/intangible.

For example: Let's look into 3 different forms of consideration, i.e., (1) Arun will prepare a software for Varun for a fee of ₹100000. (2) Arun will prepare a software to Varun and Varun in return will permit Arun to use his computer facilities for one year. (3) Arun will prepare a software to Varun and Varun will not evict Arun from his house for next one year where Arun is the tenant of Varun. All these benefits to the parties involved are called consideration. An agreement not supported by consideration is called *Nudum pactum* (bare agreement). A promise can also be a consideration for another promise. Settlement of a dispute can be a good consideration for another promise. But the mere doing of a thing which a person is already bound to do is no consideration for a new promise in his favour.

Essentials of a Consideration

The following are the essentials of a valid consideration:

i. Consideration must move at the desire of the promisor

The first essential characteristic of a valid consideration is that the act or abstinence must have been done at the desire of the promisor. It follows that any act performed at the desire of a third party cannot be a consideration. The desire of the promisor must be express or implied. A gratuitous service rendered by the promisee without any request of the promisor is not a consideration enforceable at law. For example: Anil sees Sunil drowning and saves his life. Anil cannot demand payment for his service as it is a voluntary act on his part and Sunil never asked him to do so.

ii. Consideration must move from the promisee or any other person

Consideration may proceed from the promisee or from any other person on behalf of the promisee. As long as there is a consideration for a promise, it is immaterial who has given it. So, it is clear that a person can sue on a contract even if the consideration for the promise proceeded from a third party, provided it has been done at the desire of the promisor. The words, "the promisee or any other person" in the definition clause show that a stranger to a consideration may maintain a suit. For example: Anil, Sunil and you enters into an agreement under which Anil pays ₹ 10000 to Sunil and Sunil agreed to build a house for You. Here you are a party to the contract but stranger to consideration and can enforce the contract. Chinnayya V. Ramayya, is a leading case in this regard. In this case it was held that consideration moving from third party is also good consideration. But in English law consideration must move from the promisee alone. So, a stranger to a consideration cannot sue on agreement.

iii. Consideration may be past, present or future

The words in the definition, "has done or abstained from doing; or does or abstains from doing: or promises to do or to abstain from doing" indicate that consideration may be past, present or future.

When the promisor received the consideration from the promisee even before the date of promise it is called ***past consideration***. In other words, the promisee gives consideration first and the promisor gives promise later. A past consideration is as good as present or future consideration. For example: Anil gave up his practice as a lawyer and served as manager of a land owner at the request of land owner. Land owner subsequently promised a pension. In this case it was held that there was good past consideration.

When the consideration for a promise is given simultaneously with the promise it is called ***present consideration.*** Present consideration usually arises when there is a promise to pay for goods sold and delivered. For example: Anil sells computer to Sunil for ₹50 000 and Sunil in return gives ₹50000 to Anil. In this case the performance by both the parties is simultaneous.

A ***future consideration*** is a promise to do or give something in return in future for the promise then made. It is called a promise for the promise. Mutual promises to marry, a promise to do work in return for promise of payment are examples of future consideration. Meera promises to look after the child of Maya and she further agrees to receive all expenses incurred by her from Maya at the end of the year. In this case consideration is a future one for Meera.

iv. Consideration need not be adequate

It is nowhere laid down that consideration should be adequate to the promise. What is required is that there should be some consideration for the promise. Adequacy is for the parties to decide at the time of making the agreement. If a man gets what he contracted for, the court will not enquire whether it was equivalent to the promise which he gave in return. Even a smallest consideration is sufficient provided it has some value. Inadequacy of consideration is no ground for refusing the performance of the promise, unless it is evidence of fraud. For example: Anil agrees to sell his dog worth ₹25000 to Sunil for ₹2000. The contract is valid provided Anil's consent was freely obtained.

v. Consideration must be real

Though consideration need not be adequate, yet it must be real and not illusory. Consideration is said to be unreal and illusory when (1) the act forming consideration is legally or physically impossible (2) the consideration is uncertain (3) when it seems to be present but absent in fact. For example: Promise made by a man to make two parallel lines meet is no good consideration. It is an illusory consideration and he cannot sue or claim anything on the foot of such an illusory consideration.

vi. Consideration must be lawful

The consideration for an agreement must be lawful. Consideration is said to be unlawful if (i) it is forbidden by law (ii) it is of such a nature that if permitted would defeat the provisions of any law (iii) it is fraudulent (iv) it involves or implies injury to the person or property of another (v) it is regarded by court as immoral or (vi) it is regarded by the court as being opposed to public policy. For example: Anil promises to obtain an employment for Sunil in government service and Sunil in return promises to pay Anil a sum of ₹100000. The agreement is void as the consideration is unlawful.

vii. Consideration must be something which the promisor is not already bound to

A promise to do what one is already obligated to do, either by general law or under an existing contract, is not good consideration for a new promise. There will be no benefit to the promisor above and beyond their existing rights and obligations. For example: Anil promises to pay money to a police officer to investigate a case. The agreement was held to be invalid because the officer is already under a duty to do so by law.

A stranger to Consideration (Privity of Consideration):

Under the Indian Contract Act 1872 consideration for a contract may move from the promisee or any other person i.e., a stranger to the consideration can also enforce the contract. So long as there is consideration for a promise it remains valid and it is immaterial who has furnished it. A promisee who is a stranger to consideration can sue on a contract, as the consideration can move from a third party. This law was established in the case of *Chinnayya Vs. Ramayya.* An old lady Laxmi Rani gifted her property to her own daughter Ramayya, with the direction to pay a certain sum of money annually to Chinnayya, her maternal uncle. On the same day Ramayya executed an agreement with Chinnayya agreeing to pay the amount annually. Later on, Ramayya refused to honour the agreement on the ground that there is no consideration. Chinnayya sued for the recovery of the annuity. It was held that there was sufficient consideration i.e., the property given to her by the sister of Chinnayya. Under English Law however a stranger to consideration cannot sue. Consideration must move from the promisee himself.

A stranger to a contract (Privity of Contract):

A stranger to contract is a person who is not a party to the contract. Such a party neither makes nor accepts any offer. Absence of an offer or an acceptance means that there is no agreement and subsequently there is no contract. It is a general law of contract that a person who is not a party to the contract cannot sue upon it. A stranger to a contract cannot sue in England as well as in India though it may be made for his benefit. This means that unless there is a privity of contract, a party cannot sue on it. Privity of contract means the relationship subsisting between the parties to a contract. It means that no one but the parties to a contract can be bound by it or be entitled under it. A stranger to contract does not acquire any rights under the contract. He does not attract any liability also. "Privity of contract" states that the contract confers right and obligations on contracting parties only.

For example: Anil had mortgaged some property to Binil. Anil then sold his property to Sunil, Sunil having agreed with Anil to pay off the mortgage debt to Binil. Binil brought an action to recover the mortgage money against Sunil. The Privy Council held there was no contract between Binil and Sunil. Binil could not enforce the contract to recover the amount from Sunil.

Exceptions to the rule that stranger to a contract cannot sue:

Under the Indian Law there are some exceptions to the rule that a stranger to a contract cannot sue. That is, under certain circumstances even a stranger to a contract can sue. They are explained below:

i. **Trust:** In the case of trust, the beneficiary may enforce the contract even though he is stranger to the contract creating the trust. A stranger can sue when he is beneficiary under an obligation amounting to a trust arising out of the contract. In simple words, when under a contract, one of the parties constitutes himself a trustee or a third party, the said third party may sue to enforce the trust in his favour irrespective of the fact that he is a stranger to contract. The said third party is known as beneficiary. For example: Where Anil agrees to transfer certain properties to Binil as trustee for the benefit of Sunil, Sunil can enforce the agreement even though Sunil is a stranger to contract. In this example Sunil is the beneficiary.

ii. **Contracts through an agent:** Contracts which are entered into through an agent can be enforced by his principal. For example: Anil is the agent and Binil is his principal. Anil enters into a contract with Sunil for purchasing goods on behalf of his principal Binil. Now Binil, even though a stranger to the contract can enforce the contract against Sunil.

iii. **Where provision is made in a marriage settlement:** Where an agreement is made in a connection with marriage and a provision is made for the benefit of a person, he or she may take advantage of that agreement although he or she is not a party to it. When a family arrangement between male members of a Hindu family makes a provision for the maintenance or for expenses of marriage of female members, the latter, even though they are not parties to the family arrangement, are entitled to sue since they possess an actual beneficial right. For example: Anil agreed with Piya's father that he would pay Piya ₹500 per month as allowance if she marries Anil's son. The allowance was stopped sometime after the celebration of marriage. Piya sued her father-in-law for ₹1500 as arrears of allowance. It was held that Piya could recover the money even though she was not a party to the contract. In *Subbu Ammal Vs Subramanyam,* it was held that a female member who was not a party to the family arrangement can sue as she possesses beneficial rights.

iv. **Where a charge is created on a specific immovable property in favour of a person:** Where a promise is made to an individual for the benefit of a third party and a charge is created on a specific immovable property for the performance of that promise, then the third party, though he is a stranger to the contract can enforce the same. For example: In one case Anil promised Binil to pay certain allowances to Sunil. As security, Anil created a charge on a specific immovable property. Sunil filed a case against Anil, for recovery of arrears of allowances. It was held that even though Sunil was a stranger to the contract, Sunil was entitled to proceed against the property charged in order to recover the arrears of allowances.

v. **Where the promisor has by his conduct created privity of contract:** For example: there is an agreement between tenant and sub tenant. Suppose, the sub tenant is paying the rent directly to the land lord, then the land lord is allowed to recover unpaid rent from the subtenant.

vi. **Covenants running with the land:** At the time of transfer of immovable property, a notice that the owner of land is bound due to certain obligations created by an agreement relating to land, the new purchaser will be bound by them though he was not a party to the original covenant.

Importance of Consideration

Consideration is the foundation of every contract. The law insists on the existence of consideration if a promise is to be enforced as creating legal obligations. A promise without consideration is null and void. It is called a naked promise or "Nudum Pactum". Thus, if Anil promises to pay Binil ₹1000 without anything in return, this constitutes a bare promise and gives no right of action.

Sir William Anson, author of *principles of law of contract* has brought out the importance of consideration thus, "offer and acceptance bring the parties together, and constitute an outward semblance of a contract, but most systems of law require some further evidence of the intention of the parties and in default of such evidence, refuse to recognise an obligation". This further evidence of the intention of the parties is supplied by consideration, which is one of the essential elements of a valid contract. Section 25 of the Indian Contract Act supports this contention and provides that agreement without consideration is void. (Subject to certain exceptions).

Exceptions to the Rule "No Consideration, No Contract"

Every agreement to be enforceable at law must be supported by valid consideration. In other words, gratuitous promises are not enforceable in law. A promise to contribute money to charitable purpose is a good example of the class of promises which though they may be morally binding, are not contracts. An agreement made without consideration is void and is unenforceable except in certain cases. Section 25 specifies the cases where an agreement though made without consideration will be valid. These are as:

i. **Agreement based upon love and affection [Sec: 25 (1)]:** Where an agreement is expressed in writing and registered under the law and is made on account of natural love and affection between parties standing in a near relation to each other, it is valid and enforceable even though it is not supported by consideration.

Essentials of this agreement are:

a. It is expressed in writing;
b. It is registered under the law for the time being in force,
c. It is made on account of natural love and affection, and
d. It is between parties standing in a near relation to each other.

For example: Anil for natural love and affection, promises to give his son B, ₹1000. Anil puts his promise to son into writing and registers it. This is a contract.

The mere existence of a near relation between the parties without the motivating force of natural love and affection will not render an agreement enforceable even though it is in writing and registered. For example: Maya is the wife of Anil. Often, they were quarrelling. Anil, after referring to persistent quarrels and disagreements between himself and his wife Maya, executed a registered document in favour of his wife agreeing to pay her maintenance and separate residence, but no consideration was passed from the wife. In this case it was held that the agreement is void. Nearness or relationship does not necessarily mean natural love and affection.

ii. **Agreement to pay Compensation for past voluntary services [Sec. 25 (2)]:** An agreement made without consideration may be valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promisor. To apply this rule, the following essentials must exist:

  a. The act must have been done voluntarily;

  b. The promisor must be in existence at the time when the act was done;

  c. The promisor must agree now to compensate the promisee.

  For example: Maya took care of Piya's infant son. Piya promises to pay for Maya's expenses incurred for this purpose. This is a contract. A promise to pay for past services voluntarily rendered would be enforceable under this rule. If, however, something has not been done voluntarily, this clause will not apply.

iii. **Time-barred debt [Sec. 25 (3)]:** A promise to pay a time-barred debt is also enforceable. But the promise must be in writing and be signed by the promisor or his agent authorised in that behalf. The promise may be to pay the whole or part of the debt. An oral promise to pay a time - barred debt is unenforceable. For example: Anil owes Sunil ₹10000. This debt is time barred by the Limitation Act. Even then, Sunil, promises in writing to pay Anil ₹4500 on account of debt. This is a contract.

iv. **Completed gifts:** Validity of gifts made between the donor and the donee, is not affected by the rule "No consideration, No contract". Thus, if a person gives certain properties to another according to the provisions of the Transfer of Property Act, he cannot subsequently demand the property back on the ground that there was no consideration.

v. **Agency (Sec. 185):** No consideration is needed to create an agency.

vi. **Guarantee (Sec 127):** A contract of guarantee is made without consideration.

vii. **Remission (Sec 63):** No consideration is required for an agreement to receive less than what is due. This is called remission in the law.

1.2.5 Capacity to Enter in to Contract (Competent to Contract)

Capacity refers to the legal competence of the parties to make a contract. Section 11 defines "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject". In simple words three basic conditions are necessary to be a party to a valid contract is:

a. He has attained the age of majority

b. He is of sound mind

c. He is not disqualified from contracting by any law to which he is subject

1.2.5.1 Age of Majority

In India, the age of majority is regulated by the Indian Majority Act, 1875. Every person living in India shall attain the age of majority on the completion of 18 years of age and not before. The age of majority being 18 years, a person less than that age even by a day would be a minor for the purpose of contracting. So, only a person who attained an age of 18 years, is capable to enter into a contract as per law.

Effects of minor's agreements

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

i. **An agreement with or by a minor is void**

   Section 10 of the Contract Act requires that the parties to a contract must be competent and Section 11 says that a minor is not competent. But neither section makes it clear whether the contract entered into by a minor is void or voidable. Till 1903, courts in India were not unanimous on this point. The Privy Council made it perfectly clear that a minor is not competent to contract and that a contract by a minor is void ab initio. The leading case on this point is Mohori Bibee Vs. Dharmodas Ghose (1903). The Point decided is: An agreement with or by a minor is absolutely void. In the above case, A, a minor borrowed ₹20000 from B and as a security for the same executed a mortgage in his favour. He became a major a few months later and filed a suit for the declaration that the mortgage executed by him during his minority was void and should be cancelled. It was held that a mortgage by a minor was void and B was not entitled to claim the repayment of money.

ii. **No ratification**

   An agreement with minor is completely void. A minor cannot ratify the agreement even on attaining majority, because a void agreement cannot be ratified. A person who is not competent to authorize an act cannot give it validity by ratifying it. Thus, where a minor borrowed a sum of money by executing a simple pro-note for it and after attaining majority executed a second pro-note in respect of the original loan plus interest thereon. It was held that the second pro-note was not valid and the suit was not maintainable. If on coming of age, a minor makes a new promise and not merely an affirmation of the old promise, for a fresh consideration, the new promise will be binding.

iii. **Minor can be a promisee or beneficiary**

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

Example: X, a minor, insured his goods with an insurance company. The goods were damaged. X filed a suit for claim. The insurance company took the plea that the person on whose behalf the goods were insured was a minor. The court rejected the plea and allowed the minor to recover the insurance money. [The General American Insurance Company Ltd. V. Madan Lal Sonu Lal (1935) 59 Bom 656]. The infancy of one party to a contract does not affect the other party's liability, the plea of infancy being a privilege personal to the infancy, so that although an infant may avoid a contract, the infant can, nevertheless, be held liable and, if necessary, sue the other party to the contract.

iv. No estoppel against a minor

Where a minor, by misrepresenting his age has induced the other party to enter into a contract with him, he cannot be made liable on the contract. There can be no estoppel against a minor. In other words, a minor is not estopped from pleading his infancy in order to avoid a contract. It has been held by a Full Bench of the Bombay High Court in the case of Gadigeppa v. Balangowda that where an infant represents fraudulently that he is of majority age and thereby induces another to enter into a contract with him, then in an action founded on the contract, the infant is not estopped from setting up infancy. The court may, however, require the minor to compensate the other party on the ground of equity. This is based on the rule that a minor can have no privilege to cheat men. Fraudulent misrepresentation as to age by an infant will operate against him in certain cases. If a minor obtains property or goods by misrepresenting his age, he can be compelled to restore it but only so long as the same is traceable in his possession.

v. No Specific performance

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

vi. Liability for torts

A minor is liable in tort (civil wrong). Thus, where a minor borrowed a horse for riding only, he was held liable when he lent the horse to one of his friends who jumped and killed the horse. Similarly, a minor was held liable for his failure to return certain instruments which he had hired and then passed on to a friend. But a minor cannot be made liable for a breach of contract by framing the action on tort. You cannot convert a contract into a tort to enable you to sue an infant.

vii. Insolvency

A minor cannot be declared insolvent even though there are dues payable from the properties of the minor.

viii. Partnership

A minor being incompetent to contract cannot be a partner in a partnership firm. But under section 30 of the Indian Partnership Act 1932, he can be admitted to the benefits of partnership.

ix. Minor can be an agent.

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

x. Minor cannot bind parent or guardian.

In the absence of authority, express or implied, an infant is not capable of binding his parent or guardian, even for necessaries.

xi. Joint contract by minor and adult

In such a case, the adult will be liable on the contract but not the minor.

xii. Liability for necessaries

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

Necessaries mean those things that are essentially needed by a minor. They cannot include luxuries or costly or unnecessary articles. Necessaries extend to all such things as reasonable persons would supply to an infant in that class of society to which the infant belongs. Expenses on minor's education, on funeral ceremonies of the wife, husband or children of the minor come within the scope of the word 'necessaries'. Not only must the goods supplied be such as are suitable to the minor's status, they must also be actually necessary. Ten suits of clothes are necessaries for a minor whereas even three suits may not be deemed necessary for another. The whole question turns upon the minor's status in life.

1.2.5.2 Persons of sound mind

According to section 12 of Indian Contract Act, "a person is said to be of sound mind for the purposes of making a contract if, at the time when he makes it, is capable of understanding it and of forming a rational judgment as to its effect upon his interests." It means at the time of making a contract, a person must be able to understand the terms and conditions of the contact and must be capable of making a rational judgment about the consequences of these terms and the contract itself. A person, who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind and a person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind. Idiots, lunatics and drunken persons, persons with induced sleep (hypnotized) and person with mental decay (some cases of old age) are considered to be person of unsound mind.

1.2.5.3 Contract by disqualified persons

Besides minors and persons of unsound mind, there are also other persons who are disqualified from contracting, partially or wholly, so that the contracts by such person are void. Incompetency to contract may arise from political status, corporate status, legal status, etc.

The following persons fall in this category:

a. Foreign Sovereigns and Ambassadors,
b. Alien enemy
c. Joint stock companies and corporations
d. Convicts,
e. Insolvent

1.2.6 Free Consent

Two or more persons are said to consent when they agree upon the same thing in the same sense. Parties are said to have consented when they not only agreed upon the same thing but also agreed upon that thing in the same sense. 'Same thing' must be understood as to the whole content of the agreement and if they do not agree in the same sense, there cannot be free consent. A contract cannot arise in the absence of consent and free consent is necessary for the validity of a contract.

Consent is said to be free when it is not caused by the following:

i. **Coercion**: Section (15) defined coercion as the committing, or threatening to commit, any act forbidden by the Indian Penal Code or the unlawful detaining, or threatening to detain any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement. For example, Raj got the consent of Athul to sell his house at gun point.

Case: Chikham Ammiraju V. Chikkam Seshama (1917) 41 Mad 33. Where the 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. The threat of suicide amounts to coercion.

ii. **Undue Influence**: According to 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 over the other"

Example: Anil, a man weakened by disease or old age, is induced by Sunil's influence over him as his medical attendant, to agree to pay Sunil an unreasonable sum for his professional services. Sunil here employs undue influence. It is essential in order to constitute undue influence that, some kind of relationship which is capable of using undue influence should exist between the two parties to the contract. However, in the following relationships the law presumes undue influence:

- ◊ Parent/child
- ◊ Guardian/ward
- ◊ Solicitor (attorney)/client
- ◊ Doctor/patient

iii. **Fraud**: Fraud is a wilful representation made by a party to a contract or by his agent with the intention to deceive the other party to induce such party to enter into a contract. Fraud means a false statement made knowingly and without believing it to be true.

According to Section 17, 'Fraud' means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with an intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

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

Does silence amount to fraud?

Mere silence of a party as to certain facts of the contract does not generally amounts to fraud. Silence is fraud when it is the duty of the person to speak (example: contract of insurance, contract of marriage, share allotment, etc.) and where the silence itself is equivalent to speech.

Example: Anil sell, by auction, to Sunil, a horse which Anil knows to be unsound, Anil says nothing to Sunil about the unsoundness of the horse. This is not fraud by Anil.

iv. **Misrepresentation**: It is a wrong statement or assertion made by one party to another either before or at the time of contract regarding some matter relating to the contract. Misrepresentation may be innocent or intentional. Intentional misrepresentation is known as fraud. Innocent misrepresentation is a false statement made by a person who honestly believes it be true. If consent is caused by an innocent misrepresentation the contract is voidable.

As per section 18, misrepresentation means and includes:

- ◊ The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true. It means one person believe something so strong which was actually not so and he told the same to a second person. Example: Anil on the strength of hearsay information positively asserted to you that Mr. Sunil is going to be the Director of the company to be incorporated. You bought the shares on faith of such a statement.

- ◊ Any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him; by misleading another to his prejudice or to the prejudice of any one claiming under him. It means one believes something in good sense and on that basis, he made contract with other party, once it come to know that his belief is wrong, he should inform the contracted party about it and can rescind the contract

- ◊ Causing, however, innocently, a party to an agreement, to make a mistake as to the substance of the thing which is the subject of the agreement.

- ◊ Example: Believing that the engine of his motor cycle to be in an excellent condition, Manoj without getting it checked in a workshop, told you that the motor cycle was in excellent condition. On this statement, you bought the motor cycle, whose engine proved to be defective subsequently. Here, Manoj's statement is misrepresentation as the statement turns out to be false.

v. **Mistake**: Mistake may be defined as an erroneous belief concerning something. For example, A owns two cars, one Toyota and the other Honda. He offers to sell B one of his car, A intending it to be the Toyota, B accepts the offer thinking that it is the Honda, there is mistake for both A and B. Mistake in the formation of a contract may be of two types, unilateral mistake or bilateral mistake.

- ◊ Unilateral mistake: Unilateral mistake is when only one party to the contract is under a mistake.

- ◊ Bilateral mistake: Bilateral mistake is when both the parties to a contract are under a mistake.

Table 1.2.1 Difference between Coercion and Undue influence:

Basis of difference	Coercion	Undue Influence
Nature of action	It involves physical force or threat. The aggrieved party is compelled to make the contract against its will.	It involves moral or mental pressure.

Involvement of criminal action	It involves committing or threatening to commit an act forbidden by Indian Penal Code or detaining or threatening to detain property unlawfully.	No such illegal act is committed or a threat is given.
Relationship betweenparties	It is not necessary that there must be some sort of relationship between the parties.	Some sort of relationship between the parties is absolutely necessary.
Exercised by whom	Coercion need not proceed from the promisor nor need it be directed against the promisor. It can be used even by a stranger to the contract.	Undue influence is always exercised between parties to the contract.
Enforceability	The contract is voidable at the option of the party whose consent has been obtained by the coercion.	Where the consent is induced by undue influence, the contract is either voidable or the court may set it aside or enforce it in a modified form.

Table 1.2.2 Distinction between fraud and misrepresentation:

Basis of difference	Fraud	Misrepresentation
Intention	To deceive the other party by hiding the truth.	There is no such intention to deceive the other party.
Knowledge of truth	The person making the suggestion believes that the statement as untrue.	The person making the statement believes it to be true although it is not true.
Rescission of the contract and claim for damages	The injured party can repudiate the contract and claim damages.	The injured party is entitled to repudiate the contract or sue for restitution but cannot claim the damages.
Means to discoverthe truth	The party using the fraudulent act cannot secure or protect himself by saying that the injured party had means to discover the truth.	Party can always plead that the injured party had the means to discover the truth.

1.2.6 Lawful Object and Consideration

Section 10 of the Indian Contract Act provides for the legality of consideration and objects thereto. Legality of object and consideration are two essential elements in the formation of a valid contract. The legality of object refers to the subject matter of the contract, which must not violate any laws or public policy. Consideration refers to the exchange of something of value between the parties to the contract.

Section 23 of the Act also states that every agreement of which the object or consideration is unlawful is void.

Object or consideration is unlawful if:

vi. **It is Forbidden by law**: A loan was granted to the guardian of a minor to enable him to celebrate the minor's marriage in a contravention of the Child Marriage Restraint Act is illegal and cannot be recovered. Here the act of child marriage is forbidden by law. Acts forbidden by law are those which are punishable under any statute as well as those prohibited by regulations or orders made in exercise of the authority conferred by the legislature.

vii. **It defeats the provisions of law**: Anil let a flat to Sunil at a rent of ₹1100 a year. With a view to reduce the municipal tax Anil made two contracts with Sunil. One, by which the rent was stated as ₹500 only and the other for services in connection with flat for ₹600. The court looks at the real intention of the parties to an agreement. If the intention of the parties is to defeat the provisions of law, the court will not enforce it. Here Anil could not recover ₹600 since the agreement was made to defraud the Municipality. Any contract entered into in order to defeat the provisions of any law is treated as unlawful.

viii. **It is fraudulent**: Agreements which are entered to promote fraud are void. For example,an agreement for the sale of gold for the purpose of smuggling them out of the country is void and the price of the gold so sold, cannot be recovered

ix. **It involves injury to the person or property of another**: The general term "injury" means criminal or wrongful harm to any person or property including copy right, Intellectual property, etc. Such contract is void. For example, Anil offers to pay Sunil ₹1 lakh, if he (Sunil) destroys the house of Rajesh by fire.

x. **It is immoral**: Consideration or the object against the good morals of society, is taken as immoral and such contract is void. For example, Anil had advanced money to Priya, a married woman to enable her to obtain a divorce from her husband and Priya had agreed to marry him as soon as she could obtain the divorce. It was held that Anil was not entitled to recover the amount, since the agreement had for its object the divorce of Priya from her husband. The reason being the promise of marriage given to a married woman,in this case the object was against good morals.

xi. **It is opposed to public policy**: In the name of public policy, freedom of contract is restricted by law only for the good for the community. Agreements tending to create interest against duty, agreements tending to create monopolies, and agreements not to bid at an auction are opposed to public policy. In law, public policy covers certain specified topics, e.g., trading with an alien enemy, stifling of prosecutions, champerty, maintenance, interference with the course of justice, marriage brokerage, sale of public offices, etc. In each of these cases, the consideration or object of an agreement is said to be unlawful.

xii. **The contracts are expressly declared void:** Besides the above said agreements, certain agreements have been expressly declared to be void by the Contract Act, such as:

◊ **Wagering agreements**: Anil and Sunil bet as to whether it would rain on a particular day or not. Anil promising to pay ₹500 to Sunil if it rained and Sunil promising an equal amount to Anil if it did not. This type agreement by way of wager is void. So, wagering contract is a promise to pay money or money's worth on the happening or non- happening of an uncertain event. It is an agreement involving payment of a sum of money upon of the determination an uncertain event. An agreement by way of a wager is void.

◊ **Agreement with uncertain meaning**: An agreement, the meaning of which is not certain or not capable of being made certain are void. The uncertainty may be in respect of quantity, price and title of the subject matter of the contract. For example, Anil agreed to sell coconuts to Sunil in the month of April. Here the quantity of coconut, the price and the date and year at which Anil will sell the coconut are not specified. As the agreement is without a certain meaning hence it is void.

Recap

◊ Offer - an expression of willingness to do or not to do something

◊ Express offer - an offer is made by words spoken or written

◊ Implied offer - when an offer is implied by conduct of parties or circumstances of the case

◊ Offeror - person making the proposal

◊ Consideration - something in return.

◊ Consideration - must move at the desire of the promisor

◊ Consideration - may be past, present or future

◊ Past consideration- promisor received the consideration from the promisee even before the date of promise.

◊ Present consideration- consideration is given simultaneously with the promise.

- ◊ Future consideration- Promise to do or give something in return in future for the promise then made.
- ◊ A contract must satisfy certain conditions- Offer, acceptance, consideration, competent to contract, free consent and lawful consideration and with a lawful object
- ◊ Capacity - competence of the parties to make a contract.
- ◊ Party to the contract- should have attained the age of majority and sound mind
- ◊ Consent is said to be free - when it is not caused by coercion, undue influence, fraud,mistake or misrepresentation.
- ◊ Every agreement of which the object or consideration is unlawful is void agreement

Objective Questions

1. What do you mean by consideration?
2. Whose desire leads to consideration?
3. What are the three types of consideration?
4. What does capacity of the parties to make a contract mean?
5. What type of consent is necessary for a valid contract?
6. What is an agreement that involves payment of a sum of money upon the determination of an uncertain event?
7. What is an erroneous belief concerning something known as?
8. What term is used when only one party to the contract is mistaken?
9. What is fraudulent misrepresentation called?
10. What is the legal status of a contract made with or by a minor?

Answers

1. Something in return
2. Promisor
3. Past, Present and Future
4. Competency
5. Free
6. Wagering
7. Mistake
8. Unilateral
9. Fraud
10. Void ab initio

Self-Assessment Questions

1. What is consideration?
2. Discuss acceptance and its revocation
3. What do you mean by capacity to enter into a contract?
4. What is free consent?
5. What are the essentials of a valid contract?
6. Differentiate fraud and misrepresentation.
7. Explain the various types of offers
8. Identify the essentials/rules regarding a valid offer
9. Explain the effects of minor's agreements

Assignments

1. Analyze a legal case where an express offer was pivotal. Explain the circumstances, the language used, and how the express offer was communicated.
2. Provide an example from real-life situations where an offer was implied through conduct or circumstances. Explain how the conduct implied the offer.
3. Explore and illustrate through examples the differences between past, present, and future considerations in contractual agreements.
4. Analyze a case where consideration was deemed inadequate or non-existent. Discuss how the court determined the presence or absence of consideration.
5. Investigate a case where past consideration was a significant aspect. Explain the challenges and legal implications of enforcing contracts based on past consideration.
6. Compare and contrast express offers and implied offers, citing examples and discussing the advantages and limitations of each type.

Suggested Reading

1. Kapoor, N. D., Business Law. Sultan Chand and Sons.
2. BARE Acts: Contract Act, Sale of Goods Act, RTI Act 2005, IDRA, TRAI.
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Unit 3

Performance and Termination of Contracts

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ grasp an idea of the performance of a contract
- ◊ gain an idea on the discharge of contract
- ◊ know about the breach of contract
- ◊ identify the remedies for breach of contract

Prerequisite

In the story of Alex and Bailey's house construction contract. Alex supplies high-quality materials while Bailey expertly constructs the house. As they progress, each step taken is a fulfillment of their agreed-upon duties, ensuring the contract's performance is on track.

However, as deadline apporaches, Bailey encounters unexpected difficulties and falls behind schedule, failing to meet the quality standards stipulated in the contract. This failure disrupts their agreement. Alex expected a finished house by a specific date, constructed to certain specifications Bailey's failure to deliver on time and as promised constitutes a breach of contract.

Consequently, Alex explores remedies for this breach. One option is to seek additional costs incurred due to the delay. However, faced with significant setbacks, Alex also considers the option of taking legal action to compel Bailey to complete the house as initially agreed. The breach triggers a series of considerations, pushing Alex to choose between seeking compensation or enforcing the original terms of the contract.

In this unit, our focus revolves around the intricate dynamics of contracts, focusing on the performance, breach, termination, and available remedies associated with contractual agreements.

Keywords

Breach of Contract, Changes in Contract, Discharge of Contract, Remedies for Breach of Contract

Discussion

1.3.1 Performance of Contract

A contract creates legal obligations. Performance of contract means the carrying out of these obligations. The contract may be performed by the promisor himself, his agent or his legal heirs. The parties to a contract must either perform, or offer to perform, their respective promises unless such performance is dispensed with or excused under the provisions of the Contract Act or of any other law. The basic rule is that the promisor must perform exactly what he has promised to perform and the obligation to perform is absolute. Performance may be actual or offer to perform.

Actual Performance: Where a party to a contract has done what he had undertaken to do or either of the parties has fulfilled their obligations under the contract within the time and in the manner prescribed, it is called actual performance. For example: Anil agrees you to sell his car on 10 April 2020 for ₹1 lakh. On the specified day he signs the sale letter and delivers the car and you paid ₹1 lakh as consideration. Here all terms of contract get fulfilled and so it is an actual performance of contract.

Offer to perform or attempted performance or tender of performance: It may happen sometimes, when the performance becomes due, the promisor offers to perform his obligation but the promisee refuses to accept the performance. Example: Anil promises to deliver certain goods to Sunil. Anil takes the goods to the appointed place during business hours but Sunil refuses to take delivery of goods. This is an attempted performance as Anil the promisor has done what he was required to do under the contract.

Performers of the contract (Section 40)

The promise under a contract may be performed, as the circumstances may permit, by the promisor himself, or by his agent or his legal representative.

◊ **Promisor himself**: If there is something in the contract to show that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor. This means contracts which involve the exercise of personal skill or diligence, or which are founded on personal confidence between the parties must be performed by the promisor himself. Example: Anil promises to paint a picture for you and this must be performed by the promisor himself.

◊ **Agent**: Where personal performance is not the foundation of a contract, the promisor or his representative may employ a competent person to perform it.

◊ **Legal Representatives:** A contract which involves the use of personal skill or is founded on personal consideration comes to an end on the death of the promisor. As regards any other contract the legal representatives of the deceased promisor are bound to perform it unless a contrary intention appears from the contract. But their liability under a contractis limited to the value of the property they inherit from the deceased. For example, Anil promises to you to deliver goods on 10th October 2020 on payment of ₹100000. Anil dies on 5th October 2020. Anil's legal representatives are bound to deliver the goods to you, and you are bound to pay ₹100000 to Anil's representatives.

Time and place for performance of the contract

The various rules regarding the time and place of performance are given below:

Case	Rule
1. Where the time for performance is not specified in a contract and the promisor has undertaken to perform without application by the promise.	The contract must be performed within a reasonable time. The question 'What is reasonable time' is a question of fact [Section 46].
2. Where the time for performance is specified in a contract and the promisor has undertaken to perform it without application by the promise.	The promisor must perform his promise on that particular day during the usual business hours and at a place where the promise ought to be performed [Section 47].
3. Where the time for performance is specified in a contract and the promisor has not undertaken to perform it without application by the promisee	The promisee must apply for performance at a proper place and within usual business hours [Section 48].
4. Where the place for performance is not specified in a contract and the promise is to be performed without application by the promise.	The promisor must apply to the promisee to appoint a reasonable place for the performance and to perform the promise at such place [Section 49]
5. Where the promisee prescribes the manner or time for performance	The promise must be performed in the manner and at the time prescribed by the promisee [Section 50]

Example I: A and B are mutually indebted. A and B settle an account by setting off one item against another, and B pays A the balance found to be due from him upon such settlement. This amounts to payment by A and B, respectively, of the sums which they owed to each other.

Example II: A owes B ₹2000. B accepts some of A's goods in reduction of the debt. The delivery of the goods operates as a part payment.

Example IIII: A desires B, who owes him ₹100. to send him a note for ₹100 by post. The debt is discharged as soon as B posts a letter containing the note duly addressed to A.

1.3.2 Changes in Contract

If the parties to a contract agree to substitute a new contract for original one, or to rescind or alter it, the original contract need not be performed. This may take place in the following forms:

◊ ***Novation:*** The parties to a contract may substitute a new contract for the old one. When they do so, it will be a case of novation. On novation, the old contract is discharged and consequently it need not be performed. Novation can take place only by mutual agreement between the parties.

◊ ***Rescission:*** A contract is also discharged by rescission. When the parties to a contract agree to rescind it, the contract need not be performed. In the case of rescission, only the old contract is cancelled and no new contract comes to exist in its place. It is needless to point out that novation also involves rescission. Both in novation and in rescission, the contract is discharged by mutual agreement.

◊ ***Alteration of contract:*** As in the case of novation and rescission, so also in a case where the parties to a contract agree to alter it, the original contract is rescinded, with the result that it need not be performed. In other words, a contract is also discharged by alteration. The terms of contract may be so altered by mutual agreement that the alteration may have the effect of substituting a new contract for the old one.

1.3.3 Discharge of a Contract

A contract is discharged when the obligations created by it comes to an end. A contract may be discharged in any one of the following ways:

i. **Discharge by performance**: It takes place when the parties to the contract fulfill their obligations arising under the contract within the time and in the manner prescribed. Discharge by performance may be:

    ◊ Actual performance: Actual performance is said to have taken place, when each of the parties has done what he had agreed to do under the agreement.

- ◊ Attempted performance: When the promisor offers to perform his obligation, but the promisee refuses to accept the performance, it amounts to attempted performance or tender.

ii. **Discharge by mutual agreement**: When the parties to a contract agree to substitute a new contract for original contract, or to rescind or remit or alter it, the original contract need not be performed. The principles of Novation, Rescission, Alteration and Remission are different forms or results of such mutual agreements.

iii. **Discharge by impossibility of performance**: Impossibility may exist from the very beginning of the contract (in this case, it would be impossibility ab initio) or it may supervene (supervening impossibility). Supervening impossibility arises subsequent to the formation of the contract on account of unforeseen happening of something. Supervening impossibility may take place due to:

- ◊ An unforeseen change in law;
- ◊ The destruction of the subject-matter which is essential to the performance of contract;
- ◊ The non-existence or non-occurrence of particular state of things, which was naturally contemplated for performing the contract, as a result of some personal incapacity like dangerous disease. For example, Anil contracts to act at a theatre for six months in consideration of a sum paid in advance by Sunil. On several occasions Anil is too ill to act. The contract to act on those occasions becomes void.
- ◊ The declaration of a war – In such situations the performance of contract will become impossible and so the parties get discharged from contract.

iv. **Discharge by breach of contract**: Breach means an act of breaking or failing to observe a law or agreement. Parties to the contract are expected to perform their respective obligations. If any party fails to perform his obligation, there takes place a breach of contract. Breach of contract operates as discharge of contract.

v. **Discharge by lapse of time**: A contract should be performed within a specified period as prescribed in contract, called period of limitation. If it is not performed and if no action is taken by the promisee within the specified period of limitation, he is denied of remedy at law.

1.3.4 Breach of Contract

Breach means failure of a party to perform his or her obligation under a contract. The parties to a valid contract are bound to perform their respective promises. But when one of the parties breaks the contract by refusing to perform his promise, he is said to have committed a breach. In that case, the other party to the contract obtains a right of action against the one who has refused to perform his promise. The party committing breach of contract is called the 'guilt party' and the other party is called the 'injured' or 'aggrieved' party.

Breach of contract may arise in two ways:

i. Anticipatory breach of contract

An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. When the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived, it is called Anticipatory Breach.

Anticipatory breach of a contract may take either of the following two ways:

◊ Expressly by words spoken or written, and

◊ Impliedly by the conduct of one of the parties.

Example: Anil contracts with Sunil on 15 July, 2016 to supply 10 bales of cotton for a specified sum on 14 August, 2016 and on 30 July informs Sunil, that he will not be able to supply the said cotton on 14 August, 2016, there is an express rejection of the contract.

ii. Actual breach of contract

In contrast to anticipatory breach, it is a case of refusal to perform the promise on the scheduled date. The parties to a lawful contract are bound to perform their respective promises. But when one of the parties breaks the contract by refusing to perform his promise, he is said to have committed a breach. In that case, the other party to the contract obtains a right of action against the one who has refused to perform his promise. Actual breach of contract may be committed-

◊ At the time when the performance of the contract is due. Example: Anil agrees to deliver 100 bags of sugar to Sunil on 1st February 2016. On the said day, he failed to supply 100 bags of sugar to Sunil. This is actual breach of contract. The breach has been committed by Anil at the time when the performance becomes due.

◊ During the performance of the contract: Actual breach of contract also occurs when during the performance of the contract, one party fails or refuses to perform his obligation under it by express or implied act.

1.3.5 Remedies for Breach of Contract

In case of breach of contract, the aggrieved party would have one or more, but not all, of the following remedies against the guilty party:

i. Suit for rescission

ii. Suit for damages,

iii. Suit for quantum meruit,

iv. Suit for specific performance,

v. Suit for injunction.

i. **Suit for rescission**: The injured party can approach the court to grant him a formal rescission, i.e., cancellation, of the contract. This will enable him to be free from his own obligations under the contract.

ii. **Suit for damages:** The word 'damages' means monetary compensation for loss suffered. A breach of contract may put the aggrieved party to some disadvantage or inconvenience or may cause a loss to him. The court would desire the guilty party to accept responsibility for any such loss of the aggrieved party and compensate him adequately. When the aggrieved party claims damages as a consequence of breach, the court takes into account the provisions of law in this regard and the circumstances attached to the contract. The amount of damages would depend upon the type of loss caused to the aggrieved party by the breach. The court would first identify the losses caused and then assess their monetary value. The aggrieved party would be entitled to one of the following types of damages, depending upon the circumstances of the case:

◊ **General or ordinary damages**: Losses which can be seen as arising naturally and directly out of the breach in the usual course of the things. Example: Anil contracts to deliver 100 bags of rice at ₹100/bag on a future date. On the due date he refuses to deliver. The price on that day is ₹110/bag. The measure of damages is the difference between the market price on the date of the breach and contract price, here it is ₹1000.

◊ **Special damages**: Special damages would be the compensation for the special losses caused to the aggrieved party by the special circumstances attached to the contract. Example: Anil has agreed to deliver a machine to you without delay for your mill. Anil was informed that your mill is stopped for want of the machine. Anil unreasonably delays the delivery of machine and in consequence you lose a profitable contract with the Government. You are entitled to receive from Anil by way of compensation the average amount of profit which would have been made by the working of the mill during the time that delivery of it was delayed. But, however, the loss sustained through the loss of the Government contract cannot be claimed.

◊ **Exemplary or vindictive damages**: Sometimes, the courts award damages for mental or emotional suffering also caused by the breach. Such damages are called exemplary or vindictive damages. These may be taken as an exception to the general principle that damages are awarded only for the financial loss caused by breach of contract. Example: Breach of promise of marriage

◊ **Nominal damages**: If the breach of contract causes no loss to the aggrieved party, no damages need be awarded to him. However, in order to record the fact of breach by guilty party, the courts may award nominal or token damages. Example: a compensation of ₹10.

Rules regarding award of damages

◊ **Compensation not penalty:** The fundamental purpose of awarding damage is to compensate the aggrieved party for any loss suffered and not to punish the guilty party for causing breach.

◊ **Limited damages:** The aim of the courts, in awarding damages, would be to place the aggrieved party, as far as money can do it, in the same position in which he would have been, had the contract been properly performed.

◊ **Damages for attributable losses**: Damages are awarded for the losses which can be attributed to the breach.

◊ **Mitigation of losses**: The aggrieved party is expected to make sincere efforts to minimise the losses that are resulting out of breach of contract.

◊ **Damages in case of contracts of sale of goods**: The basic idea in this context is that in case a party breaks a contract for sale of goods, the aggrieved party must take a quick action to protect himself.

◊ **Stipulation for liquidated damages or penalty:** Sometimes, the parties to contract may themselves stipulate an amount in the contract to be payable by the guilty party to the aggrieved party as damages for breach of contract. This stipulation of the amount may be by way of liquidated damages or by way of penalty.

◊ **Cost of suit**: The breach of contract by a party forces the other to initiate legal action against the guilty party. This necessarily entails expenditure. This cost of suit can be recovered from the guilty party only at the discretion of the court.

iii. **Suit for quantum meruit**: The term quantum meruit means 'as much as earned'. It implies a payment deserved by a person for the reason of actual work done. When a party has done some work under a contract, and the other party repudiates the contract or somehow the full performance of the contract becomes impossible, then the party who has done the work can claim remuneration for the work performed under a suit for quantum meruit. Likewise, where one party has expressly or impliedly requested another to render him a service without specifying any remuneration, but the circumstances of the request imply that the service is to be paid for, there is an implied promise to pay quantum meruit.

iv. **Suit for specific performance:** In certain cases of breach of a contract, damages may not be an adequate remedy. Then the Court may direct the party in breach to carry out his promise according to the terms of the contract. This is a direction by the Court for specific performance of the contract at the suit of the party not in breach. But in general, Courts do not wish to compel a party to do that which he has already refused to do. Cases where specific performance may be ordered:

- ◊ Where there exists no standard for ascertaining the actual damage caused to the aggrieved party by the non- performance
- ◊ Where monetary compensation will not be adequate relief. Example: a contract for sale of a rare antique.

v. **Suit for injunction:** 'Injunction' is a court order or decree to a person asking him to refrain from doing a contemplated act or from continuing an ongoing act. Such an order of injunction becomes a remedy for the aggrieved party when the court orders the guilty party to refrain from doing precisely that which is causing the breach of contract. For example, Mehak, a film star agreed to act exclusively for Pyaari, a production house, for one year. During the year she contracted to act for some other producer. Here Pyaari can restrain Mehak from acting in other films by way of injunction from a court having jurisdiction.

1.3.6 Contingent Contract

A contingent contract, is a contract to do or not to do something, if some event, collateral to such contract does or does not happen.

Example: A contracts to pay B ₹10000 if B's house is burnt. This is a contingent contract.

Essentials of a contingent contract

i. The performance of a contingent contract is made dependent upon the happening or non-happening of some event.

ii. The event on which the performance is made to depend, is an event collateral to the contract, i.e., it does not form part of the reciprocal promises which constitute the contract.

iii. The contingent event should not be the mere will of the promisor.

1.3.7 Quasi Contracts

A quasi-contract is a kind of contract by which one party is bound to pay consideration of money to the other party. Though no contractual relation exists between the parties, law makes out a contract for them and such a contract is called a quasi-contract. The basis of quasi- contract is to prevent unjust enrichment or unjust benefit, i.e., no man should grow rich out of another person's loss.

A contract is the result of an agreement enforceable by law. It comes into existence from the action of the parties. The parties make actual promises knowing fully well that legal relationship will come into existence. But sometimes there is no intention on the part of the parties to enter into a contract but obligations resembling those created by a contract are imposed by law. Such obligations imposed by law constitute what is known as quasi- contracts under the English law, and certain relations resembling those created by contracts under the Indian law. A quasi-contract is not in fact a contract at all, but merely resembles one and produces similar effect.

Example: If A pays a sum of money to B believing him to be his creditor, when as a matter of fact he was not, B is bound to return the money to A on the assumption that the above sum given to him was by way of loan.

Situations deemed as Quasi Contracts

i. **Claims for necessaries supplied**

If a person incapable of entering into a contract, is supplied by another person with necessaries suitable to his condition in life, the supplier is entitled to get compensation from the property of the incapable person. Example: A supplies to B, a lunatic, with necessaries of life. A is entitled to be re-imbursed from B's property.

ii. **Payment by an interested person**

This section provides that a person who is interested in the payment of money which another is bound by law to pay and who, therefore, pays it, is entitled to be reimbursed by the other. Example: B holds land in Bengal on a lease granted by A, the Zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the revenue law, the consequence of such sale will be the annulment of B's lease. B, in order to prevent the sale and the consequent annulment of his own lease pays to the government the sum due by A. A is bound to make good to B the amount so paid.

iii. **Obligation of a person enjoying benefit of non-gratuitous 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 make compensation to the former in respect of, or to restore the thing so done or delivered. Examples: (a) A, a tradesman leaves goods at B's house by mistake. B treats the goods as his own. He is bound to pay A for them.

iv. **Responsibility of finder of goods (Section 71)**

A person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee. A finder of goods is bound to take as much care of the goods found as a man of ordinary prudence would take of his own goods under similar circumstances. He cannot appropriate the goods without taking proper steps to find out the owner and should keep them for a reasonable time, so that the owner may turn up and take them. The finder of the goods is entitled to retain the goods until he receives compensation from the owner. He is also entitled to the possession of the goods as against the whole world except the true owner.

The finder, however, can retain / sell the goods in the following cases:

◊ Where the thing found is in danger;

- ◊ Where the owner cannot with reasonable diligence be found out;
- ◊ Where the owner is found out, but refuses to pay lawful charges of the finder;
- ◊ Where the lawful charges of the finder, in respect of the thing found, amount to two-thirds of the value of thing found.

Example: H picked up a diamond from the floor of F's shop and handed over to F to keep it till the owner is found. In spite of best efforts, the true owner could not be reached. After sometime, H tendered to F the lawful expenses incurred by him for finding the true owner and asked him (F) to hand over the diamond to him (H). F refused. It was held that F must return the diamond to H.

v. Money paid by mistake or under coercion (Section 72)

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

Example: A and B jointly owe ₹100 to C. A alone pays the amount to C and B not knowing of this fact, pay ₹100 over again to C. C is bound to repay the amount to B.

Recap

- ◊ Performance of contract - carrying out of obligations made in contract.
- ◊ Contract - performed by the promisor himself, agent or his legal heirs.
- ◊ Performance - actual or attempted.
- ◊ Novation - the parties to a contract may substitute a new contract for the old one.
- ◊ Rescission -the old contract is cancelled and no new contract comes to exist in its place.
- ◊ Contract is discharged - when the obligations created by it come to an end.
- ◊ Breach -failure of a party to perform his or her obligation under a contract.
- ◊ Breach of contract - the aggrieved party can exercise his claim for remedies against the guilty party.
- ◊ Damages - monetary compensation for loss suffered.

- ◊ Injunction - court order or decree to a person asking him to refrain from doing a contemplated act or from continuing an ongoing act.
- ◊ Quantum meruit - as much as earned
- ◊ Contingent contract – contract to do or not to do something, if some event, collateral to such contract does or does not happen
- ◊ Quasi contract - obligation imposed by law upon a person for the benefit of another even in the absence of a contract.

Objective Questions

1. What is an act of breaking or failing to observe a law or agreement?
2. What happens to a contract when the obligations created by it come to an end?
3. What are the two ways of performance of a contract?
4. What is a court order or decree to a person asking him to refrain from doing a contemplated act or from continuing an ongoing act?
5. What would be the compensation for the special losses caused to the aggrieved party known as?
6. What is mean by refusal to perform the promise on the scheduled date by either of the parties?
7. What is performance of a contract?
8. How can a contract be changed?
9. What are the consequences of a material breach of contract?

Answers

1. Breach
2. Discharged

3. Actual & Offer to perform
4. Injunction
5. Special damage
6. Actual breach of contract
7. Fulfillment of obligation as set out in the contracts
8. Mutual agreement
9. The aggrieved party may terminate the contract and seek damages

Self-Assessment Questions

1. How to discharge a contract?
2. What is breach of contract?
3. What are the remedies of breach of contract
4. What is performance of contract?
5. How to alter a contract?
6. Differentiate contingent contract and Quasi Contract.
7. What are the essential elements of a contingent contract?
8. Explain the situations deemed as Quasi Contracts.

Assignments

1. Analyze a legal case where the performance of a contract was disputed. Evaluate the outcome and its impact on contract law principles.
2. Investigate a legal case where novation was used to substitute a new contract for an old one. Assess the implications for the parties involved.

3. Analyze different types of damages available in breach of contract cases. Calculate damages in a hypothetical scenario and justify the approach.
4. Present examples of contingent contracts. Discuss the legal complexities and challenges associated with such contracts.
5. Create a checklist outlining the key obligations a party must fulfill to ensure the proper performance of a contract.
6. Research and present instances where the legal heirs of a promisor had to perform a contract. Discuss legal considerations and outcomes.
7. Analyze cases of breach of contract, discussing the nature of the breaches and the legal consequences. Evaluate court decisions and reasoning.

Suggested Reading

1. Kapoor, N. D., Business Law. Sultan Chand and Sons.
2. BARE Acts: Contract Act, Sale of Goods Act, RTI Act 2005, IDRA, TRAI.
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BLOCK 02

Bailment and Pledge

Unit 1

Bailment

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ gain insights on the concept of bailment
- ◊ familiarize themselves with the rights and responsibilities of both the bailor and the bailee
- ◊ familiarise the essential elements of bailment
- ◊ differentiate between the general lien and the particular lien

Prerequisite

When we examine the history of nations, even preceding the formation of what we now call nations, we find that every society, whether small or large, was governed by various practices and procedures. These practices enabled these social formations to exist in a way that maintained a semblance of discipline in their daily lives. Over centuries, these practices gradually evolved into rules, regulations, and laws.

Law, essentially a body of rules, serves to regulate the conduct of a society's members. Every country in the world has enacted laws tailored to its specific needs. Business law, also known as Mercantile or Commercial law, falls under Civil law. In today's increasingly complex business world, the scope of business law has significantly expanded, now governing trade and its ancillary facets such as transportation, banking, warehousing, insurance, etc.

The previous block detailed various legal provisions governing the activities of individuals and business organizations. Additionally, these entities might engage in specific contracts governed by special provisions. The legal aspects concerning these special contracts are covered in sections 124 to 238 of the Indian Contract Act. These special contracts include the Contract of Indemnity and Guarantee, the Law of Bailment and Pledge, the Law of Agency, etc.

This unit specifically focuses on legal provisions related to the special contracts of bailment among the aforementioned specialized contracts.

Keywords

Bailment, Bailor, Bailee, Lien, Finder of lost goods

Discussion

2.1.1 Bailment

The word 'Bailment' is derived from a French word 'bailer' which means 'to deliver'.

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

Bailment is a legal relationship in which one person (the bailor) delivers personal property to another person (the bailee) for a specific purpose, under an express or implied agreement.The bailee is entrusted with the possession of the property and is responsible for returning it to the bailor or disposing of it according to the bailor's instructions. Bailment can be created by express agreement or by the conduct of the parties. The relationship of bailment can arise in various situations, such as storing goods, lending personal property, or repairing items. In a bailment, the bailor retains ownership of the property, while the bailee has a duty to care for the property and use it only for the agreed-upon purpose.

Examples of Bailment:

a. X who is going out of station delivers a horse to Y for proper care.

b. X lends a horse to Y for his riding only without charge.

c. Y hires a horse from X for riding.

d. X delivers a horse to a doctor Y, for medical treatment.

e. X sells a horse to Y who leaves the horse in the possession of X.

2.1.1.1 Parties involved in a Bailment

Bailor: The person who delivers the personal property to another person for a specific purpose, with the understanding that the property will be returned to them once the purpose of the bailment is fulfilled. The bailor is the owner of the property and retains the title and ownership of the property during the bailment.

Bailee: The person who receives the property from the bailor for a specific purpose, with the understanding that they will return the property to the bailor once the purpose of the bailment is fulfilled. The bailee has possession of the property but not the ownership, and must use the property only for the purpose for which it was given to them.

2.1.1.2 Essential Elements of a Bailment

The essential elements of a bailment include:

i. ***Delivery of possession:*** The bailor must deliver possession of the property to the bailee. The bailee must have exclusive control and possession of the property, and the bailor must relinquish control over the property.

ii. ***Purpose:*** The transfer of possession must be for a specific purpose, such as for storage, repair, transportation, or safekeeping.

iii. ***Agreement:*** The bailment must be based on an agreement between the bailor and the bailee, either expressed or implied.

iv. ***Return of the property:*** The property must be returned to the bailor or disposed of in accordance with the bailor's instructions once the purpose of the bailment has been fulfilled.

2.1.1.3 Rights of a Bailor

As the person who transfers possession of personal property in a bailment, the bailor has certain rights, including:

i. ***Right to Terminate the Contract in Case of Unauthorised Use [Section 1531*** If the bailee does any act in respect of goods bailed, which is inconsistent with the conditions of the bailment, the bailor has a right to terminate the contract of bailment

ii. ***Right to Claim Compensation in Case of Unauthorised Use [Section 154]*** If the bailee does not use the goods bailed according to the conditions of the bailment the bailor has a right to claim compensation from bailee for any damage arising to the goods from or during such use of them.

iii. ***Right to Claim the Separation of Goods in Case of Unauthorised Mixture [Section 156]*** If the bailee, without the consent of the bailor mixes bailor's goods with his own goods and the goods can be separated, the bailor has a right to claim his goods after separation.

iv. ***Right to Claim Compensation in Case of Unauthorised Mixture of Goods which cannot be Separated [Section 157]*** If the bailee, without the consent of the bailor mixes bailor's goods with his own goods and the goods cannot be separated, the bailor has a right to claim compensation from bailee for the loss of the goods.

v. ***Right to Demand Return of Goods [Section 160]*** The bailor has a right to demand return of goods after the accomplishment of the purpose or after the expiry of period of bailment.

vi. ***Right to Claim Compensation in Case of Unauthorised Retention of Goods [Section 161]*** If the bailee does not return or deliver the goods according to the bailor's directions, after the accomplishment of purpose or after the expiry of period of bailment, the bailor has a right to claim compensation for any loss, destruction or deterioration of the goods from that time.

vii. ***Right to Demand Accretion to Goods [Section 163]*** In the absence of contract to the contrary, the bailor has a right to demand any increase or profit which may have accrued from the goods bailed.

2.1.1.4 Duties of a Bailor

i. ***Duty to disclose defects in the property [Section 150]*** The bailor has a duty to disclose any defects in the property that are known to them and that may affect the bailee's use of the property.

ii. ***Duty to bear the risk of loss [Section 152]*** The bailor must bear the risk of loss of goods provided the bailee has taken all reasonable steps to protect the goods from loss.

iii. ***Duty to bear expenses Section [158]*** If the bailment is for the mutual benefit of both parties, the bailor has a duty to compensate the bailee for any expenses incurred in connection with the bailment.

iv. ***Duty to indemnify the bailee in the case of premature termination of gratuitous bailment [Section 159]*** A gratuitous bailment may be terminated by the bailor at any time even though the bailment was for a specified time or purpose.

v. ***Duty to indemnify the bailee against the defective title of the bailor [Section 164]*** The bailor has a duty to indemnify the bailee for any losses or damages that may result from defects in the property that were not disclosed to the bailee. The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods, or to give directions respecting them. Similarly, the bailor must receive back the goods when the bailee, in accordance with the terms of bailment, returns the goods to him. If the bailor refuses to receive back the goods, he must repay to the bailee all the expenses which the bailee has incurred for the safe custody of goods.

2.1.1.5 Rights of a Bailee

i. ***Right to recover compensation for damages [Section 150]*** If the bailor fails to disclose any faults in the property that may cause damage to the bailee or if the bailor fails to compensate the bailee for any damages caused to the property by the bailor's actions, the bailee has a right to recover compensation for such damages.

ii. ***Right to claim reimbursement of expenses [Section 158]*** In case of Gratuitous Bailment, the bailee has a right to claim reimbursement of all the necessary expenses (whether Ordinary or Extraordinary) which he has already incurred for the purpose of bailment. In case of Non-gratuitous Bailment, the bailee has a right to claim reimbursement of all the extra-ordinary expenses which the bailee has already incurred for the purpose of bailment.

iii. ***Right to be indemnified in case of premature termination of gratuitous bailment [Section 159]*** The bailee has a right to be indemnified in case the loss arising due to premature termination of the gratuitous bailment exceeds the benefits actually derived by him.

iv. ***Right to recover loss in case of bailor's defective title [Section 164]*** The bailee has a right to be indemnified in case he suffers any loss because of the defective title of the bailor.

v. ***Right to recover loss in case of bailor's refusal to take the goods back [Section 164]*** The bailor has a right to be indemnified in case he suffers any loss because of bailor's refusal to take the goods back.

vi. ***Right to deliver goods to anyone of the joint bailors [Section 165]*** In the absence of any contract to the contrary, the bailee has a right to deliver back the goods to anyone of the joint owners or may deliver the goods back according to the directions of one joint owner without the consent of all.

vii. ***Right to deliver the goods to bailor in case of bailor's defective title [Section 166]*** If the bailor has no title to the goods, and the bailee, in good faith, delivers them back to, or according to the directions of the bailor, the bailee is not responsible to the owner in respect of such delivery.

viii. ***Right to Particular Lien [Section 170]*** Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect to them.

2.1.1.6 Duties of Bailee

i. ***Duty to take reasonable care of the bailed property [Section 151 and 152]*** The bailee must take reasonable care of the bailed property and use it only for the purpose for which it was bailed. The bailee is responsible for any loss or damage to the property due to their negligence or willful misconduct.

ii. ***Duty not to make any unauthorized use of the property [section 154]*** The bailee must not make unauthorized use of the bailed property or use it for any purpose other than the purpose for which it was bailed. If the bailee uses the property for an unauthorized purpose, they may be liable for conversion.

iii. ***Duty not to mix bailor's goods with his own goods [Section 155 to 157]*** If the bailed property is not identical, the bailee must not mix it with their own property or with property bailed to them by another person.If the bailee does mix the property, they may be liable to the bailor for any resulting loss.

iv. ***Duty to return the property [Section 160 and 161]*** The bailee must return the bailed property to the bailor or according to the bailor's instructions once the purpose of the bailment is fulfilled.

v. ***Duty to return accretions to the goods [Section 163]*** In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

vi. ***Duty not to set up any adverse title:*** The bailee must not do any act which is inconsistent with the title of the bailor. He must not set up his own title or a third party's title on the goods bailed to him.

2.1.2 Lien

Lien means the right of a person having possession of goods belonging to another to retain those goods until the satisfaction of sum claimed by the person in possession of the goods. It may be noted that the possession of goods must be lawful and continuous. For example, imagine a scenario where Person A rents a storage facility from Person B for ₹10000 per month. The agreement allows Person A to deposit or retrieve goods from the facility at any time. After six months, Person A stops paying the rent. In response, Person B auctions off Person A's goods and asserts a lien. However, Person B cannot claim a lien in this case because the initial agreement explicitly stated that Person A could freely retrieve his goods whenever he wished.

2.1.2.1 Types of Lien

A lien may be either a particular lien or a general lien.

i. ***Particular Lien [Section 170]*** A particular lien is a right to retain only those goods in respect of which some charges are due. This right is available only if the following conditions are fulfilled:

   a. The bailee must have rendered some service involving the exercise of labour or skill in respect of the goods bailed.

   b. The bailee must have rendered the service in accordance with the purpose of the bailment.

   c. The goods must be in the possession of the bailee.

   d. There must not exist any contract for payment of price in future.

   e. The labour and skill must have been used so as to confer an additional value on the article.

   Note: The bailee has a right to recover the charges for the services performed even if the goods are destroyed or stolen without any fault on his part.

   Example: Imagine Person A hires a carpenter, Person B, to craft a custom-made table. Person A agrees to pay upon the completion of the table. If Person B hasn't extended any credit period for payment, they have the right to retain the table until they receive payment. However, if Person B allowed a one-month credit period for payment and the table is finished within that time frame, Person B is not entitled to withhold the table after that month has passed without receiving payment.

ii. ***General Lien [Section 171]*** A general lien allows a creditor to hold on to all of a debtor's goods as security for the entire outstanding debt, regardless of whether the goods are specifically related to the debt. This means the creditor can keep the goods until the debtor fully pays off all their debts, even if some of those debts are not related to the retained goods.

Who can claim a general lien?

In the absence of a specific contract, only certain professionals can claim a general lien. These include:

◊ Bankers: For debts related to banking services.

◊ Factors: For debts related to the sale of goods entrusted to them.

◊ Wharfingers: For charges related to the storage of goods.

◊ Attorneys of a High Court: For unpaid professional fees.

◊ Policy brokers: For unpaid insurance premiums.

Table 2.1.1 Distinction between Particular Lien and General Lien

Basis of Distinction	Particular Lien	General Lien
Goods in respect of which lien is available	It is available against those goods in respect of which some charges are due.	It is available against all goods whether in respect of which claims are due or not
Purpose	It is available only for non-payment of remuneration for the services	It is available for a general balance of account
Who can exercise?	It is available to every bailee to whom the goods have been bailed.	It is available only to specific bailees like bankers, factors, Wharfingers, attorneys of High Court and policy brokers.
Rendering of service	It is available only when some service involving the exercise of labour or skill has been rendered.	It is available even when no such service has been rendered.
Purpose of delivery of goods	The purpose of delivery of goods is to confer an additional value as the goods bailed.	The purpose of delivery of goods is to deposit the goods as security.

2.1.3 Finder of lost goods

Finding is not keeping. A finder of lost goods is treated as the bailee of the goods found as such and is charged with the responsibilities of a bailee, besides the responsibility of exercising reasonable efforts in finding the real owner.

However, he enjoys certain rights also. His rights are summed up here under:

iii. Right to retain the goods (Section 168)

A finder of lost goods may retain the goods until he receives the compensation for money spent in preserving the goods and/or amount spent in finding the true owner. A finder, however, cannot sue for such compensation.

But where, a specific reward has been offered by the owner for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it.

iv. Right to sell (Section 169)

When a thing which is commonly the subject of sale is lost, if the owner cannot with reasonable diligence be found or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it:

◊ when the thing is in danger of perishing or of losing the greater part of its value.

◊ when the lawful charges of the finder in respect of the thing found, amount to two-third of its value.

Recap

◊ Bailment - transfer of possession

◊ Parties involved - Bailor, Bailee

◊ Bailor - gives possession

◊ Bailee - receives possession

◊ Lien - right to retain

◊ General lien - overall debt security

◊ Particular lien - specific property security

◊ Duties of bailor - care, compensation

◊ Duties of bailee - safekeeping, return

Objective Questions

1. What is bailment?
2. Who are the parties involved in bailment?
3. What role does a bailor play?
4. What is the role of a bailee?
5. What is constructive bailment based on?
6. What are the primary duties of a bailor?
7. What responsibilities does a bailee have?
8. What does "lien" refer to in bailment?
9. Define a general lien.
10. Describe a particular lien.

Answers

1. Transfer of possession
2. Bailor, Bailee
3. Gives possession
4. Receives possession
5. Implied arrangement
6. Care, compensation
7. Safekeeping, return
8. Right to retain
9. Overall debt security
10. Specific property security

Self-Assessment Questions

1. Discuss the compensation of a bailor and their potential liability for breach.
2. Define bailment and explain its key characteristics.
3. Define transfer of possession and explain its key characteristics.
4. Discuss the compensation of a bailor and their potential liability for breach.
5. Outline the safekeeping of a bailee and the consequences of failure to fulfill them.
6. Outline the duties of a bailee and the consequences of failure to fulfill them.
7. Outline the safekeeping of a bailee and the consequences of failure to fulfill them.
8. Explain the difference between general lien and particular lien and provide examples of each.
9. Outline the return of a bailee and the consequences of failure to fulfill them.

Assignments

1. Can a bailment be of immovable property? Explain.
2. Explain bailment with examples of everyday situations illustrating the concept.
3. Compare and contrast the responsibilities of a bailor and a bailee in a bailment agreement.
4. When does the bailment come to an end?
5. Discuss the types of liens in bailment and provide scenarios where each type would apply.

6. Describe the legal implications of a general lien versus a particular lien in bailment arrangements.
7. Analyze the significance of constructive bailment in legal terms, citing relevant cases or examples.
8. Elaborate on the duties of a bailor towards the property bailed and the corresponding obligations of a bailee.
9. Evaluate scenarios where a bailor's compensation for a bailee's services becomes a contentious issue and the legal remedies available.

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Unit 2

Pledge

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ familiarise the term pledge
- ◊ identify the parties involved in a pledge agreement
- ◊ gain an insight on the rights and duties of pawnor
- ◊ be aware of the rights and duties of Pawnee

Prerequisite

Imagine you and your friend, Arya, decide to start a lemonade stand together. To make this happen, you need some supplies like a table, cups, and lemons. Now, let's say you don't have all the money to buy these supplies upfront, but Arya does. To ensure she'll get her money back, you both create a pledge agreement.

Here's how it works:

- ◊ Agreement: You both agree that Arya will provide the money for the supplies, but you'll be responsible for paying her back.
- ◊ Collateral: To guarantee you'll repay her, you agree to use your bike as collateral. It's like a promise - if you can't repay, Arya gets to keep your bike.
- ◊ Terms: You discuss how much money Arya is lending you, when you'll repay her (let's say in a month), and if there's any interest involved (maybe a small extra amount for borrowing the money).
- ◊ Responsibilities: You agree that you'll run the lemonade stand and use the money you make to repay Arya on time.

So, the pledge agreement is a formal promise between you and Arya. It outlines what you're borrowing, when you'll give it back, and what Arya gets if you can't repay.

In the previous unit, we discussed a type of special contract called bailment. This unit specifically focuses on another type of special contract called pledge or pawn.

Keywords

Pledge, Pawnor, Pawnee, Hypothecation

Discussion

2.2.1 Pledge [Section 172]

The bailment of goods as security for payment of a debt or performance of a promise is called pledge (or Pawn)

A pledge is a legal relationship where a borrower (the pawnor/pledgor) pledges personal property as security for a debt or obligation to a lender (the pawnee/ pledgee). In a pledge, the pledgor retains ownership of the property but gives possession to the pledgee, who has the right to sell the property in order to recover the debt or obligation if the pledgor fails to fulfill their obligations.

For example, imagine you approach a bank for a loan and offer your gold jewellery as collateral. The bank assesses the value of your gold and agrees to lend you money based on that assessment. You and the bank enter into a pledge agreement, where you pledge your gold as security for the loan.

The rights and duties of the pledgor and pledgee are governed by the terms of the pledge agreement and by applicable laws in the jurisdiction where the pledge takes place. The pledge agreement will typically set out the terms of the pledge, including the value of the property, the duration of the pledge, and the conditions under which the property may be sold by the pledgee.

> Every pledge involves bailment but every bailment does not amount to pledge.

2.2.1.1 Parties involved in Pledging

i. ***Pawnor or pledgor:*** The pawnor is the party who pledges or offers something as security or collateral in a pledge agreement. In simpler terms, the pawnor is the person who owns the item being pledged. For instance, if someone offers their jewellery or any valuable asset as collateral to secure a loan, they are the pawnor. The pawnor retains ownership of the pledged item but risks losing it if they fail to meet the terms of the agreement, such as repaying the loan.

ii. ***Pawnee or pledgee:*** On the other side, the pawnee is the party who receives the pledged item as security or collateral in a pledge agreement. The pawnee is usually the lender or the party to whom the pledge is made. In the context of a loan, the pawnee is the entity that provides the loan in exchange for the pledged item. They hold the rights to possess the pledged item if the pawnor defaults on the agreement by not repaying the loan according to the agreed terms.

2.2.1.2 Essential elements of pledge

As per the Indian Contract Act, 1872, the essential elements of pledge are:

i. ***Debt:*** There must be an existing or future debt or liability for which the pledge is created.

ii. ***Pledger/ Pawner***: The person who creates the pledge is called the pledger or pawner. The pawner must be the owner or have possession of the property being pledged.

iii. ***Pawnee/Pledgee***: The person to whom the property is pledged is called the pawnee or pledgee. The pawnee must have the right to take possession of the pledged property.

iv. ***Delivery of possession:*** The pawner must deliver the possession of the property to the pawnee or someone authorized by the pawnee.

v. ***Intention to create a pledge:*** There must be an intention to create a pledge, which may be expressed or implied.

vi. ***Specific identification of the property:*** The property being pledged must be identifiable and specific.

vii. ***Transfer of ownership:*** The pledge agreement must provide for the transfer of ownership of the pledged property to the pawnee in case of default by the pawner.

2.2.1.3 Rights of pawner

Under the Indian Contract Act, 1872, the pawner (also known as the pledgor) has certain rights, including:

i. ***Right of redemption:*** The pawner has the right to redeem the pledged property by paying the debt for which it was pledged, along with any interest or charges that may have accrued. This right of redemption can be exercised at any time before the sale of the pledged property.

ii. ***Right to notice before sale:*** If the pawnee (pledgee) intends to sell the pledged property due to the pawner's default, the pawner has the right to receive notice of the sale. The notice must specify the date, time, and place of the sale, as well as the amount of debt owed.

iii. ***Right to any surplus from sale:*** If the pledged property is sold by the pawnee, and the sale price exceeds the amount of debt owed, the pawner has the right to receive the surplus amount.

iv. ***Right to sue for wrongful sale:*** If the pawnee sells the pledged property without giving proper notice or without following the legal procedures, the pawner has the right to sue for wrongful sale and claim damages.

v. ***Right to receive the property back in good condition***: If the pawner redeems the pledged property, they have the right to receive it back in the same condition in which it was pledged, subject to normal wear and tear.

2.2.1.4 Duties of Pawner

Under the Indian Contract Act, 1872, the pawner (also known as the pledgor) has certain duties, including:

i. ***Duty to deliver the pledged property:*** The pawner must deliver the pledged property to the pawnee (pledgee) along with any relevant documents or information related to the property.

ii. ***Duty to pay the debt:*** The pawner must pay the debt for which the property is pledged, along with any interest or charges that may have accrued, on or before the due date. Failure to pay the debt may result in the pawnee having the right to sell the pledged property.

iii. ***Duty to inform of any changes in ownership or other details:*** The pawner must inform the pawnee of any changes in ownership or other details related to the pledged property that may affect the validity of the pledge.

iv. ***Duty to indemnify the pawnee***: The pawner must indemnify the pawnee against any loss or damage that may occur due to defects in the title or quality of the pledged property.

2.2.1.5 Rights of Pawnee

Under the Indian Contract Act, 1872, the pawnee (also known as the pledgee) has certain rights, including:

i. ***Right to retain possession of pledged property [Section 173]:*** The pawnee has the right to retain possession of the pledged property until the debt for which it was pledged is repaid.

ii. ***Right to claim expenses [Section 173]:*** The pawnee has the right to claim any expenses incurred in the preservation or protection of the pledged property.

iii. ***Right to sue for recovery of debt [Section 176]:*** If the pawner fails to repay the debt on the due date, the pawnee has the right to sue for recovery of the debt.

iv. ***Right to sell the pledged property [Section 176]:*** If the pawner fails to repay the debt even after the due date, the pawnee has the right to sell the pledged property after giving proper notice to the pawner.

v. ***Right against true owner [Section 178A]*** When the pawnor has obtained possession of the goods pledged by him under a contract on voidable under section 19 or 19A, but the contract has not been rescinded at the time of the pledge, the pawnee acquires a good title to the goods provided he acts in good faith and without notice of the pawnor's defect of title.

2.2.1.6 Duties of Pawnee

Under the Indian Contract Act, 1872, the pawnee (also known as the pledgee) has certain duties, including:

i. ***Duty to take reasonable care of the pledged property:*** The pawnee must take reasonable care of the pledged property and ensure that it is protected from any damage or loss.

ii. ***Duty to return the property on repayment of debt:*** If the pawner repays the debt for which the property was pledged, the pawnee must return the property to the pawner in the same condition in which it was pledged, subject to normal wear and tear.

iii. ***Duty not to make unauthorised use of goods:*** The pawnee must not make unauthorised use of the goods pledged.

iv. ***Duty to act in good faith:*** The pawnee must act in good faith and not misuse the pledged property for their own benefit or to the detriment of the pawner.

v. ***Duty to follow legal procedures:*** If the pawnee intends to sell the pledged property due to the pawner's default, they must follow the legal procedures and give proper notice to the pawner before the sale.

2.2.2 Pledge by Non-Owners

According to the general rule, only the true owner can pledge the goods but under the following cases, even a non-owner can make a valid pledge:

i. ***Pledge by a Mercantile Agent [Section 178]*** If a mercantile agent acts unauthorizedly against the instructions of his principle, the pledge made shall be valid if the following conditions are fulfilled:

- ◊ The pawnor must be a mercantile agent. According to section 2(9) of the Sale of goods act, 1930, a mercantile agent is a person who in the customary course of business has an agent's authority either to sell or consign the goods for the purpose of sale or to buy goods or to raise money on the security of goods.

◊ Mercantile agent must be in possession of goods or documents of title to goods.

◊ Mercantile agent must be in possession of goods with the consent of the owner.

◊ Pledge must have been made by the mercantile agent, when acting in the ordinary course of business of a mercantile agent.

◊ The pawnee must have acted in good faith.

◊ The pawnee must not have the notice that the agent has no authority to pledge.

ii. ***Pledge by Person in Possession under Voidable Contract [Section 178A]*** The pledge by a person in possession under voidable contract (as per Section 19 or 19A of the Indian Contract Act) is valid if the following conditions are fulfilled:

◊ The pledge is made before the contract is rescinded

◊ The pawnee has acted in good faith.

◊ The pawnee has no knowledge of the defective title of the pawnor.

iii. ***Pledge where Pawnor has a Limited Interest [Section 179]*** Pledge by a person who has only a limited interest in the goods is valid to the extent of that interest. For example, a finder of goods, a mortgagee or a person having lien over the goods may make a valid pledge of such goods to the extent of his interest in the goods.

iv. **Pledge by a Co-owner in Possession** Pledge by a co-owner is valid if the following conditions are fulfilled:

◊ The goods must be owned by more than one person.

◊ The goods must be in the possession of one of the co-owners.

◊ Such sole possession must be with the consent of other owners.

v. **Pledge by Seller or Buyer in Possession [Section 30 of Sale of Goods Act,1930]** A pledge by a seller who is in possession of goods after sale with the consent of buyer or by a buyer who is in possession of goods before sale with the consent of seller, is valid if the following conditions are fulfilled:

◊ The pawnee must act in good faith.

◊ The pawnee must not have knowledge of the defect in title of the pawnor.

Table 2.2.1 Distinction between Pledge and Bailment

Basis of distinction	Pledge	Bailment
Purpose	Pledge is bailment of goods for a specific purpose, i.e. repayment of a debt or performance of a duty.	Bailment is for a purpose of any kind
Right to use	Pawnee cannot use the goods pledged	Bailee can use the goods as per terms of bailment
Right to sell	Pawnee can sell the goods pledged after giving notice to the pawnor in case of default by the pawnor	Bailee can either retain the goods or sue the bailor for his dues.

Recap

◊ Pledge: A pledge is a legal relationship where a borrower (the pawnor/ pledgor) pledges personal property as security for a debt or obligation to a lender (the pawnee/ pledgee).

◊ Parties involved in Pledging

◊ Essential elements of pledge

◊ Rights of pawner

◊ Duties of Pawner

◊ Rights of Pawnee

◊ Duties of pawnee

◊ Pledge by Non-Owners

Objective Questions

1. Who pledges the asset?
2. Who receives the pledged asset?
3. What is another term for a security agreement involving collateral?
4. What are the responsibilities of the asset owner in a pledge agreement?
5. What are the obligations of the lender in a pledge agreement?
6. In a pledge, who maintains ownership of the pledged item?

Answers

1. Pawnor
2. Pawnee
3. Pledge
4. Maintain Collateral
5. Protect Interest
6. Pawnor

Self-Assessment Questions

1. Clearly distinguish between a pledge and a mortgage, highlighting the key differences in terms of possession, transfer of title, and remedies available.
2. Explain the concept of a pledge agreement and its significance in financial transactions.
3. Describe the roles and responsibilities of a pawnor in a pledge agreement. Provide examples to illustrate these duties.

4. Analyze the risks associated with being a pawnee in a pledge arrangement. How can a pawnee mitigate these risks?
5. Investigate the legal implications of defaulting on a pledge agreement from the perspective of both the pawnor and the pawnee.

Assignments

1. Explore the various types of assets commonly used in pledge agreements and their significance in securing loans or transactions.
2. Critically evaluate the importance of collateral valuation in the context of a pledge agreement. How does it impact the overall agreement?
3. A company pledges its machinery as collateral for a business loan. Discuss the implications of this action on the company's operations and control over the pledged asset. What happens if the company faces financial difficulties and defaults on the loan?
4. Compare and contrast the legal framework governing pledges in India with that of another country you are familiar with. Highlight any significant differences in terms of formalities, rights, and remedies.
5. Evaluate the ethical considerations involved in using personal assets as collateral for loans. Discuss the potential risks and challenges faced by borrowers, particularly vulnerable individuals, in such situations.
6. Research and discuss the recent legal developments or proposed reforms related to pledges and collateral in India. Analyze the impact of these changes on businesses, financial institutions, and borrowers.

Suggested Reading

1. Kapoor, N. D., Business Law. Sultan Chand and Sons.
2. BARE Acts: Contract Act, Sale of Goods Act, RTI Act 2005, IDRA, TRAI.

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BLOCK 03

Indemnity and Guarantee

Unit 1

Indemnity

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ identify the term indemnity
- ◊ gain an insight on the essential features of an indemnity contract
- ◊ familiarise the rights of indemnity holder or indemnified
- ◊ aware of the rights of indemnifier

Prerequisite

You lend your friend your favourite skateboard. You love this skateboard, but your friend accidentally damages it while using. You might feel upset about the damage and worried about the cost of repairs or getting a new one.

Now, let's say you have a contract of indemnity in place before lending the skateboard. This contract outlines that if any damage happens to the skateboard while it is in your friend's possession, they will cover all the costs associated with repairing or replacing it. Essentially, it is an agreement where your friend promises to take responsibility for any harm or loss caused to the skateboard.

In a broader context, a contract of indemnity works similarly. It is a legal agreement between two parties where one party agrees to compensate the other for any losses, damages, or liabilities that may arise from a specified event. This contract serves as a safeguard, ensuring that one party is protected against financial losses due to the actions or situations outlined in the agreement.

In the previous block, we discussed special contracts known as bailment and pledge. Another type of special contract is the contract of indemnity, which we will explore in detail in this unit.

Keywords

Indemnity, Indemnified, Indemnifier, Express contract, Implied contract

Discussion

3.1.1 Contract of Indemnity

Consider a scenario where Arun is traveling in a car to watch a movie. Along the way, an accident occurs, causing damage to a bike but resulting in no injuries to anyone involved. The bike owner, Varun, takes legal action against the driver (Arun) to claim compensation for the bike's repairs and other losses due to the accident. In this situation, the insurance company, with a contractual agreement with the driver (Arun), intervenes to cover Varun's expenses resulting from the accident. This exemplifies a specific type of contract known as the Contract of Indemnity.

"A Contract of indemnity refers to a promise made by one person (the indemnifier) to compensate another person (the indemnitee) toany loss or damage incurred or that may be incurred by acting at the indenifiier's request or for their benefit". A contract of indemnity may be express or implied.

If Arun is found liable to pay Varun a sum of ₹25,000 as compensation, the insurance company pays this amount to Varun on Arun's behalf. In this example, the 'Insurance company' is the 'indemnifier' or 'promisor' as they promise to save Arun from the loss, and Arun is the 'indemnified' or 'promisee,' as they are the recipient of this promise.

Definition

Contract of indemnity has been defined under section 124 of the Contract Act as *"a contract by which one party promises to save the other from the loss caused to him by the conduct of the promisor himself or by the conduct of any other person"*.

The object of Contract of Indemnity is essentially to protect the promisee against anticipated loss and the term indemnity means 'to make good the loss'. Thus, indemnity is an act to compensate or protect somebody against loss, or to make good the loss suffered.

3.1.1.1 Essential Features of a Contract of Indemnity

i. **Express or Implied**

- ◊ **Express contract of indemnity:** Where the terms of contract are expressed in oral or written format, it is called express contract. For example: Policy of motor vehicle insurance between you and your insurance company.
- ◊ **Implied contract of indemnity:** Where the contract can be inferred from the circumstances of the case or from the relationship of the parties, it is called

implied contract. Example: You and Arun are Principal and Agent. Arun has to supply goods to you for your business. Arun supplied goods but you did not want them and denied taking the same. Arun can sell the goods and if he incurs any loss while selling them, then you have to make good the loss of Arun and the law will ensure the same.

ii. **Compensation for loss:** One party must promise to save the other party from any loss which he may suffer. Therefore, court treats all the general insurance contracts as contract of indemnity. However, life insurance contracts are not contracts of indemnity because in such contract payment is made for consideration other than the loss suffered by the insured.

iii. **Essentials of a valid contract:** A contract of indemnity should possess all the essentialsof a valid contract.

3.1.1.2 Parties involved in a contract of indemnity

◊ ***Indemnifier:*** The person who promises to make good the loss is called the 'indemnifier'.

◊ ***Indemnified:*** The person whose loss is to be made good is called 'indemnified' or 'indemnity-holder'.

3.1.1.3 Rights of Indemnity Holder or Indemnified (Sec 125)

When sued, an indemnity holder is entitled to recover from the indemnifier the following:

i. **Damages**: Indemnity holder is entitled to recover all the damages which he may be compelled to pay in any suit.

ii. **Costs**: All costs which he may be compelled to pay in any such suit. But the indemnity holder can recover such cost only if the indemnifier authorised him to bring or defend the suit.

iii. **All sums paid for compromise**: All sums which he may have paid under the terms of any compromise of any such suit.

3.1.1.4 Rights of Indemnifier

The Act makes no mention of the rights of an indemnifier. It has been held [Jaswant Singhji vs. Section of State 14Bom.299] that his rights, in such cases, are similar to the rights of a surety under section 141., he becomes entitled to the benefit of all the securities which the creditor has against the principal debtor whether he was aware of them or not.

When does the liability of indemnifier commence?

Although the Indian Contract Act, 1872 is silent on the time of commencement of liability of indemnifier but on the basis of judicial pronouncement of courts, it can be said that the liability of an indemnifier commences as soon as the liability of the indemnity-holder becomes absolute and certain. In other words, if the indemnity-holder has incurred an absolute liability even though he has himself paid nothing, he is entitled to ask the indemnifier to indemnify him. Example: X promises to compensate Y for any loss that he may suffer by filing a suit against Z. The court orders Y to pay Z damages of ₹5000. As the loss has become certain, Y may claim the amount of loss from X and pass it on to Z.

Recap

- ◊ Indemnity – to make good the loss or to compensate the party who has suffered from loss.
- ◊ Contract of indemnity – one party promises to save other from loss caused by him by the conduct of the promisor himself or by the conduct of any other person
- ◊ Indemnifier – the person who promises to make good the loss
- ◊ Indemnity holder -the person whose loss is to be made good
- ◊ Rights of indemnity holder – recover all damages, costs and sums which he may be compelled to pay
- ◊ Liability of an indemnifier – commences as soon as the liability of the indemnity-holder becomes absolute and certain.
- ◊ Mode of contract of indemnity – a contract of indemnity may be express or implied.

Objective Questions

1. What is the primary purpose of indemnity?
2. In a contract of indemnity, who promises to compensate for the loss suffered?
3. Who is referred to as the 'indemnity holder'?
4. What rights does an indemnity holder possess?
5. When does the liability of an indemnifier begin?
6. How can a contract of indemnity be established?

Answers

1. To compensate for loss
2. Indemnifier
3. The person suffering the loss
4. Recover all damages and costs
5. When the indemnity holder's liability is certain
6. Both express and implied agreements

Self-Assessment Questions

1. What are the "Rights of the Indemnity Holder" under a contract of indemnity? How can an indemnity holder enforce these rights?
2. Draft a sample clause for an indemnity agreement, clearly outlining the scope of the indemnity, the parties involved, and the specific situations where it applies.
3. Compare and contrast the differences between an express and an implied contract of indemnity. Highlight the advantages and disadvantages of each type, providing examples to illustrate your points.
4. Discuss the legal principles governing the commencement of the indemnifier's liability. Include relevant case law and statutory provisions to support your explanation.

Assignments

1. Explain the concept of indemnity in contracts. Provide examples to illustrate the application of indemnity in real-world scenarios
2. Discuss the fundamental principles of indemnity in contracts, highlighting the roles and responsibilities of the indemnifier and the indemnity holder. Provide examples to illustrate your points.

3. Analyze a real-life case involving a contract of indemnity. Describe the circumstances, the parties involved, the obligations outlined in the contract, and the legal implications of the indemnity agreement.
4. You are advising a company on the importance of having indemnity clauses in their contracts. Explain the significance of such clauses, the protections they offer, and situations in which they might be particularly crucial for the company's risk management.
5. Consider a hypothetical scenario where Party A promises to indemnify Party B for certain losses. Identify potential situations that could trigger the indemnity clause and discuss the legal implications for both parties

Suggested Reading

1. Kapoor, N. D., Business Law. Sultan Chand and Sons.
2. BARE Acts: Contract Act, Sale of Goods Act, RTI Act 2005, IDRA, TRAI.
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1. Government of India. (1872). *The Indian Contract Act, 1872* (Act No. IX of 1872). https://www.oreilly.com/library/view/business-law/9789332511248/xhtml/chapter001.xhtml
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Unit 2

Guarantee

Learning Outcomes

After completing this unit, the learner will be able to:

◊ familiarise with the concept of 'Contract of Guarantee'

◊ identify the parties involved in the contract of guarantee

◊ analyse the kinds of guarantee

◊ gain an understanding on the rights of a surety

Prerequisite

Consider John and his business partner, Sarah, requiring specific materials for their upcoming project. Seeking these goods, they approach Zachariah, a supplier. In a conversation aimed at ensuring payment security, John tells Zachariah, 'Please supply the materials to Sarah, and in the event that she cannot fulfill payment, I will cover the costs.'

Is this interaction legally binding? If so, what type of contract does it represent?

Previously, we explored distinctive legal relationships within bailment, involving the transfer of goods' possession without transferring ownership; pledge, entailing the delivery of goods as collateral for a debt; and indemnity, where one party promises compensation for another's losses. It is now imperative to explore another specialized contract known as the contract of guarantee.

In the aforementioned scenario, the agreement is identified as a contract of guarantee. This unit will provide an exhaustive examination of the intricacies associated with the contract of guarantee.

Keywords

Contract of Guarantee, Principal Debtor, Creditor, Surety, Kinds of Guarantee

Discussion

3.2.1 Contract of Guarantee

On certain occasions, you may require the support of someone else's credibility to enter into a contract. For instance, imagine you need to engage in a contract with Arun, a businessman who is a stranger to you. However, Varun is a mutual friend of both you and Arun. In such a scenario, as you are not closely acquainted with Arun, he might be hesitant to enter into the contract initially. But Varun intervenes and vouches for your performance in the contract to Arun. Trusting Varun, Arun proceeds to enter into the contract with you. This contract falls under the category of a 'Contract of Guarantee,' a special type facilitating an individual to secure employment, a loan, goods, or services based on another person's reputation or credit.

3.2.1.1 Parties Involved in a Contract of Guarantee

◊ ***Creditor:*** The person to whom the guarantee is made, expecting the fulfillment of the obligation.

◊ ***Principal Debtor:*** The person whose obligation or debt is being guaranteed.

◊ ***Surety/Guarantor:*** The individual providing the guarantee, taking responsibility if the principal debtor defaults.

In the given example, you are the principal debtor, Varun acts as the surety, and Arun stands as the creditor.

Additionally, there exists a party known as the 'co-surety' in a contract of guarantee. Often, a single debt can be guaranteed by multiple individuals. When the debt is guaranteed by more than one person, they are referred to as co-sureties. Therefore, in relation to a guarantor, a co-surety denotes any other person named as a 'guarantor' or someone who assures payment of the money.

Meaning and Definition

The term ‘guarantee’ means an undertaking by one person to another person for performing a promise, or discharge the liability to pay an amount due from a third person, on his default.

According to Section 126 of the Act “A contract of guarantee is a contract to perform the promise, or discharge the liability, of a third person in case of his default”.

Example: Arun advanced a loan of ₹100000 to you at the request of Varun and Varun promised to Arun that if you do not repay the amount, Varun will pay the amount for you.

3.2.1.2 Essential Features of a Contract of Guarantee

The essential features of a contract of guarantee are as follows:

i. **Three parties:** A contract of guarantee is an agreement among three parties namely the *'principal debtor', 'creditor'* and '*surety'*.

ii. **Identity of minds:** Free consent or identity of minds of all the three parties in respect ofthe subject matter of the contract should be present.

iii. **Three contracts:** There are three contracts in a guarantee, i.e.,

◊ One contract between the creditor and the principal debtor

◊ One between the surety and the creditor

◊ One between the surety and the principal debtor

iv. **Liability:** The term 'liability' means a liability which is enforceable at law. There must be an existing liability or a promise whose performance is guaranteed. If that liability does not exist, there cannot be a Contract of Guarantee.

v. **Capacity to contract:** For a valid contract, all the parties must be competent to contract. But, in a contract of guarantee, the principal debtor need not be a person competent to contract. His incapacity should be in the knowledge of the surety.

vi. **No misrepresentation and concealment:** Any guarantee which the creditor has obtained by means of misrepresentation or by keeping silence as to material facts to the contract is invalid.

vii. **Consideration:** Consideration is necessary for a contract of guarantee. The consideration received by the principal debtor may be a sufficient consideration to the surety for giving guarantee. There need not be any direct and separate consideration between the surety and the creditor.

3.2.1.3 Kinds of Guarantee

Guarantee may be classified under the following two categories:

i. Specific guarantee

ii. Continuing guarantee

i. **Specific guarantee**

A guarantee which extends to a single debt or specific transaction is called a specific guarantee. The liability of the surety comes to an end when the guaranteed debt is duly discharged or the promise is duly performed.

Example I: X ensures payment to Y for the price of five bags of flour that Y will deliver to Z, with payment due within a month. Y fulfills the delivery of the five bags to Z, and Z settles the payment for the goods received. This arrangement constitutes a specific guarantee contract wherein X's guarantee specifically covers the payment for the set of five bags of flour, all delivered at once.

Example II: X leased his godown to Y for a duration of 10 years at an annual rent of ₹ 12,000. Z provided a guarantee that ensured Y's compliance with the lease obligations. This arrangement is categorized as a specific guarantee contract due to the indivisible nature of the 10-year lease. It cannot be segmented into separate, distinct transactions; rather, it is treated as a single, unified transaction.

ii. Continuing Guarantee [Section 129]

A guarantee which extends to a series of transactions is called a 'continuing guarantee'. A surety's liability continues until the revocation of the guarantee.

Example I: Based on S's recommendation, C hired P to collect rent from his tenants. S committed to rectify any defaults made by P in this responsibility. This arrangement constitutes a continuing guarantee contract.

Example II: A provided a guarantee to B, a tea-dealer, for up to ₹100 regarding any tea supplied to C over time. Initially, B supplied tea to C worth ₹100, and C duly paid for it. Later, B supplied additional tea to C, this time amounting to ₹200. However, C failed to make the payment for this supply. The guarantee extended by A was a continuing one, and therefore, A is liable to B for the sum of ₹100 in accordance with the terms of the guarantee.

A continuing guarantee may be given for a part of the entire debt or for the entire debt subject to a limit.

Revocation of Continuing Guarantee

A continuing guarantee as to future transactions may be revoked in any of the following ways:

iii. By Notice of Revocation [Section 130] A continuing guarantee may at any time be revoked by the surety as to the future transactions by notice to the creditor. However, the surety remains liable for the past transactions which have already taken place.

Example X gives guarantee to the extent of ₹60000 for the loans given time to time by Y to Z. Y gave a loan of ₹20,000 to Z. Afterwards, X gives notice of revocation. X is discharged from all liability to Y for any loan granted after the revocation of guarantee but he is liable to Y for ₹20000 on default of Z.

iv. By Death of Surety [Section 131] In the absence of any contract to the contrary, the death of surety operates as a revocation of a continuing guarantee as to the future transactions taking place after the death of surety. However, the surety's estate remains liable for the past transactions which have already taken place before the death of surety.

v. By Modes of Discharging the Surety A continuing guarantee is also revoked in the same manner in which the surety is discharged such as:

a. Novation (Section 62]

b. Variance in terms of contract [Section 133]

c. Release or discharge of principal debtor [Section 134]

d. When the creditors enter into an arrangement with the principal debtor [Section 135]

e. Creditor's act or omission impairing surety's eventual remedy [Section 139]

f. Loss of security [Section 141]

3.2.1.4 Rights of Surety

Surety has his rights against all the three parties, i.e.; (1) the creditor, (2) the debtor, and (3)the co –sureties.

a. Right against creditor

◊ ***Right to ask the creditor to demand payment from the debtor:*** After the debt has become due and before he is asked to pay, the surety may require the creditor to take all measures to realise the dues from the principal debtor. The surety should indemnify all losses resulting there from.

◊ ***Right of subrogation:*** On payment of the guaranteed debt, the surety is subrogated to all the rights of the creditor and gets the right to demand from the creditor all the securities (of principal debtor) at the time of payment.

◊ ***Right to claim set off:*** On being sued by the creditor for payment of principal debtor's liability, the surety can claim set off, if any, which the principal debtor had against the creditor.

b. Right against Principal Debtor

◊ ***Right to be relieved from liability:*** Surety can compel the principal debtor to relieve him from liability by paying off the debt.

◊ ***Right of Subrogation:*** On payment of the guaranteed debt, the surety gets all the rights of creditor against the principal debtor.

◊ ***Right to indemnity:*** The debtor has to indemnify the surety. The surety can recover from the debtor all payments properly made by him to the creditor.

c. Rights against co- sureties

When a debt is guaranteed by two or more sureties, they are called co-sureties. The co- sureties are liable to contribute towards the liability according to the agreed proportions or equally as the case may be to the extent of default.

3.2.1.5 Liabilities of Surety

i. ***Liability of surety is secondary:*** The surety's liability arises only when the principal debtor makes a default and not before.

ii. ***Liability of surety is co-extensive with that of principal debtor:*** Surety is liable for what the principal debtor is liable. By a special contract the liability can be made less than debtor but never more. The creditor may choose to proceed against the surety first, omitting to sue the debtor.

3.2.1.6 Discharge of Surety from Liability

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

A surety is discharged from liability in the following ways:

i. Discharge of surety by revocation

ii. Discharge of surety by the conduct of creditor

iii. Discharge of surety by invalidation of the contract

i. Discharge of surety by revocation: The contract of guarantee can be revoked by the surety in the following cases:

a. ***Revocation by giving notice (Sec 130)***: A surety may revoke the guarantee, at any time, by giving notice of revocation to the creditor. Specific guarantee cannot be revoked.

b. ***Revocation by death (Sec 131):*** Death of a surety discharges him from all liabilities unless there is contract to the contrary.

c. ***Revocation by novation (Sec 62):*** When a new contract of guarantee is substituted for an old one, the existing contract of guarantee is discharged and new contract comes into existence. The surety is discharged from the liability of the former contract.

ii. Discharge of surety by conduct of creditor: If the conduct of the creditor has any of the following consequences, a surety may be discharged from his liability.

a. ***Variation in terms of the contract (Sec 133):*** Any variation made in the terms of the contract by the creditor without the surety's consent will lead to discharge of surety's liability.

b. ***Release of principal debtor (Sec 134):*** Any release of principal debtor by the creditor is release of the surety also. The surety is discharged if the creditor:

◊ Makes a fresh contract with the principal debtor, by which the principal debtor is released, or

◊ Does any act or omissions, the legal consequence of which is the discharge of the principal debtor

c. ***Composition with debtor (Sec 135):*** The surety is discharged if the creditor without the consent of surety, makes an arrangement with the principal debtor for composition, or promise to give him time for not to sue him.

d. ***Creditor's act or omission (Sec 139):*** If the creditor does any act against the right of surety or omits to do any act which, his duty to surety requires him to do, the surety will be discharged.

e. ***Loss of securities (Sec 141):*** If the creditor loses or parts with the security (of the principal debtor) without the consent of surety, the surety is discharged from his liabilities to the extent of the value of the security.

iii. Discharge of surety by invalidation of the contract:

a. ***Guarantee obtained by misrepresentation (Sec142)***: Any guarantee which has been obtained by means of misrepresentation made by a creditor is invalid and surety gets discharged.

b. ***Guarantee obtained by concealment (Sec143)***: Any guarantee which has been obtained by means of keeping silence by the creditor to the material facts to the contract is invalid.

c. ***Lack of any essential element of a contract:*** If any of the elements of contract is not present,the contract is void and the surety is discharged.

d. ***Failure of a person to join as* Co-surety (sec 144):** Where a person gives a guarantee upon a contract that a creditor shall not act upon it until another person has joined in as co-surety, the guarantee is not valid if that person does not join.

Table 3.2.1 Distinction between contract of indemnity and contract of Guarantee

Basis of Distinction	Contract of Indemnity	Contract of Guarantee
No. of Parties	There are two parties-indemnifier and the indemnity-holder.	There are three parties-principal debtor, creditor and surety.
No. of Contract	There is only one contract between indemnifier and indemnity-holder. The indemnifier undertakes to save the indemnity-holder from any loss.	There are three contracts, one between creditor and principal debtor, second between surety and principal debtor, and third between surety and the creditor.
Undertaking	The liability of indemnifier is primary unconditional.	The liability of surety is secondary and conditional. The surety undertakes for the payment of debts of principal debtor.

Nature of liability	The liability arises only on the happening of a contingency.	Surety's liability is secondary in the sense that the primary liability is of principal debtor. Surety's liability is conditional in the sense that it arises only on default of principal debtor.
Nature of event	The liability arises only on the happening of a contingency.	The liability arises only on the non- performance of an existing promise or non-payment of an existing debt
Request	The indemnifier need not act at the request of indemnity-holder.	The surety acts at the request of the principal debtor.
Right to sue	The indemnifier cannot sue a third party in his own name because of absence of privity of contract between him and third party. He can sue the third party in his own name if there in an assignment in his favour.	A surety, on discharging the debt of principal debtor, can sue the principal debtor in his own name.

Recap

- Guarantee - guaranteeing the performance of a contract of one person by another.
- No. of parties in guarantee – principal debtor, creditor and surety
- Specific guarantee – guarantee which extends to a single debt or specific transactions.
- Principal debtor – the person in respect of whose default the guarantee is given.
- Creditor – the person to whom the guarantee is given
- Guarantee – the person who gives the guarantee
- Continuing guarantee - guarantee which extends to a series of transaction
- Modes of discharge of surety- Revocation, conduct of creditors and invalidation of contract

Objective Questions

1. What is the primary purpose of a guarantee in a contract?
2. How many parties are typically involved in a guarantee?
3. Who is the principal debtor in a guarantee?
4. What characterizes a specific guarantee?
5. Who is the creditor in a guarantee agreement?
6. What is continuing guarantee?
7. What are the modes of discharge of a surety?

Answers

1. Assurance
2. Three
3. Person in whose behalf a gurantee is given
4. Single debt or specific transaction
5. Guarantee recipient
6. Series of transaction
7. Revocation, conduct of creditors and invalidation of contract

Self-Assessment Questions

1. Explain the concept of a continuing guarantee and provide an example to illustrate its application in a real-life scenario.
2. Discuss the roles of the principal debtor, creditor, and surety in a guarantee agreement, highlighting their individual responsibilities and obligations.

3. Compare and contrast a specific guarantee and a continuing guarantee, highlighting their differences in scope, applicability, and limitations.
4. Describe the modes of discharge of a surety in detail, emphasizing the circumstances under which a surety's obligations can be terminated.
5. Analyze the legal implications of revocation as a mode of discharge of a surety in a guarantee agreement, citing relevant case law or examples.
6. Differentiate between contract of indemnity and contract of guarantee.
7. Explain the rights of a surety against creditors, principal debtors and co-sureties.

Assignments

1. Evaluate the significance of a guarantee in business transactions and discuss its role in mitigating risks for involved parties.
2. Illustrate with examples the importance of specifying the terms and limitations of a guarantee agreement to avoid misunderstandings and conflicts among the parties involved.
3. Select a legal case where the concept of guarantee played a crucial role. Analyze the facts, court decisions, and implications for defining guarantee law.
4. Present hypothetical scenarios demonstrating the role of guarantee in different transactions. Discuss legal rights and obligations of the parties involved.
5. Compare and contrast the legal responsibilities of the principal debtor, creditor, and surety in different types of guarantee (specific, continuing, etc.).
6. Prepare a guide outlining the modes through which a surety can be discharged from the guarantee obligation. Explain each mode with examples.

Suggested Reading

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04

Sale of Goods Act 1930

Unit 1

Introduction to Sale of Goods Act 1930

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ familiarise with the essentials of contract of sale of goods
- ◊ identify the classification of goods
- ◊ differentiate between the condition and warranties
- ◊ gain insights on the concept of 'Doctrine of Caveat Emptor'

Prerequisite

Sale of Goods Act 1930:

Amal, a college student, purchased a laptop from a local electronics store, "Tech World," for ₹70,000. The laptop was advertised as "brand new" and "latest model." Amal was excited to use his new laptop for his studies. However, within a week of purchasing the laptop, Amal discovered that it had a defective battery and an overheating issue. Despite numerous complaints to Tech World, the store refused to replace or repair the laptop. Amal was frustrated and felt cheated. He consulted a lawyer, who advised him to file a case under the Sale of Goods Act 1930.

The lawyer explained to Amal that the Sale of Goods Act 1930 protects consumers like him from defective goods. The Act presumes certain conditions in a contract of sale, including that the goods must be of merchantable quality, fit for purpose, and correspond with the description. A warranty is a promise made by the seller about the quality or performance of the goods. If the goods are defective or do not meet the implied conditions, the buyer can seek remedies, such as replacement, repair, or refund.

Amal's lawyer argued that the laptop did not have merchantable quality because of the defective battery and overheating; the lawyer argued that Tech World had breached an implied condition about the fitness for purpose, given that the purchased laptop was fundamentally unsuitable for Amal in her studies. The court accepted Amal's case and mandated Tech World to replace the said laptop with another new one for Amal. Amal was relieved and happy with the outcome. Amal learned a valuable lesson about the importance of understanding his rights as a consumer. He realised the Sale of Goods Act 1930 protects faulty goods.

Keywords

Contract of sale, sale, agreement to sell, Classification of goods, Condition and Warranties, Transfer of property in goods, Caveat Emptor

Discussion

4.1.1 Sale of goods Act 1930

The Indian Sale of Goods Act, 1930 is a mercantile law which came into existence on 1 July 1930, during the British Raj. It borrowed heavily from the United Kingdom's Sale of Goods Act 1893. The Act incorporated many of its provisions except those which were not suited to the needs of the country. It does not affect the rights, interests, obligations and titles acquired or which accrued before the commencement of the Act. It provides for the setting up of contracts where the seller transfers or agrees to transfer the title (property/ ownership) in the goods to the buyer for a consideration.

The law relating to the sale of goods was originally contained in Chapter VII (Sections 76- 123) of the Indian Contract Act, 1872. The provisions of Chapter VII were subsequently found to be unsatisfactory and so it was repealed and re- enacted as a new Act, namely, the Indian Sale of Goods Act, 1930. The Act was amended on 23 September 1963 and renamed as 'The Sale of Goods Act,1930'. The contracts for sale of goods are subject to the general principles of the law relating to contracts i.e., the Indian Contract Act. Though the law relating to the sale of goods is contained in the separate enactment, many of the general principles embodied in the Indian Contract Act continue to be applicable to the contract of sale of goods. For example, offer and acceptance, free consent, capacity of parties, agreement in restraint of trade, etc., contained in the Indian Contract Act, 1872 will apply to the Contract of Sale of goods.

4.1.2 Meaning and Definition of Contract of Sale

Suppose you make a visit to a car showroom to buy a car and the car dealer gives you two options. The first option is that you can buy the car by making full payment and get the ownership and delivery of the car on that particular day itself. Another option is that you can pre-book the car by giving a down payment and get the delivery of the car a month ahead. In this case the transfer of ownership will be taking place only after the payment in full. In both these cases, there is a contract of sale.

Contract of Sale is a specific contract where by one party (seller) transfers or agrees to transfer the property (ownership) in the goods to another party (buyer) for a price (consideration). Section 4(1)

Section 4 of the Sale of Goods Act defines a contract of sale as *"A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to a buyer for a price".*

The term contract of sale includes both: Section 4(2)

i. Sale (Absolute Sale)

ii. Agreement to sell (Conditional Sale).

Sale or Absolute Sale: Where the ownership in the goods is immediately transferred from the seller to the buyer, and nothing is left to be done on the part of the seller, there is a sale or absolute sale. For example, On 1 Jan. 2021 Arun sells 5 bags of cement to Varun for a sum of ₹2000. This transaction is called a sale since the ownership of 5 bags of cement is transferred from Arun to Varun.

Agreement to sell or Conditional sale: Where the transfer of ownership in the goods shall take place in future or on the fulfilment of certain conditions, it shall be an agreement to sell or a conditional sale. For example: On 1 Jan. 2021, Arun and Varun agree that Arun should sell 5 bags of cement to Varun on 1 Feb. 2021 for a sum of ₹2000. It is an agreement to sell, since Arun agrees to transfer ownership in the future. It is an agreement which gives birth to sale. Agreement to sell becomes sale when the time elapses or the subject on which the property in the goods is to be transferred is fulfilled.

Table 4.1.1 Difference between Sale and agreement to sell

Point	Sale	Agreement to Sell
Ownership of Goods at the time of Contract	Ownership of goods passes to the buyer	Ownership does not pass at the time of the contract
Contract Status	Executed contract	Executory contract
Payment	Payment is made at the time of sale	Payment may be made at a future date
Risk of Loss on Goods Destruction	Falls on the buyer	Falls on the seller
Remedies for Breach by Seller	Personal remedy (claim for damages) against seller	Personal remedy (claim for damages) against seller and additional remedies as an owner (e.g., suit for conversion or detinue)

4.1.3 Essentials of Contract of Sale

Following essential elements are necessary to constitute a contract of sale:

iii. **Contract:** The word contract means an agreement enforceable at law. All the essential elements of a contract must be present in a contract of sale too. It presumes free consent on the part of the parties who should be competent to contract. The agreement must be made for a lawful consideration and with a lawful object.

iv. **Two parties:** There must be a minimum of two parties to a contract of sale namely, the seller and the buyer. Both the parties must be competent to enter into a contract and the seller and buyer must be two different persons. A man cannot purchase his own goods, however, a joint owner can sell the goods to another joint owner.

v. **Transfer of property:** The transfer of property from the seller to buyer is the most important element in the contract of sale. Property here means ownership or title of goods. Though passing of the title in the goods is essential ingredient of sale, physical delivery of goods is not essential.

vi. **Goods:** It is the subject matter of the contract of sale, the ownership of which is to be transferred from the seller to the buyer. Goods of any kind except immovable goods may be transferred. Sale and purchase of immovable property are covered under Transfer of Property Act 1882.

vii. **Price:** There shall be a consideration for the transfer of goods from the buyer to the seller which is called price. Goods given in exchange for goods or as remuneration for work cannot be treated as sale. However, consideration partly in money and partly in goods can be treated as sale. For example; when an old car is returned to the dealer for a new one and the difference is paid in cash that would be a sale.

4.1.4 Goods- the subject matter of Contract of Sale

Subject matter: The term *'subject matter'* means things for which a contract of sale can bemade. Only goods can be the subject matter of contract of sale.

Meaning of Goods: The term *'goods'* means every kind of movable property other than actionable claims and money; and includes stocks and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed (i.e., separated)from the land before sale or under the contract of sale. Section 2(7)

It may however, be noted that the things attached to or forming part of the land may be the subject matter of the contract of sale only if it is agreed that they shall be removed from the earth, e.g., standing crops or trees may be sold if agreed to be removed from the earth.

The term *'goods'* does not include money and actionable claims. The term *'money'* means the legal tender (i.e., currency) and not old or rare coins. The term *'actionable* *claims'* means claim which can be enforced through the court of law e.g., debt due from one person to another is an actionable claim, and cannot be the subject matter of sale.

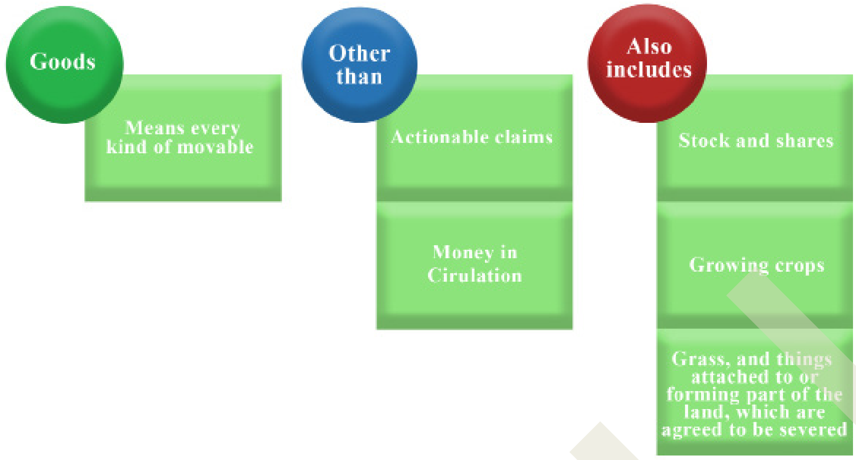

Fig 4.1.1 Meaning of Goods

4.1.5 Classification of Goods

The goods forming subject matter of the contract of sale may be classified as under:

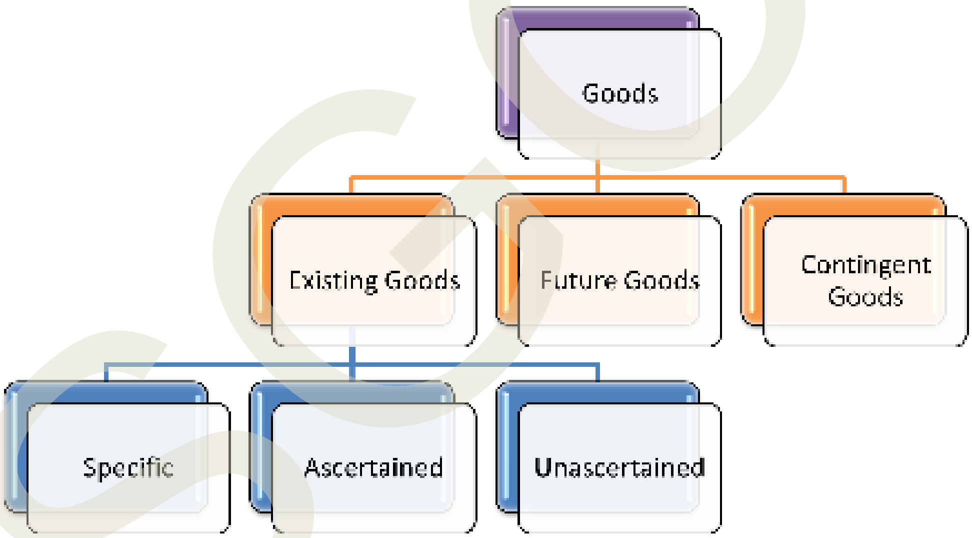

Fig 4.1.2 Classification of Goods

viii. Existing Goods (Section 6)

Goods owned and possessed by the seller at the time of making the contract of sale is called existing goods. Sometimes the seller may be in possession but may not be the owner of goods. In the case of sale by a mercantile agent, the goods are possessed but not owned by the seller. Existing goods may again be classified into specific, ascertained and unascertained goods.

◊ **Specific Goods:** Specific goods are those goods which are identified and agreed upon at the time of making the contract of sale. For example, Arun (seller) may agree to sell Varun (buyer) a specific car bearing a specific registration number. (Section 2(14)

◊ **Ascertained goods:** Though normally used as a synonym for specific goods, they are different in the sense that specific goods are identified at the time of contract of sale whereas ascertained goods are identified after the contract of sale as per the terms decided. For example: If Arun had 20 chairs of same kind and offers to sell 10 to Varun, the goods are ascertained only when the 10 particular chairs be appropriated towards the contract. On appropriation the goods become ascertained.

◊ **Unascertained goods:** When the goods are not separately identified or ascertained at the time of making a contract of sale, they are known as unascertained goods. For instance, a seller may agree to sell a buyer one out of a number of items of the same type without defining which specific item the buyer will receive. For example: A farmer agrees to sell a bushel of wheat from his crop. The wheat is not yet harvested, so the exact bushel of wheat to be sold has not been identified or specified at the time of the agreement.

ix. Future Goods Section 2(6)

Future goods are goods that are not yet in existence or that do not yet belong to the seller when the contract of sale is made. This could be goods that are yet to be manufactured or produced or acquired by the seller after the making of contract of sale. For example, a farmer may agree to sell a buyer all of the milk produced by his/her cows in the coming year. This is called an "agreement to sell." Because the milk does not yet exist at the point of making the contract, it is an example of future goods.

x. Contingent Goods Section 6(2)

Although contingent goods are a type of future goods, they differ in that they are dependent on a specific contingency which may or may not happen. For example, a seller may agree to sell a buyer some specific goods that are due to arrive on a particular ship. In this case the contract becomes performable only when the goods safely reach the seller. If the goods are lost during the voyage on account of sea perils, the contract becomes unenforceable. This is because, the sale was contingent on the safe arrival of the ship containing those specific goods.

4.1.6 Documents of Title to Goods

Any document used in the ordinary course of business, as proof of the possession or control of goods, or authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of document to transfer or receive goods thereby represented is document of title of goods (Sec 2(4)). It is a proof of ownership of goods and authorizes its holder to receive goods or further transfer such right to another person by proper endorsement and delivery.

Documents of title to goods contain an undertaking on the part of the issuing authority to deliver the goods to the holder thereof unconditionally. Although these documents can be transferred by mere delivery or by endorsement, it is regarded as 'quasi negotiable instrument', because the title of transferee even if bonafide will not be superior to that of the transferor in the case of transfer of such documents.

Examples of the Documents of Title to Goods

◊ **Bill of lading:** A bill of lading is a receipt given by the ship owner acknowledging the receipt of goods for carriage.

◊ **Dock-warrant:** A dock warrant is document which is issued by a dock owner. It contains the details of the goods; certifying that the goods are held on behalf of the person whose name is appeared in it or his assignee by endorsement. It authorises the person holding it to receive the possession of the goods.

◊ **Warehouse keeper's certificate:** Warehouse is a building in which goods are stored. Warehouse keeper's certificate is a document issued by the warehouse keeper stating that the goods specified in the document are in the warehouse or wharf.

◊ **Railway receipt:** A railway receipt is a document which is issued by the railway as the acknowledgement of the receipt of goods for transportation and delivery.

◊ **Delivery order:** A delivery order is an order which is given by the owner of goods directing a person who holds the goods on his behalf to deliver them to a person named therein.

4.1.7 Condition and Warranties (Section 12)

A contract of sale of goods contains various terms or stipulations with reference to the goods which are the subject matter of sale. For example: stipulations relating to the nature and quality of the goods, the price and the mode of its payment, the delivery of goods and its time and place, etc.

All these stipulations cannot be treated on the same footing. Some of these terms are essential to the contract and their non- fulfilment may seem to frustrate the very basis of the contract. Such terms are known as ***"Conditions"***, the breach of which, therefore, will be regarded as the breach of the whole contract. On the other hand, there may be certain stipulations which are not so vital to the contract that their breach will not put an end to the contract. Such terms are known as ***"Warranties".*** Thus, conditions are more important terms and warranties are less important terms in the contract of sale.

Meaning and Definition:

Condition: Arun says to Varun, a horse dealer, "I want a horse which runs at a speed of 60kilometers per hour". Varun points out at a particular horse and says that it runs at

60 kilometers per hour. Arun buys the horse and later finds that the horse runs at only 45 kilometers per hour. Here there is a breach of condition, as the stipulation made by the seller regarding the horse is a condition forming the very basis of the contract.

Sec 12 (2) of the Sale of Goods Act, 1930 has defined a ***condition*** as "A stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated".

From the definition, it is clear that a condition is a stipulation essential to the main purpose of the contract and the breach of which gives the aggrieved party a right to treat the contract as repudiated.

Warranty: Arun says to Varun, a horse dealer, "I want a good horse". Varun shows a particular horse and says "It can run at a speed of 60 kilometers per hour. Arun buys the horseand later finds that the horse runs only 45 kilometers per hour. Here there is only a breach of warranty, as the stipulation made by Varun is only a collateral term, constituting only a warranty.

A warranty is defined by Sec 12 (3) of the Sale of Goods Act, 1930 as "A stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not a right to reject the goods and treat the contract as repudiated".

From this definition, one can say that a warranty is a stipulation which is only collateral or incidental to the main purpose of the contract, and the breach of which gives the aggrieved party only a right to sue for damages, not the right to treat the contract as repudiated.

4.1.7.1 Characteristic of a Condition

i. A condition is a stipulation or term regarding goods forming part of the contract of sale, and it is not a mere expression of opinion or commendatory statement.

ii. A condition is a stipulation in a contract of sale essential to the main purpose of the contract. It goes to the very root of the contract and forms the very foundation of it.

iii. The breach of a condition gives the aggrieved party the right to treat the contract as repudiated, and also entitles him to claim damages.

iv. If a condition in contract of sale is broken, no doubt, the aggrieved party can treat the contract as repudiated and reject the goods. But he has also an alternative option. That is, he can treat the breach of condition as a breach of warranty and can claim only damages without rejecting the goods.

4.1.7.2 Characteristic of a Warranty

i. A warranty is a stipulation or term regarding goods forming part of the contract of sale, and is not a mere expression of opinion or statement of commendation or praise.

ii. A warranty is a stipulation or term which is not essential to the main purpose of the contract and is only collateral (minor) to the main purpose of the contract. In short it is of secondary importance.

iii. The breach of a warranty gives the aggrieved party only the right to sue for damages, and not the right to repudiate the contract. It may be noted that the measures for damages for breach of warranty is the estimated loss directly or naturally resulting in the ordinary course of events from the breach.

Table 4.1.2 Distinction between Condition and Warranty

Basis	Condition	Warranty
Relation to main purpose	Essential to the main purpose of contract	Subsidiary to the main purpose of contract
Rights of aggrieved party	Breach of condition gives the aggrieved party a right to repudiate the contract and to get damages	Breach of warranty entitles the aggrieved party to claim damages only
Breach of condition and warranty	Under certain circum-stances a breach of condition may be treated as breach of warranty at the discretion of the aggrieved party	A breach of warranty cannot become breach of a condition
Legal effect of breach	Breach of condition will affect the legality of the contract	Breach of warranty will not affect the legality of the contract

4.1.7 Express and Implied Conditions and Warranties

Conditions and warranties may either be express or implied. They are express, when they are expressly agreed upon by the parties at the time of contract of sale. They are stated in definite words as the basis of the contract. On the other hand, there are certain conditions and warranties which are not written but applied to the contract by operation of law or by trade or custom. They are called implied conditions and warranties.

Implied Conditions and Warranties:

Implied conditions are those conditions which the law incorporates into a contract of sale of goods unless the parties stipulate to the contrary (Section 14 to 17) deals with implied conditions. Unless a contrary intention is expressed in a contract, certain warranties are implied in every contract of sale. A sum up of implied conditions and warranties are given below:

Implied Conditions	Implied Warranties
◊ Conditions as to the title of goods sold (Section 14(a))	◊ Quiet possession (Section 14(b))
◊ Sale by Description (Section 15)	◊ Freedom from encumbrance (Section 14(c))
◊ Condition as to fitness or quality (Section 16(1))	◊ Implied warranty as to usage of trade (Section 16(3))
◊ Conditions as to merchantability (Section 16(2))	◊ Disclosure of dangerous nature of goods
◊ Condition as to wholesomeness	
◊ Condition as to sample (Section 17)	

Important Implied Conditions

i. **Conditions as to the title of goods sold (Section 14 (a)):** In a contract of sale there is an implied condition that the seller has got the right to sell the goods. Seller should ensure that he has a right to sell the goods. In the case of an agreement to sell, he will have the right to sell the goods at the time when the ownership in the goods is to pass from seller to buyer. For example: Arun purchased a motor car from Varun and used it for several months. After sometime Anoop, the true owner spotted the car and demanded it from Arun. The car was stolen by Varun from Anoop and Arun was forced to surrender it to Anoop. Arun was entitled to recover the full price amount even though he had used the car for several months as there is breach of implied condition as to the title of goods sold.

ii. **Sale by Description (Section 15):** "Where there is contract of sale by description there is an implied condition that the goods shall correspond with that description". If the buyer has not seen the goods sold and relies completely on seller's description, the buyer can repudiate the contract if the goods differ from description. For example: Arun wants to sell his watch. He describes to Varun, the prospective buyer that it is a new watch of a particular brand. Varun agrees to purchase it and on delivery Varun finds that it is an old unbranded watch. In this case Varun can repudiate the contract.

iii. **Condition as to fitness or quality (Section 16 (1)):** As a general rule, a buyer is supposed to satisfy himself about the quality of goods he purchases. But in some cases, there are certain exceptions to this rule. These circumstances are:

a. If the buyer expressly or by implication brings to the knowledge of the seller the purpose for which the purchase is done.

b. When the buyer relies on the seller's skill and judgement.

c. When it is the seller's duty to sell by description.

In these circumstances there is an implied condition that the goods should be reasonably fit for that purpose. For example: Arun sold a refrigerator to Varun. The refrigerator performed all other functions but failed to make ice.

iv. **Condition as to merchantability (Section 16 (2)):** This condition is implied only where the sale is by description. Goods are of merchantable quality if:

a. They are reasonably saleable under the description by which they are known in the market.

b. They are purchased for personal use; they must be reasonably fit for the purpose for which they are generally used.

For example: Anoop bought woolen cloth from a company dealing in such goods. After wearing them, Anoop contracted a skin disease due to excessive presence of chemicals. It was held that the cloth was not merchantable as they could not be worn next to skin and the company was liable to pay damages.

v. **Condition as to wholesomeness:** In the case of eatables and provisions, in addition to the condition of the merchantable quality, there is an added obligation on the part of the seller that the goods must be wholesome. Wholesomeness means promoting physical health.

For example: Arun purchased milk from Varun. The milk contained typhoid germs and Arun incurred serious health issues. Arun filed a suit for damages and the court held that Varun was liable to pay damages.

vi. **Condition as to sample (Section 17):** When we purchase a good by examining a sample and satisfying ourselves with the sample, there is implied condition that;

a. The bulk shall correspond with the sample.

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

c. The goods supplied shall be free from any defect which would not be apparent on reasonable examination of the sample.

For example: A company sold by sample certain shoes to Arun. The shoes were found to contain paper not discoverable by ordinary inspection. Arun was entitled to the refund of price plus damages.

Important Implied Warranties

i. **Quiet possession of the goods bought (Section 14 (b)):** In a contract of sale, there is an implied warranty that the buyer shall have quiet possession of the goods and shall enjoy them unless the circumstances of the contract are such as to show a different intention. In other words, where the buyer has obtained possession of the goods and the buyer is in anyway disturbed in the enjoyment of goods, the buyer has the right to sue the seller for the damages caused.

ii. **Freedom from encumbrance (Section 14 (c)):** Contract of sale have an implied warranty that the goods shall be free from any charge or encumbrance, in favour of any third party not declared or not known on the part of the buyer before or at the time when the contract was made or he has been given notice of them. For example: Anoop has pledged his goods and took them from pledgee under some pretext and sells them to Arun. While Arun is in possession, it is disturbed by the pledgees. Then Arun can invoke the provision of warranty and claim for damages.

iii. **Implied warranty as to usage of trade (Section 16 (3)):** An implied warranty as to quality or fitness for a particular purpose may be fixed by the usage of trade.

iv. **Disclosure of dangerous nature of goods:** There is another implied warranty on the part of the seller, that when the goods are dangerous and the seller is aware of its dangerous nature, he should warn the buyer about the probable danger. For example, Arun sold his dog to Sunil without disclosing the fact that the dog used to bite people. In this case Arun is liable for non-disclosure of dangerous nature of goods.

4.1.8 Doctrine of Caveat Emptor

The term '*caveat emptor*' is a Latin word which means '*let the buyer beware'* i.e., buyers purchase the goods at their own risk provided the seller is acting within the law. It is the buyer's duty to select goods of their requirement. The seller is not bound to supply the goods which shall be fit for any particular quality. This rule is known as the *'doctrine of caveat emptor'*.

Opening words of Section 16 of the Sale of Goods Act states it as *Subject to the provisions of the Act and any other law for the time being in force, there is no implied warranty or conditions as to the quality or fitness for any particular purpose of goods supplied under a contract of sale.*

Simply it is not the seller's duty to give to the buyer the goods which are suitable for a particular purpose of the buyer. The buyer must take care of his own purpose while purchasing the goods. The buyer must take care while purchasing the goods. If the buyer makes a wrong choice of the goods, he cannot blame the seller if the goods do not serve his purpose. The seller is not supposed to know the particular purpose for which the buyer is purchasing the goods.

4.1.8.1 Exceptions to the Doctrine of Caveat Emptor

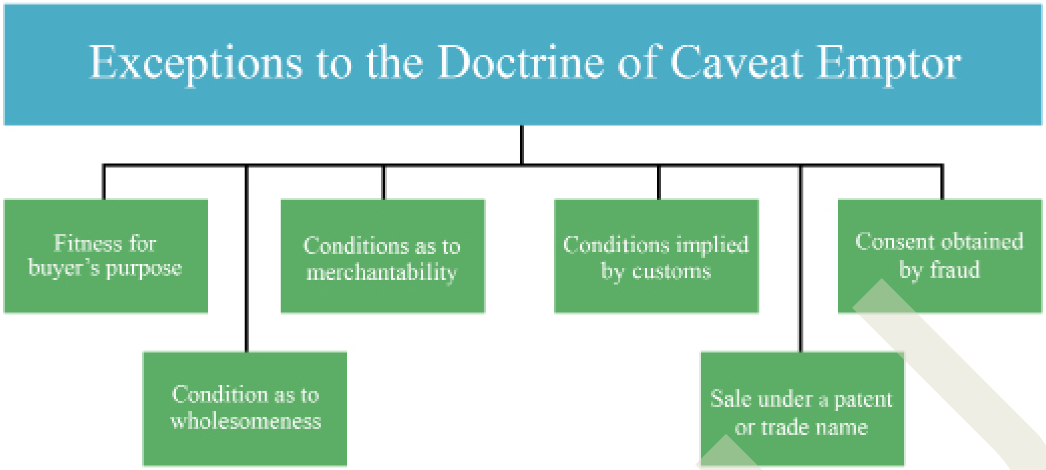

Fig 4.1.3 Exceptions to the Doctrine of Caveat Emptor

i. **Fitness for buyer's purpose:** Usually the seller cannot be made responsible if the goods don't fit for a particular purpose of the buyer. But in certain circumstance, if the buyer makes his purpose clear to the seller and buys the goods relying upon his skill and judgement, then there is an implied condition that the goods shall be fit for the buyer's specific purpose. In such case the doctrine of caveat emptor does not apply.

ii. **Conditions as to merchantability (Section 16(2):** Sometimes the goods are sold by description. In such cases, there is an implied condition that the goods shall be of merchantable quality. Thus, in case of sale by description the seller is bound to deliver the goods of merchantable quality and in such cases the doctrine of caveat emptor does not apply.

iii. **Condition as to wholesomeness:** It is a part of condition as to merchantability. This condition is applicable in cases of eatables, i.e., foodstuffs and other goods which are used for human consumption. In such cases, in addition to the principal condition as to merchantability, another implied condition is that the goods must be wholesome i.e., sound, pure and fit for consumption at the time of sale.

iv. **Conditions implied by customs:** The implied condition as to fitness and merchantability are applicable only if certain requirements are fulfilled. However, the implied condition as to the quality or fitness for a particular purpose may be attached by the custom or usage of trade. This is so because the parties enter into an agreement with reference to those known usages. A custom may provide that a particular defect will amount to unfitness and the buyer can reject the goods. But the customs must not be unreasonable and also not be inconsistent with the express terms of the contract.

v. **Sale under a patent or trade name:** In the case of contract for the sale of a specified article under its patent or other trade name, there is no implied condition that the goods shall be reasonably fit for any particular purpose.

vi. **Consent obtained by fraud:** Where the consent of the buyer, in a contract of sale, is obtained by the seller by fraud or where the seller knowingly conceals a defect which could not be discovered on a reasonable examination i.e., where there is latent defect in the goods, the doctrine of caveat emptor does not hold good.

4.1.9 Transfer of Property in Goods (Section 18(26)

The transfer of property in goods is an important stage in the performance of a contract of sale. It is important to know the precise time at which the property in goods passes from the seller to buyer. It may be noted that there is a difference between property in goods and possession of goods. '*Property in goods*' means the *'ownership of goods'* whereas *'possession of goods'* refers to *'custody or control of goods'*. Merely because some goods are delivered to a person and it is in his custody, he will not become the owner of the goods. Unless the ownership is transferred, he will not become the owner.

For example: Arun sells a washing machine to Varun on hire purchase agreement. The washing machine is delivered to Varun and he is in possession of the same. Merely because Varun has the possession of it, he will not become the owner. Only after the payment of the full amount by Varun to Arun, Varun will become the owner. Until then Arun is the owner of the washing machine.

4.1.9.1 Significance of Transfer of Property / Rules regarding Transfer of Property

Some rules are observed with regard to the transfer of property in goods as the rights and liabilities of the parties are linked with this.

i. **Risk follows ownership:** According to section 26 of the Act "A risk prima facie passes with the title". It means risk follows ownership, whether the goods are delivered or not and the price is paid or not. In a contract of sale, the goods remain at seller's risk, until the property in goods is transferred to the buyer. If the title is transferred, the goods are at buyer's risk. Thus '*risk*' and '*property*' goes together.

ii. **Only owner can sue:** When the goods are in any way damaged or destroyed by the action of third parties, it is only the owner of the goods who can take action against them.

iii. **Suit for price:** The seller can sue for the recovery of the price only if the goods have become the property of the buyer.

iv. **Insolvency of the buyer or seller:** In the event of insolvency of either the buyer or the seller, the question whether the official receiver or assignee can take over the goods or not depends on whether the property in the goods has passed from the seller to the buyer. If the ownership has passed to the buyer and buyer is declared insolvent then buyer's official receiver shall have a right to take possession of the goods even though the goods are lying with the seller. On the other hand, if the goods are in possession of the seller and he is declared as insolvent, then the buyer has a right to take possession of the goods from seller's official receiver.

4.1.9.2 Rules relating to Transfer of Property

The primary rules relating to Transfer of Property can be studied under the following heads:

a. Transfer of property in specific or ascertained goods.

b. Transfer of property in the unascertained or future goods.

c. Transfer of property in case of sale on approval.

a. Transfer of property in specific or ascertained goods (Section 20-22)

The rules relating to transfer of property in specific goods are as follows:

i. **Passing of property at the time of contract:** When there is an unconditional contract for the sale of specific goods in deliverable state, the property in the goods passes to the buyer when the contract is made. Deliverable state means such a state that the buyer would under the contract be bound to take delivery of them.

ii. **Passing of property delayed beyond the date of contract:**

   a. **Goods not in a deliverable state:** According to section (21) where there is a contract of sale of specific goods not in a deliverable state i.e., the seller has to do something to the goods to put them into a deliverable state, the property does not pass until such things (putting them into a deliverable state) is done and the buyer has notice of it.

   b. **When the price of the goods is to be ascertained by weighing, etc.:** As per section (22) if the specific goods are in a deliverable state but the seller is yet to weigh, measure, test or do some other act or thing in connection with the goods for the purpose of ascertaining the price, the ownership does not pass to the buyer until such act or thing (weigh, measure, test or do some other act) is done and buyer has the notice thereof.

b. Transfer of property in the case unascertained or future goods (Section 23):

The goods which are not identified and ascertained at the time of sale are unascertained goods. The rules regarding transfer of property of unascertained goods are as follows:

i. **Goods must be ascertained:** In the case of sale of unascertained goods property is not transferred from the seller to the buyer unless and until the goods are ascertained. There is merely an agreement to sell until goods are ascertained - Sec (18).

ii. **Unconditional appropriation of goods:** Where there is a contract for the sale of unascertained goods, the property in such goods passes to the buyer only when the goods have been unconditionally appropriated as per the requirements of the contract- Sec (23(1)). Appropriation means the process by which the goods are selected or separated with the common or mutual consent of the seller and buyer so as to determine and identify the actual goods to be delivered. Thus, completion of this process leads to ascertainment of goods.

c. **Transfer of property in case of sale on approval (Section 24):**

When, goods are delivered to the buyer on approval or on 'sale or return' or other similar terms, the property there in passes to the buyer:

i. **When the buyer signifies approval:** When buyer signifies his approval or acceptance to the seller, the property passes to the buyer at that time. It may be by way of sending message of acceptance.

ii. **When the buyer retains the goods:** When he does any act, which results in the adoption of the transaction, the ownership in goods passes to buyer. For example, Y takes delivery of jewellery from X on sale or return basis. After that Y sells or pledges the same to C. Thus, Y's act of selling or pledging the jewelry to Z shows that Y has purchased the goods from X and the ownership has been passed from X to Y.

iii. **When the buyer fails to return the goods:** If a time is fixed for approval or return of goods, and if the buyer fails to return the goods within that time, the property in goods passes to the buyer on expiration of such a time.

iv. **When the buyer makes the return of goods impossible:** When the buyer makes the return of goods impossible by his act or default, the property in the goods passes when he does the act or makes the default. For example, Arun gifts some goods to his niece which he bought from Sunil on sale or return basis. Here, the return of goods to Sunil becomes impossible and hence the property in goods is transferred to Arun.

4.1.9.3 Transfer of Title by Non- Owners (Section 27-30)

The general rule of law as to transfer of title is that only the owner of goods can transfer a valid title. The rule is expressed by the Latin maxim "*Nemo dat quod non habet*",which means that "*no one can give what he has not got*". For example, A found a ring from the road and sold the same to B. C, the true owner of the ring demands his ring and it was held that the true owner can recover the ring from B.

The buyer cannot acquire a better title than what the seller had. According to Section 27 of the Sale of Goods Act 1930, a buyer cannot get a good title to the goods unless he has purchased the same from the owner. If he purchases goods from non- owner, his title will remain defective irrespective of the fact that the buyer has purchased the same bonafide for value. For example, if goods are purchased from a thief,the buyer gets no title because the thief is not the owner.

4.1.9.4 Exceptions to the rule that only an owner can sell

i. **Sale under title by estoppels:** Section 27 provides that by his conduct the owner of the goods may be precluded from denying the seller's authority to sell. For example, Varun who had unlawfully acquired the goods of Arun, sells them to Anoop in the presence of Arun. Here if Arun remains silent then he will be prevented from denying Varun's authority to sell the said goods.

ii. **Sale by a mercantile agent:**(Section 27) Even though a mercantile agent is not the owner of the goods,he can sell the goods and the buyer who purchases the same from mercantile agent, gets a good title if the following conditions are satisfied.

    a. The agent must be in possession of the goods or a document to title of goods.
    b. Such possession is with the consent of the owner
    c. The agent sells the goods in the ordinary course of the business.
    d. The buyer acts in good faith and has no notice that the agent has no authority to sell.

iii. **Sale by co-owner (Section 28):** If a property, either movable or immovable belongs to one or more persons, they are called '*co-owners*'. If a person purchased the goods from one of the co-owners who is in sole possession of goods with the permission of other co- owners, the person or buyer will get a valid title over the goods.

iv. **Sale of goods obtained under a voidable agreement (Section 29):** When the seller of the goods has obtained possession thereof under a voidable agreement, but the agreement has not been rescinded at the time of sale, the buyer obtains a good title to the goods provided he buys them in good faith and without notice of seller's defect of the title.

v. **Resale by seller in possession after sale (Section 30(1)):** Where a seller having already sold the goods and is in possession of goods, resells the same in good faith and for value and without notice of previous sale, the new buyer gets good title. For example, Arun buys a painting from a shop and leaves it there. The shopkeeper sells it to Varun who has no knowledge of the previous sale. Varun will get the good title of the painting. Arun can only claim for damages from the shopkeeper.

vi. **Sale by buyer in possession over which the seller has some rights (Section 30(2)):** When goods are sold subject to some lien or right of seller the buyer may sell goods to a third party and give him good title. For example, Arun purchases a laptop on hire purchase in which the ownership will pass to him only after the payment of last instalment. Arun sells the same to Varun before the payment of last instalment. Varun will obtain good title over the laptop provided he has purchased the laptop in good faith and without the notice of the hire purchase agreement.

vii. **Sale by an unpaid seller (Section 54(3)):** Where an unpaid seller who had exercised his rights of lien or stoppage in transit resells the goods, the buyer acquires the good title over the goods as against the original buyer.

viii. **Sale under provisions of other Acts:** There are other laws providing that the seller,even though is not the owner, might have the right to give a better title to the goods. This is expressed by the use of words "subject to the provisions of any other law for the time being in force. Sale by a pawnee or pledgee under certain circumstances (Section 176 of the Indian Contract Act). For example, A pawnee or pledgee has the right to sell the goods pledged with them if the pawnor or pledger makes default of the payment of loan. In such a case, the buyer will get a better right even though the seller i.e., the pawnee or pledgee is not the real owner of the goods.

Recap

◊ Contract of sale of goods - contract whereby the seller transfers or agrees to transfer the property in goods to a buyer for a price.

◊ Goods - subject matter of Contract of Sales.

◊ Existing goods - goods owned and possessed by the seller at the time of making the contract of sale.

◊ Specific goods - identified and agreed upon at the time of making the contract of the sale.

◊ Ascertained goods - identified after the contract of sale as per the terms decided.

◊ Unascertained goods - not separately identified or ascertained at the time of making a contract of sale

◊ Future goods - goods not yet in existence or do not yet belong to the seller when the contract of sale is made

◊ Document of Title to Goods - the proof of ownership of goods.

◊ Condition - a stipulation essential to the main purpose of the contract.

◊ Warranty - a stipulation which is only collateral or incidental to the main purpose of the contract.

◊ Express Conditions and warranties - when conditions and warranties expressly agreed upon by the parties at the time of contract of sale.

◊ Implied Conditions - conditions which the law incorporates.

◊ Implied warranties - which are implied in every contract of sale.

◊ Property in goods - ownership of goods.

◊ Possession of goods - custody or control of goods.

Objective Questions

1. Who are the two parties involved in a Contract of Sale?
2. What type of goods does the Sale of Goods Act deal with?
3. What is the name given to the goods identified at the time of a contract of sale?
4. What are the exceptions to goods according to the Sale of Goods Act 1930?
5. Who gives a delivery order?
6. What is a stipulation essential to the main purpose of a contract called?
7. What is a stipulation collateral to the purpose of a contract called?
8. Which term embodies the concept of 'let the buyer beware'?
9. What is the term Property in good known for?
10. What is the term Possession of goods known for?

Answers

1. Seller & Buyer
2. Movable
3. Specific goods

4. Actionable claims and money
5. Owner
6. Condition
7. Warranty
8. Caveat Emptor
9. Ownership of goods
10. Custody or control of goods

Self-Assessment Questions

1. What does the term "contract of sale" entail, and what are its essentials?
2. Explain the various types of goods.
3. Can you provide examples of documents that serve as Title to Goods?
4. How do you differentiate between conditions and warranties?
5. What exceptions exist to the principle of caveat emptor?
6. What rules govern the Transfer of Property?
7. Discuss the significance of possession of goods in a contract of sale, providing examples to illustrate its importance.

Assignments

1. Discuss the distinctions between "specific goods" and "unascertained goods" under the Sale of Goods Act.
2. Analyze a case study involving a breach of warranty in a contract for the sale of goods and outline the potential legal remedies available to the affected party.

3. Compare and contrast the significance of implied conditions and implied warranties in a contract of sale.

4. Explore the legal implications of the doctrine of caveat emptor in modern consumer transactions, citing relevant cases or scenarios.

5. Examine a real-world case where the terms of a contract of sale were disputed, and analyze the legal implications and outcomes of the case.

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Unit 2

Unpaid Seller

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ familiarise with the concept of 'Contract of Guarantee'
- ◊ identify the parties involved in the contract of guarantee
- ◊ analyse the kinds of guarantee
- ◊ gain an understanding on the rights of a surety

Prerequisite

Sunny, a wholesaler, sold a consignment of textiles to a retailer, John, for ₹500,000. The agreement was that John would pay the amount within 30 days. But John did not pay the amount even after 60 days.

Sunny sent several reminders to John, but he did not receive any response. Sunny then decided to take action under the Sale of Goods Act. Sunny's lawyer explained to him that as an unpaid seller, he had certain rights under the Sale of Goods Act. The Act provides that an unpaid seller may: Withhold delivery of goods until the payment is made. Sell the goods to another buyer if the original buyer does not pay. Sue the buyer for the unpaid amount. Sunny's lawyer told him that since John had not paid, Sunny could resell the goods to another buyer. Sunny could also sue John for the unpaid amount. Sunny decided to resell the goods and recover his losses. He sold the textiles to another retailer for ₹520,000. Sunny learned a lesson about the importance of ensuring payment before delivering the goods. He also understood his rights as an unpaid seller under the Sale of Goods Act.

Keywords

Unpaid seller, Buyer's right, Auction sale

Discussion

4.2.1 Unpaid Seller

The Indian Contract Act offers various rights and remedies to both buyers and sellers when a breach of contract occurs. Among these remedies is the right of the unpaid seller, which becomes applicable if the buyer neglects to fulfill the payment obligations for the goods.

According to **Section 45(1)** of the Sale of Goods Act, an unpaid seller or vendor means a seller:

a. Who has not been paid or tendered the whole of the price of goods sold or

b. A seller who had received a Bill of Exchange or any other negotiable instrument like cheque as conditional payment but which is subsequently dishonored.

Thus, an unpaid seller is a seller who has not been paid the whole of the price or the one who has received any negotiable instruments which is subsequently dishonored.

Example: Arun sold goods worth ₹5000 to Varun on credit. Here Arun is deemed to be an unpaid seller:

a. If the whole of the purchase price ₹5000 is not paid on the due date or

b. If payment is made in the form of a negotiable instrument and the instrument is dishonored on the due date.

4.2.1.1 Rights of an Unpaid Seller

Under the Sale of Goods Act, the unpaid seller has two forms of rights:

A. Right against the goods sold

B. Right against the buyer personally

A. Right of Unpaid Seller against goods sold (Section 46(1))

The unpaid seller has right against the goods sold whether the property in the goods has passed to the buyer or not.

a. When the ownership in the goods is transferred to the buyer, the unpaid seller has the following rights:

   i. Right of lien

   ii. Right of stoppage of goods in transit

   iii. Right of re-sale

i. **Right of lien (Section 47-49):** *'Lien'* means a right to retain the possession of goods until payment of the price. In the case of unpaid seller's lien, the seller is entitled to retain the goods of the buyer until the whole price is paid even though the ownership is passed from the seller to the buyer. A lien may be of two kinds:

◊ **General lien:** A general lien is a right to retain any goods, belonging to another, which are in the possession of the person who wants to exercise his lien.

◊ **Particular lien:** Particular lien is available only against those particular goods in respect of which the price remains unpaid. The right of an unpaid seller to retain thegoods in his possession till the whole price is paid, is a particular lien.

The right of lien can be exercised only subject to the following conditions:

◊ Ownership must have been passed to the buyer

◊ The goods must be in possession of the seller

◊ In the case of credit sale, the term of credit must have expired

◊ The price or part of price must remain unpaid

◊ The lien is only for non-payment of price of goods, and not for any other expense

◊ There must not be contrary intention expressed in the contract, i.e., If the contract expressly excludes the right to lien, lien cannot be exercised.

ii. **Right of stoppage of goods in transit (Section 50-52):** Right of stoppage of goods in transit is an extension of the right of lien. It means stopping the goods while they are on the way to buyer's place to regain possession of goods till the price is paid or tendered. The right of stoppage in transit can be exercised only when the goods are in transit i.e., in the intermediate stage where they have left the seller's possession but have not yet reached the buyer.

According to Section 50 of the Sale of goods Act, 1930 if the seller is unpaid and the property in goods has passed to the buyer, then the right of stoppage of goods in transit can be exercised in the following cases:

◊ The seller must have parted with the possession of goods, i.e., the goods must not be in the possession of seller.

◊ The buyer has become insolvent

◊ The goods are in transit

Duration of Transit: Goods are deemed to be in transit from the time they are delivered to a carrier or other bailee for transmission to the buyer until the buyer or his agent takes delivery thereof. (Section 51)\

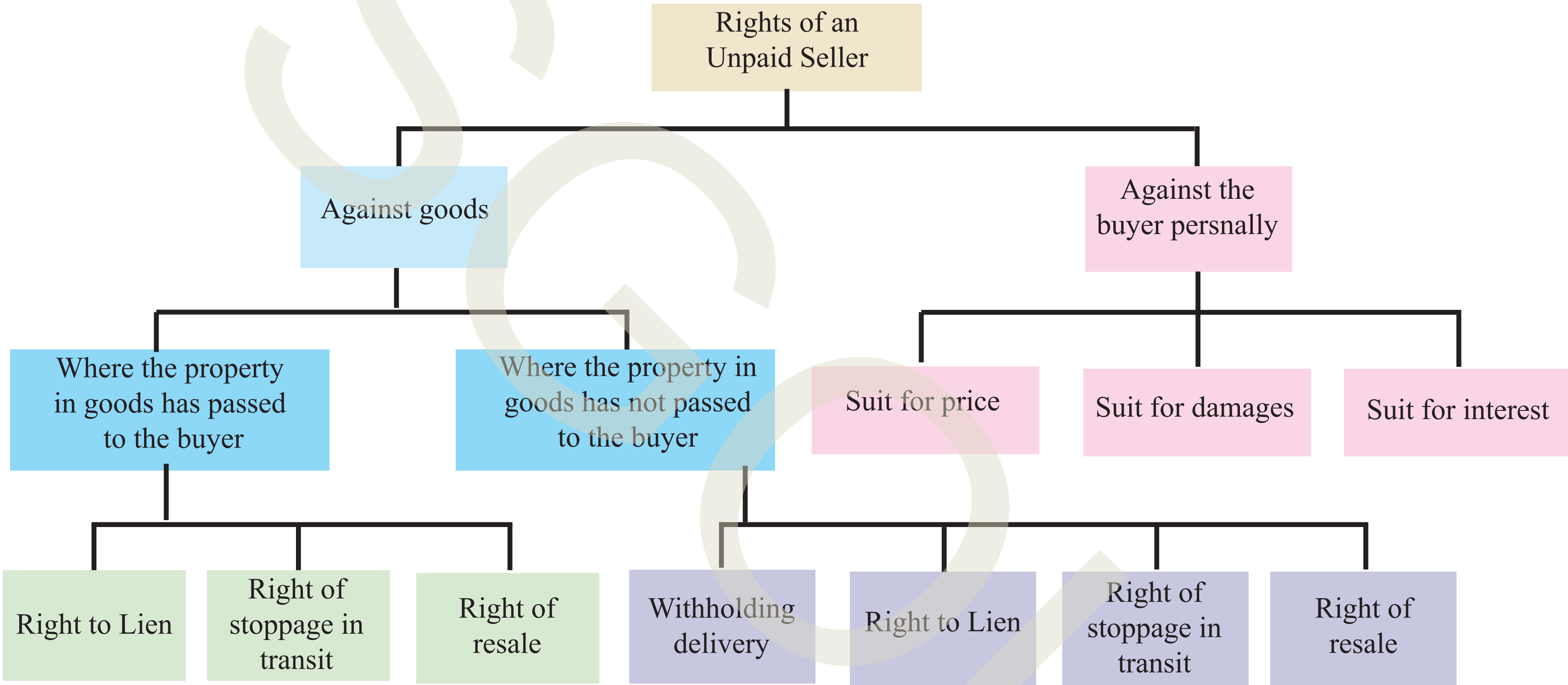

Fig 4.2.1 Rights of an Unpaid Seller

Table 4.2.1 Difference between right to lien and right to stoppage of goods in transit

Basis of distinction	Rights of Lien	Rights of Stoppage in transit
Possession of goods	The goods must be in actual possession of the seller.	The goods must be in the possession of a carrier or other bailee who is acting as an independent person.
Solvency	The right can be exercised even when the buyer is solvent but refuses to pay the price.	This right can be exercised only when the buyer has become insolvent.
End vs. Commencement on delivery to carrier	This right comes to an end when the seller delivers the goods to a carrier.	This right commences only when the seller delivers the goods to a carrier.

iii. Right of re-sale (Section 54): The unpaid seller who retained the possession of goods in exercise of the right of lien or who has regained possession from the carrier can resell the goods under following conditions:

- ◊ When the goods are of perishable nature, the unpaid seller may resell the goods without any notice to the buyer.
- ◊ In other cases, after giving notice to the buyer, calling upon him to pay or tender the price within reasonable time and upon the failure of the buyer to do so.
- ◊ Where the seller expressly reserves a right of re-sale in case the buyer makes default.

On resale, if there is any deficiency in the amount due from the original buyer and the amount actually realised, the seller is entitled to claim the deficiency from the original buyer. If he receives more than what is due to him, he can retain the excess amount.

For example, Arun sold a radio to Varun for ₹2000. Since Varun fails to pay the price, Arun resells the radio to Anoop at ₹1500. In this case Arun can claim the deficiency of ₹500 from Varun. On the other hand, if an amount of ₹2500 was realised on resale of radio, the excess amount of ₹500 can be retained by Arun.

b. When the ownership in the goods has not passed from the seller to the buyer:

Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit where the property has passed to the buyer [Section 46(2)].

B. Rights of Unpaid Seller against Buyers Personally:

The unpaid seller can exercise the following rights against the buyer personally. It is also called rights in personam.

iii. **Suit for price (Section 55):** "Where under a contract of sale the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of the goods". Generally, seller cannot sue for the price unless property has passed. But if it was agreed by the buyer to pay the price on a certain fixed day, irrespective of the delivery, the seller may sue for the price even though the property has not passed. If credit has been given, the seller cannot sue during the period for which the credit is given even though property has passed. Here the point to notice is that the seller should prove that the buyer wrongfully neglected and refused to pay the price. Then only the seller can sue him for the price.

iv. **Suit for damages (Section 56):** Where there is no default of the seller and the buyer wrongfully refuses to make payment and take delivery of goods within reasonable time, the seller may sue him for damages for non-acceptance. The seller is entitled to:

  a. Recover any loss caused by buyer's refusal or neglect to take delivery and

  b. Recover reasonable charge for the care and custody of the goods.

iii. **Suit for repudiation (Section 60):** Where the buyer repudiates the contract before the due date of delivery, the seller may treat the contract as subsisting and wait till the due date,or may treat the contract as rescinded and sue for damages for the breach of the contract. This rule is called 'rule of anticipatory breach of contract'.

iv. **Suit for interest (Section 61):** Where there is specific agreement between the buyer and seller regarding the interest on the price of goods, the seller may claim it from the date when payment becomes due. In the absence of any such agreement, the seller may recover interest from such date as the seller may notify to the buyer. In the absence of a contract to the contrary, the court may award interest as such rate as it thinks fit.

4.2.1.2 Rights of Buyer

The following rights are available to the buyers:

1. Suit for Damages for Non-delivery [Sec. 57]	Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.
2. Suit for Specific Performance [Sec. 58]	In any suit for breach of contract to deliver specific or ascertained goods, the court may direct that the contract shall be performed specifically.
3. Suit for Breach of Warranty [Sec. 59]	Where there is a breach of warranty by the seller, or where the buyer elects or is compelled to treat any breach of a condition on the part of the seller as a breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods, but he may- (i) set up against the seller the breach of warranty in diminution or extinction of the price; or (ii) sue the seller for damages for breach of warranty. ***Note:*** The fact that a buyer has set up a breach of warranty in diminution or extinction of the price does not prevent him from suing for the same breach of warranty if he suffered further damage. [Section 59(2)] Example X sold a second-hand Radio to Y who spent 100 on the repair of this radio. This radio was seized by the police as it was a stolen one. Y filed a suit against X for recovery of damages for breach of warranty of quite possession including the cost of repairs. It was held that Y was entitled to recover the same. [Mason v. Burmingham)
4. Right to Treat the Contract as Rescinded or Operative in Case of Repudiation of Contract by Seller before due Date [Sec. 60]	Where seller repudiates the contract before the date of delivery, the buyer may either treat the contract as subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach
5. Suit for Interest [Sec. 61(2)]	In case of breach of the contract on the part of the seller, the buyer may sue the seller for interest from the date on which the payment was made.

4.2.2 Auction Sales (Section 64)

A sale by auction is a public sale where different intending buyers try to outbid each other. It is a manner of selling property by bids usually to the highest bidder by public competition. The auction is made public by advertising and being open to public. The offer of the price is known as ‘bid’ and the person making the bid is known as ‘bidder’. The ‘auctioneer’ who conducts the auction is an agent to the seller. On the sale by auction, a contract is formed between the auctioneer and the buyer.

KSFE chitty is a good example for auction sales where the total of the periodic subscription, called the chitty amount, will be given out as “prize money” to the person who bids by allowing for the maximum reduction in the prize money.

4.2.2.1 Rules regarding sale by auction

Section 64 of the Sale of Goods Act lays down the following rules in the case of sale byauction:

Separate contract	Where goods are put up for sale in lots, each lot is prima facie deemed to be the subject of a separate contract of sale (Section 64(1)].
Completion of Sale	A sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner. For example, by saying one, two and three, or by shouting going, going, gone, etc. (Section 64(2)]
Right to withdraw bid	Until the announcement of completion of sale is made, any bidder may withdraw his bid [Section 64(2)].
Seller’s Right to bid	A right to bid may be reserved expressly by or on behalf of the seller and, where such right is expressly so reserved, the seller or anyone person on his behalf may bid at the auction [Section 64(3)].
Fraudulent Sale	Where a sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person, and any sale contravening the rule may be treated as fraudulent by the buyer [Section 64(4)].
Reserve Price	A sale may be notified to be subject to a reserved or upset price (Section 64(5)]. The term 'reserved' or 'upset' price may be defined as the minimum price below which the auctioneer will not sell the goods put up for auction sale.
Voidable Sale	If a seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer (Section 64(6)].

Recap

- ◊ Unpaid seller -seller who has not been paid the whole of the price.
- ◊ Lien - right to retain possession of goods until payment of the price.
- ◊ General lien -right to retain any goods, belonging to another.
- ◊ Particular lien - available only against those particular goods in respect of which the price remains unpaid.
- ◊ Right of stoppage of goods in transit - regaining possession of goods till the price is paid or tendered.
- ◊ Auction sale - public sale where different intending buyers try to outbid each other.

Objective Questions

1. What is the right of an unpaid seller to retain goods in their possession called?
2. What is the right of an unpaid seller to stop goods while they are in transit?
3. What is the term for the unpaid seller's right to re-sell goods if the buyer fails to pay?
4. What is the buyer's remedy if goods are not delivered?
5. What right allows the buyer to claim the exact goods specified in the contract?

Answers

1. Lien
2. Stoppage in transit
3. Right of resale
4. Damages
5. Specific performance

Self-Assessment Questions

1. Who is an unpaid seller? What are the rights of an unpaid seller?
2. Write a note on transfer of title by non-owners.
3. What do you mean by auction sale?
4. What are the rules regarding sale by auction?
5. Differentiate between general lien and particular lien.
6. What do you mean by stoppage of goods in transit?
7. Briefly explain the rights of buyer.

Assignments

1. Analyze the legal rights and remedies available to an unpaid seller when a buyer defaults on payment for goods.
2. Explore the concept of stoppage of goods in transit in detail, its conditions, and its significance in protecting the rights of an unpaid seller.
3. Investigate the concept of lien in the context of an unpaid seller. Discuss general lien, particular lien, and their application.
4. Explain the process and legal implications of an unpaid seller regaining possession of goods in the event of default by the buyer
5. Assess the rise of online auction platforms, their impact on traditional auction sales, and the legal challenges or opportunities they present.
6. Investigate how auction sales comply with consumer protection laws and examine instances where consumer rights might be at risk.
7. Examine the responsibilities, legal obligations, and ethical considerations for auctioneers within the context of auction sales.

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BLOCK

05

Companies Act 2013

Unit 1

Introduction to Companies – An Overview

Learning Outcomes

After completing this unit, the learner will be able to:

◊ know about company and its characteristics

◊ identify different types of companies

◊ familiarize themselves with the promotion and formation of companies

Prerequisite

Every society comprises of various groups, including individuals, households, organizations, and the Government. Each group in society has its our distinct nature and structure. Therefore, it becomes necessary to establish a code of behavior suitable for each group to enable harmonious coexistence and functioning. Laws have been universally recognized as the most appropriate tool for regulating the behaviour of various institutions in society. In India, we have the Indian Constitution, Civil Laws, Criminal Laws, etc., governing the social life of Indian citizens. Similarly, all entities in society, including business organizations, must follow specific code of behavior.

Since an organization is a collective of individuals working toward a common goal, the code of behaviour meant for individuals is inadequate to govern these groups. As a result, India has enacted various laws, to request business activities such as the Indian Contract Act, the Factories Act, the Minimum Wages Act, the Indian Partnership Act, the Indian Companies Act.

August 8, 2013, stands as a historic day in the Indian corporate scenario because it marked the legislative approval of the new Companies Act 2013, replacing the age-old Companies Act of 1956. The Act comprises 470 sections across 29 chapters with seven schedules, regulating the entire spectrum of company activities and functions in India. It encompasses legal provisions and procedures regarding company formation, management, administration, governance, restructuring, capital mobilization, the rights, duties, and obligations of various stakeholders, company meetings, corporate social responsibility, liquidation, and winding up. The law offers a comprehensive framework governing a corporate entity from its inception, promotion all the way through to its winding up. In this unit, we will also focus on understanding different types of companies and their characteristics.

Keywords

Company, Promotion, Memorandum of Association, Articles of Association, Incorporation, Types of companies

Discussion

5.1.1 Company

Names like Reliance Group, Tata Group, Adani Group, Lulu Group, etc., have become very familiar in our present-day lives. Why and how have these names become well-known, even among school children? What captures increasing attention toward these names? It's because they represent the biggest business groups in our country, engaging in various business activities worldwide.

How do these business groups grow and establish their own business empires? This is achieved by forming and registering themselves as corporate entities with legal existence and the capacity to act akin to individuals. For example, Reliance Industries Private Ltd. is a company registered in India, headquartered in Mumbai, and led by Mr. Mukesh D. Ambani. It offers a wide array of products spanning chemicals, petroleum, textiles, digital services, and more.

Under the Indian Companies Act, a company is a corporate entity registered in India. Upon registration, it becomes an artificial person, established and governed by the provisions of the Companies Act. The primary purpose of forming a company is to conduct business on a larger scale with the collective aim of achieving specific business objectives.

Artificial person

Artificial means something which is not naturally created. A company is artificial because it is created by human being by complying with the provisions of a law or statute. Even though it is not a natural person, the law gives all the rights and privileges similar to a natural person to such artificial entities. Therefore, they are treated as artificial persons. A company can file a complaint against any individual or any individual can take legal proceedings against a company. Similarly, a company can purchase or sell property (land, building, machinery etc.) in its own name like a normal person can do.

Definition

Section 2(20) of the Companies Act, 2013 defines a company to mean a company incorporated under this Act or under any previous company law. This definition does not bring out the meaning and nature of the company into a clear perspective. In order to understand meaning of a company, let us see the definitions as given by different authorities. Some these definitions are: -

Lord Lindley has described the company as an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business: and who share the profit and loss (as the case may be) arising therefrom. The common stock so contributed is denoted in money and is "the capital" of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his “share". The member may sell his share in the company, thus withdrawing himself and making someone else a member to whom he transfers shares, The shares in a company are transferable. As a natural consequence of transferability of shares the company has what is commonly known as perpetual succession. With the withdrawal or death of a member of a company, the latter does not come to an end. The life of the company is independent of the lives of the members of the company. Members may come and members may go, the company continues until it is dissolved.

Section 9 of the Companies Act, 2013 gives the effect of registration of a company under the Companies Act by identifying the features it acquires as a consequence thereof. The Section provides that-

From the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, 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.

5.1.1.1 Characteristics of a Company

The registration of an entity as a company will add certain features to such entity.

Such distinctive characteristics of a company are discussed below:

i. **Independent corporate existence:** A company has separate legal existence apart from its members which means that the company and its members are two distinct persons. A company is considered to be an independent person like an individual having all legal rights and duties.

ii. **Limited liability:** The liability of the members of a company is limited. This otherwise means that the members are not personally liable for the liabilities of the company. The liability of the members is limited to the extent of the face value of shares held by them.

iii. **Perpetual succession:** The term perpetual succession indicates long term existence.If a company is formed with 3 members A, B and C and subsequently they transfer their shares to X, Y and Z, it will result only in a change in the members of the company and not the existence of the company. The company will continue to carry on with its business with X, Y and Z as members.

iv. **Separate property:** As a company is a legal person, it can buy, own, manage and dispose of property in its own name.

v. **Common seal:** Similar to the signature of an individual, every company is functioning under a common seal. The common seal with the name and registered office address of the company is used as the authentication for all the documents and contracts which the company enters with.

vi. **Capacity to sue and be sued:** A company can file a suit against third parties for enforcing its rights. Similarly, the third parties can file a suit against a company for breach of any legal dues binding on the company.

vii. **Transferability of shares:** The shares of a company are transferable. In the case of public company, the shares are freely transferable. In the case of private company, the shares are transferable with the consent of the company.

viii. **Professional management:** The corporate sector attracts young, talented and competent management graduates to join companies. This facilitates fresh blood in the company and thereby innovation, technology and new work methods can be adopted in the company easily.

ix. **Incorporated association:** A company must be incorporated or registered under the Companies Act. Minimum number required for this purpose is seven in the case of a 'public company' and two in the case of a 'private company'. However, Section 3 of the Companies Act, 2013 allows formation of "One Person Company' also.

5.1.1.2 Classification of companies

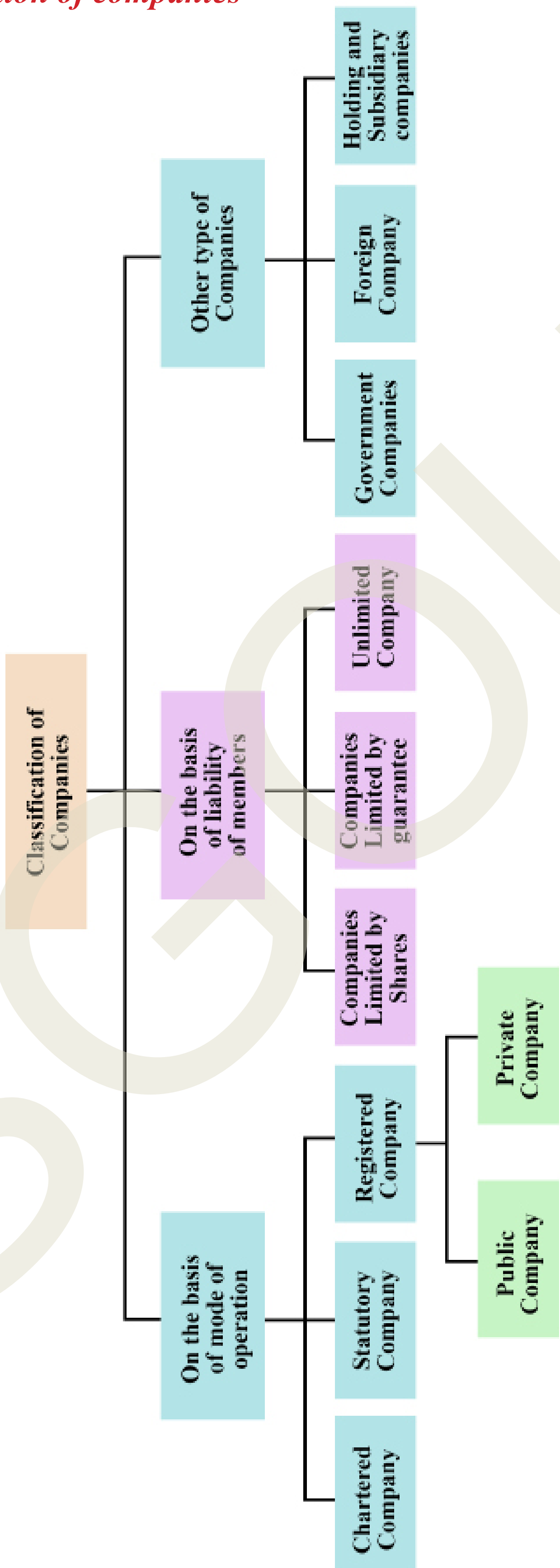

Fig 5.1.1 Classification of Companies

A. Classification of company on the basis of mode of operation

x. Chartered Company

A chartered company is a type of corporation that's granted a royal charter or formal document by a government or monarch, giving it certain rights, privileges, and responsibilities. These companies were prevalent during the colonial era and were often granted monopolistic powers over trade in specific regions or industries. East India Company is a chartered company formed in the early 1600s by the Royal Charter issued by Queen Elizabeth. This is the first company in pre-independent India. The Royal Charter contained the objectives, the constitution and the power that can be exercised to govern the affairs of the company. The Bank of England is also established as Per Royal Charter which is another example for chartered companies.

xi. Statutory company

Statutory companies are entities that are established by a specific statute or law passed by the government. These companies are created with the powers and obligations outlined in the statute that brings them into existence. They operate under the provisions and regulations set forth by the legislation that established them. Eg; LIC, GIC, FCI etc.

xii. Registered Company

These are the companies registered under the Companies Act 2013. The Companies Act 1956 has been in force for many decades. However, the new corporate environment in the background of liberalisation and globalisation necessitated a revamping of the Act and thus legislated a new Companies Act in 2013. The powers and activities of the companies are regulated by their own Memorandum and Articles of Association subject to the provision of the Companies Act 2013. Registered companies are further classified in to:

a. Public companies
b. Private companies

a. Public company:

Public companies, as defined by this legislation, are created to offer shares to the public and are traded on stock exchanges, necessitating adherence to higher capital requirements. They do not face restrictions on the number of shareholders and allow for the free transferability of shares. Names such as Reliance Industries Ltd, Adani Enterprises, Associated Cement Company Ltd, Tata Consultancy Services Ltd, and Microsoft are familiar to us, as they represent prominent examples of Public Ltd. Companies. These entities are termed public companies because members of the public are also among their shareholders

According to Companies Act 2013:

Public company means a company which—

◊ is not a private company;

◊ has a minimum paid-up share capital as may be prescribed.

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.

Features of public company

◊ ***Minimum Shareholders:*** A public company must have a minimum of seven shareholders to be incorporated.

◊ ***Minimum Directors:*** It needs at least three directors. At least one of these directors must be an Indian resident.

◊ ***Issue of Prospectus:*** A public company is required to issue a prospectus or file a statement in lieu of a prospectus before it can start business or allot shares.

◊ ***Transferability of Shares:*** Shares of a public company are freely transferable, and there are no restrictions on their transfer.

◊ ***Name:*** The name of the company must end with "Limited" or "Ltd" to denote its status.

◊ ***Meetings and Reporting:*** A public company must hold statutory meetings, such as an Annual General Meeting (AGM) and Extraordinary General Meetings (EGMs). It also needs to adhere to extensive reporting requirements, including filing annual financial statements and other disclosures with the Registrar of Companies.

◊ ***Listing and Trading:*** Public companies can apply to list their shares on stock exchanges for trading, allowing the public to buy and sell their shares in the secondary market.

◊ ***Statutory Compliance:*** There are more stringent regulatory requirements and compliance measures for public companies compared to private companies, including transparency, corporate governance, and accountability.

b. Private company:

Private limited companies (Ltd), under the Companies Act, cannot offer shares to the public and usually have a limited number of shareholders, restricting share transfers without the consent of other shareholders. They typically have lower minimum capital requirements and face fewer regulatory burdens compared to PLCs. Their name usually ends with "Private Limited Company" or "Ltd" and they are structured to operate within a more private framework, allowing for more control over ownership and shareholding within a closed group.

Features of private company

- ◊ Minimum number of members required to form a private company is 2 persons.
- ◊ Maximum number of members is limited to 200.
- ◊ The private company cannot invite the public by using a prospectus to subscribe its shares and debentures.
- ◊ Private company should add the word "Private Limited" or "Pvt. Ltd" or "(P). Ltd. to its name.
- ◊ A private company restrict free transferability of shares.

B. Classification of company on the basis of liability of members

i. Companies Limited by shares: Mr. Anil is a member of ABC Ltd. He owns 500 shares valued at ₹100 each, amounting to a total capital contribution of ₹50,000. As the company is limited by shares, Anil's liability within the company is restricted to a maximum of ₹50,000 (500 shares × ₹100), which was the amount he committed to contribute upon purchasing the shares. If he has already paid ₹40,000 to the company before its winding up, he remains liable to pay the remaining ₹10,000 (₹50,000 - ₹40,000) to fulfill his commitment. Anil's liability is constrained by the face value of the shares he holds in the company. Such companies are recognized as companies limited by shares. However, the term 'limited liability' doesn't imply a limit on the company's liability towards third parties; they can make claims against the company for outstanding dues. Nevertheless, shareholders' liability is restricted in the case of a Limited Liability Company

ii. Companies Limited by guarantee: Mr. Anil, a member of XYZ Co. Ltd, has agreed to pay ₹1,00,000 in addition to any amount due on account of share capital (though some cases might not have share capital) in the event of the company's winding up. This commitment serves as a guarantee offered by Anil to the company, and his liability remains restricted to this specific guaranteed amount. Should the company wind up, Anil is obliged to pay ₹1,00,000. In companies limited by guarantee, each member pledges a predetermined amount to the company upon its winding up.

These companies fall into two categories:

- ◊ ***Company limited by guarantee with a share capital:*** These companies maintain a share capital in addition to the guaranteed amount. The guaranteed sum is treated as Reserve Capital, to be called upon during winding up.

◊ ***Company limited by guarantee without share capital:*** These companies operate without a share capital, acquiring funds for operations from members through entrance fees, membership fees, etc. Upon winding up, each member is obligated to contribute the guaranteed amount to the company.

iii. **Unlimited Companies:** An unlimited company is a company not having any limit on the liability of its members. The members of such a company are liable, in the event of its being wound up, to the full extent of their personal assets to meet the obligations of the company. However, the members are not liable to the company's creditors. The company, being a separate legal entity from the persons who constitute it, is liable to its creditors. If the creditors cannot obtain payment from the company, they may petition the Court for the winding up of the company. The liquidator will then call upon the members to contribute to the assets of the company without limitation of their liability for the payment of the debts of the company.

C. Other types of companies

i. Government Companies

A Company in which either the Central Government or any State Government or jointly by the Central Government and one or more State Governments hold 51% of shares or more is known as Government company. A government company, according to the Companies Act, refers to a company where the majority of the share capital is held by the government or where the government has control by appointing the majority of the directors. These companies are established or incorporated under the Companies Act and operate in various sectors, including industries, infrastructure, services, and more. They function with a mix of governmental and corporate objectives, aiming to serve public interests while also working with commercial motives. Example, Bharat Electronics, Bharat Heavy Electricals Limited, etc.

ii. Foreign Companies

We are all familiar with companies like Amazon and Flipkart, major online e-commerce websites operating in India. Among them, Amazon stands out as a foreign-born company, incorporated in Washington and operating worldwide. Flipkart, on the other hand, is an Indian company with its headquarters in Bangalore, engaging in similar activities.

Similarly, Google and Apple are also foreign-born companies, both registered in California but offering their products and services globally. These companies are registered outside India but operate within the country. Such companies are referred to as foreign companies, entities registered outside India yet conducting business within its borders.

Foreign companies, by definition, are those registered outside India but with a presence and business operations within the country

iii. Holding and Subsidiary Companies

Have you ever noticed that Jio Platforms is always associated with the Reliance Group? This is because Jio Platforms is a subsidiary of Reliance Industries Ltd. Reliance Industries offers a wide variety of goods and services globally, providing digital services through its subsidiary, Jio. A significant portion of Jio's capital is contributed by Reliance Industries. Therefore, Reliance is termed the holding company, and Jio is its subsidiary.

Holding companies and subsidiaries are groups of companies wherein one company has control over another. A company holding a major share in another company is referred to as the holding company, while the other company, whose major shares are held by the holding company, is termed the subsidiary.

5.1.2 Promotion and formation of company

Have you heard of the story of iD Fresh Food? It's a story of five cousins from Kerala bonded by a strong determination and the shared thought of "Think Big, Think Different." P C Mustafa, the CEO and co-founders of iD Fresh Food, created a non-fancy "idli" business with ₹50,000 initial capital in the Bangalore city. They faced many challenges in initially making the business viable. However, today, it has become a booming business that operates all over India, UAE, and the US. Two major investors brought investment for the company, and it has now turned into a ₹1000 crore brand valued business in India. This is just one example of how every business starts with identifying an expected opportunity and taking all risks to make it successful. A company is built as such by going through different stages, starting with identifying a good business proposal.

This section deals with various stages of company formation. There are mainly 4 stages in the formation of company. They are:

i. Promotion

ii. Incorporation

iii. Raising of capital

iv. Commencement of business

i. Promotion of company

Promotion is the first step in the formation of a company. It involves identifying a potentially profitable business idea and conducting a detailed investigation to assess its feasibility. This stage also includes activities like market research, financial analysis, and business plan development.

A business emerges from the pursuit of an idea, a commercial venture designed to generate income. The individual who spearheads these activities and drives the company's formation is known as the promoter.

Functions/ Duties of promoters

a. ***Identification of a business idea:*** A good business idea is the fundamental requirement for initiating a business entity. The success of such an entity depends upon the feasibility of the business idea and its implementation. When deciding on the nature of the business, the promoter must have a clear vision of its future prospects.

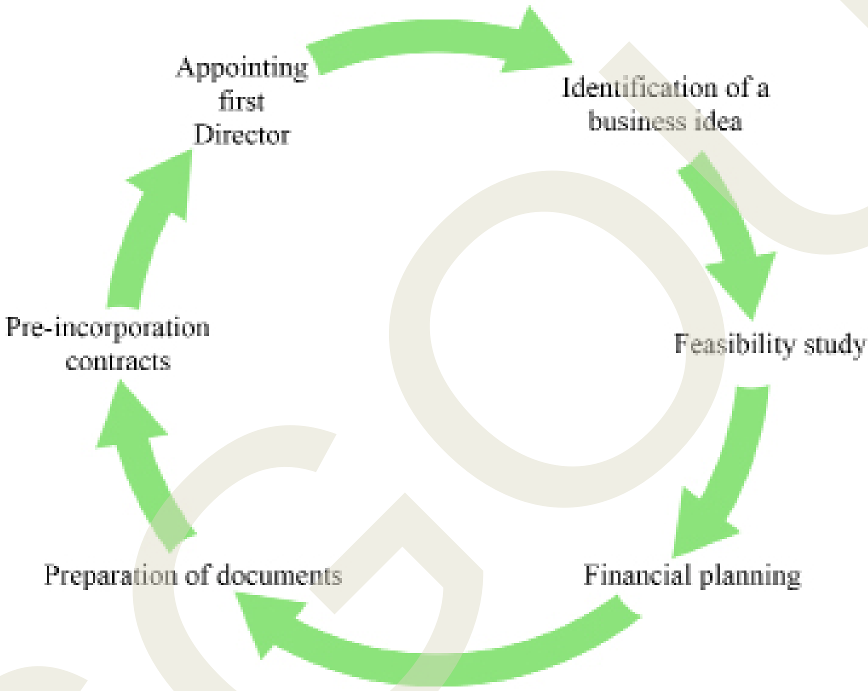

Fig 5.1.2 Functions/Duties of promoters

b. ***Feasibility study:*** Once the business idea is identified, the promoter investigates whether the proposal is viable. At this stage, the promoter assesses the feasibility of implementing the conceived business idea, considering aspects such as the availability of capital, profitability, marketability, and more.

c. ***Financial planning:*** Commencing any business necessitates finance. Identifying the fund requirements to materialize the proposed business idea is a primary function of promoters.

d. ***Preparation of documents:*** The Memorandum of Association and Articles of Association serve as the foundational documents of a company. These documents are essential for registering a company under the Companies Act 2013. It is the duty of the promoter to prepare these documents in accordance with the specifications provided in the Act.

e. ***Pre-incorporation contracts:*** Promoters, acting on behalf of the company, engage in various contracts before the company's registration. These contracts include agreements with legal consultants for drafting and printing the memorandum and articles, purchasing machinery and other properties, acquiring infrastructure facilities, and more.

f. ***Appointment of first Directors:*** The promoters appoint the initial directors of the company. These first directors are responsible for the initial proceedings of the business post its incorporation (registration).

Legal position of promoters

Promoters have a major role in the formation of a company. In the eyes of law, they have a distinct position in the company. Promoters are not agents of the company because an agent cannot be appointed by a non-existing entity. Likewise, a promoter cannot be the trustee of the company on the same grounds.

The promoter takes a fiduciary role in the proposed business. It is a relationship of trust and confidence. Promoter acts honestly in the formation of the company. They have to disclose all the material facts about the proposed company to the board and the shareholders.

ii. Incorporation of company

Incorporation simply means registration. A company comes in to existence after its incorporation. The central government has appointed the office of Registrar for the purpose of company registration.

Procedure of Registration:

For the purpose of registration, a company has to file an application in the prescribed format along with the required registration fee to the Registrar of companies, where the registered office of the company is to be situated. The application form must be accompanied by the following documents:

◊ Memorandum of Association

◊ Article of association

◊ Any contract which the company proposes to enter into

◊ The list of directors

◊ A statutory declaration stating the compliances with the companies Act 2013.

When the requisite documents are presented, the Registrar will scrutinize the application. If the Registrar is satisfied with all the documents, they will enter the name of the company in the Register of Companies. Subsequently, a certificate of incorporation (as per section 7) will be issued by the Registrar, certifying the company's incorporation under the Companies Act 2013. The Registrar shall allot a Corporate Identity Number to each company on or after the date of incorporation.

Upon incorporation, the subscribers of the memorandum become members of the company. The company becomes a body corporate bearing the name specified in the memorandum, capable of exercising all functions of an incorporated company.

iii. Raising of capital

After incorporation, the company has to raise capital for the business. The first directors (generally promoters) make decisions about the amount of capital to be raised. They also appoint a finance officer to look after the capital mobilization. Usually, companies raise capital by way of issuing shares. A private company can raise capital by privately from to friends, family members, etc. In contrast, a public company can issue a prospectus to raise capital from the public by offering shanes on other recruities.

iv. Commencement of business (Sec. 11)

A company can commence its business only after a declaration is made to the Registrar stating that the subscribers to the memorandum have paid the value of shares held by them and the company has fulfilled the condition of minimum subscription. Companies shall make a declaration with regard to its registered office. If the company does not file the declaration within 180 days, the Registrar has the power to remove the name of the company from the Register of companies.

Recap

◊ Company - artificial person created by law.

◊ Chartered company - company formed under royal charter

◊ Statutory companies - created by special statute of central or state Government.

◊ Registered Companies -registered under the Companies Act 2013.

◊ Public company- public hold a portion of shares

- ◊ Private company - private parties own shares
- ◊ Company Limited by shares- liability of members is limited to the capital
- ◊ Company limited by guarantee - the liability of members is limited to the amount of guarantee
- ◊ Unlimited company -the liability of the member is unlimited.
- ◊ Government Company - government owns 51% or more shares
- ◊ Foreign companies -registered outside India.
- ◊ Holding company- company holding major shares in another company

Objective Questions

1. What is used as the signature of the company?
2. Which company is formed by statute of parliament?
3. How many members are required to form a public company?
4. Which company's shares are freely transferable?
5. What is the maximum number of members a private company can have?
6. Who holds more than 51% of a government company?
7. Which company holds more than 50% of the paid-up capital of another company?
8. Which company is registered outside India and operating within India?

Answers

1. Common seal
2. Statutory company

3. Minimum 7 members
4. Public company
5. Maximum of 200 members
6. Central or State Government
7. Holding company
8. Foreign company

Self-Assessment Questions

1. Differentiate between a public company and a private company.
2. What is a public company?
3. How can a company be registered?
4. What are the duties of promoters?
5. What are the types of companies?
6. Compare and contrast the legal requirements for forming a public company versus a private company in your country.
7. Discuss the advantages and disadvantages of a company having freely transferable shares.
8. Analyze the significance of the statute of parliament in the formation and regulation of specific types of companies.

Assignments

1. Explain the concept of an "artificial person" in company law and its implications on liability and legal standing.

2. Evaluate the role and responsibilities of shareholders in a company, considering their rights and obligations.
3. Investigate and discuss the process and criteria for a company to be registered outside India but operate within the country.
4. Critically examine the minimum and maximum member requirements for private companies and their impact on governance and decision-making.
5. Explore the differences in the signature requirements for various legal documents within a company and their legal implications.
6. Assess the significance of majority shareholding (more than 51%) in a government company and its influence on decision-making and control.
7. Research and explain the concept of one company holding more than 50% of the paid-up capital of another company, elucidating the implications and potential effects on both entities.

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Unit 2
Introduction to Companies Act

Learning Outcomes

After completing this unit, the learner will be able to:

- ◊ Explore the Companies Act, 2013.
- ◊ Identify the major highlights of Companies Act, 2013
- ◊ Gain awareness on the key highlights of Companies (Amendment) Act, 2019
- ◊ Familiarise themselves with the history and framework of company law in India

Prerequisite

Imagine a group of friends passionate about technology and want to start a software company. They have big dreams, but they are unsure about how to turn their ideas into a structured business.

At first, they discuss various aspects: what they want to achieve, how they'll operate, and the roles each person will play. However, as their ambitions grow, they realize they need a solid plan and clear guidelines to ensure everyone is on the same page.

They start drafting their vision, ...down the company's purpose, the services they'll offer, and the boundaries within which they will function. This becomes their Memorandum of Association—a document that .... company's objectives and limits. It's like sketching the company's ultimate goals and the directions they are allowed to explore.

As they delve deeper, they realize they need more than just broad ideas; they need detailed rules for decision-making, roles, and responsibilities. This is where the Articles of Association come in. They meticulously outline how they'll manage conflicts, who can make decisions, and how meetings will run. It's like a .... book defining the company's inner workings and ensuring smooth operations.

In this unit we are going to discuss the Memorandum of Association, Articles of Association, prospectus, CIN, major highlights of Companies Act 2013 and Companies (Amendment) Act, 2019.

Keywords

Memorandum of Association, Articles of Association, prospectus, Companies Act 2013, Companies (Amendment) Act, 2019

Discussion

5.2.1 History and Framework of Company Law in India

In 1850, the first Company enactment for registering joint-stock companies was introduced in India, based on the English Companies Act of 1844. In 1857, the concept of limited liability was recognized, but it wasn't extended to banking companies until 1858.

In 1866, another Companies Act was passed to consolidate and amend the laws concerning the incorporation, regulation, and winding up of trading companies and other associations. This Act drew upon England's Companies Act of 1862. It was revised in 1882 and remained in effect until 1913.

In 1913, another Indian Companies Act was enacted, based on the English Companies Consolidation Act of 1908. The Companies Act of 1913 underwent amendments in 1914, 1915, 1920, 1926, 1930, and 1932. This act governed Indian business companies until 1956.

5.2.2 Post independent Company Law in India

The period of the Second World War and the post-war years witnessed a decline in industrial and commercial activity in India. Immediately after the war ended, the Government of India initiated the revision of the Company Law. Two professionals were appointed by the government to review and overhaul the Companies Act of 1913.

On October 28th, 1950, the Government of India formed a committee comprising twelve members representing various interests, chaired by Shri H. C. Bhabha. This committee, famously known as the Bhabha Committee, aimed to revise the Companies Act to bolster India's trade and industry. The Committee submitted its report in March 1952, proposing comprehensive changes to the Companies Act of 1913. The report incorporated suggestions from Chambers of Commerce, trade associations, professional bodies, leading industrialists, shareholders, and representatives of labour.

The final draft of the Companies Act, 1956, was presented in Parliament on September 2, 1953. The new Companies Act (I of 1956) came into effect on April 1, 1956.

5.2.3 New Legislature for a New Society

The era of liberalization, privatization, and globalization necessitated a transformation in the Companies legislation, which was originally made for a closed market environment. Consequently, the old legislature proved inadequate to manage global entry. To adapt to these changes, the Companies Act of 1956 underwent numerous amendments. Eventually, the new Companies Act came into existence in August 2013.

The Companies Act of 2013 replaced its predecessor, the Companies Act of 1956. The key features of Companies Act of 2013 includes:

◊ Companies Act 2013 came into force on 30 August 2013

◊ It contains 470 sections and 7 schedules and 23 Chapters

◊ This Act extended to the whole India.

◊ Corporate social responsibility has been made applicable for all companies registered under this Act

◊ The legislators introduced ideas of the likes of: One Person Company (OPC), Small Company, Dormant Company and Inactive Company.

◊ Financial statement of a company comprises of

  - Balance sheet as at the end of the financial year.
  - Profit and loss account / income and expenditure account.
  - Cash flow statement.
  - A statement of 'changes in equity' (if applicable).
  - Explanatory notes annexed to balance sheet, profit and loss account, cash flow statement and statement of changes in equity.

◊ It made compulsory for every company or body corporate to have financial year ended on 31 March. And to align financial year of an existing companies to 31st march.

◊ Introduced the concept of Key managerial person as

  - The CEO or Managing Director or Manager
  - Whole-time Director
  - Chief Financial Officer
  - Company Secretary

- ◊ Replaced company law board by National Company Law Tribunal (NCLT)
- ◊ It includes provisions for the appointment of women director, resident director and independent directors.
- ◊ It made compulsory internal audit of books of account of the company.

5.2.4 Major Highlights of the Companies Act, 2013

The Companies Act of 2013 introduced significant changes to the regulations in India. Here are some of the major highlights:

a. Governance:

Board Diversity:

- ◊ One woman director: Mandatory for listed companies and companies with a paid up capital of ₹100 crore or more, or a turnover of ₹300 crores or more. Encourages gender diversity and broader perspectives.
- ◊ Independent directors: Minimum of one-third of the board must be independent for listed companies and public companies with a paid-up share capital of INR 10 crore or more, turnover of ₹100 crore or more or if total of outstanding loans, debentures, and deposits is in excess of ₹50 crores. Promotes objective decision-making and protects minority shareholder interests.

Director Accountability:

- ◊ Increased Penalties: Stringent penalties for insider trading, fraudulent accounts, and other misconducts. Promotes responsible behaviour and deters wrongdoing.
- ◊ Disqualifications: Directors can be disqualified for specific offenses like financial mismanagement or failing to comply with statutory obligations. Ensures responsible leadership and protects stakeholders.

Corporate Social Responsibility (CSR):

- ◊ Mandatory for companies exceeding INR 5 crore net profit or INR 1,000 crore turnover or networth of more than ₹500 crores: Promotes social responsibility and sustainable development.
- ◊ 2% CSR spending: Companies must spend 2% of their average net profit made during immediately preceeding 3 financial years on CSR activities in areas like education, poverty alleviation, environmental protection, and others. Ensures tangible social impact.

b. Transparency and Disclosure:

Enhanced Disclosure Norms:

- ◊ Financial statements: More detailed disclosure requirements for financial statements, including segmental reporting and related party transactions. Provides investors with comprehensive financial information.

◊ Corporate governance report: Mandatory report disclosing board composition, remuneration, internal controls, and other corporate governance practices. Enhances transparency and accountability.

◊ Insider trading: Stringent reporting requirements for insider transactions to prevent market manipulation.

Electronic Filing:

Most documents, including returns, financial statements, and board resolutions, must be filed electronically with the Ministry of Corporate Affairs (MCA). Improves efficiency and transparency in administrative processes.

Class Action Suits:

Shareholders can file collective lawsuits against companies for specific violations like misleading prospectus or mismanagement. Empowers shareholders and protects their interests.

c. Incorporation and Regulation:

One-Person Company (OPC):

Individuals can now form a company with themselves as the sole shareholder. Simplifies business formation for entrepreneurs and startups.

Small Company Concept:

Companies with paid-up capital equal to or below ₹4 crore or such a higher amount specified not exceeding more than ₹10 crores and turnover equal to or below ₹40 crores or such a higher amount specified not exceeding more than ₹100 crores. Enjoy simplified compliance procedures and reduced regulatory burden.

Dormant Company:

Inactive companies can declare themselves dormant, reducing compliance obligations and annual filing fees. Streamlines operations for non-functioning companies.

Streamlined Mergers and Acquisitions:

Simplified procedures for mergers and acquisitions, including fast-track mergers and cross-border mergers. Facilitates business restructuring and consolidation.

National Company Law Tribunal (NCLT):

Dedicated tribunal for adjudicating company law matters, streamlining dispute resolution and reducing judicial backlog.

d. Additional Highlights:

Whistleblower Protection:

Companies must establish mechanisms for receiving and investigating whistleblower complaints in confidence. Protects individuals who report corporate wrongdoing.

Enhanced Shareholder Rights:

Improved voting rights, easier postal ballots, and simplified procedures for meetings and resolutions. Empowers shareholders and increases their participation in company decision-making.

Focus on Corporate Governance:

The Act emphasizes the importance of robust corporate governance practices through strong regulatory framework, stakeholder engagement, and ethical conduct. This aims to ensure responsible business conduct, protect investor interests, and promote sustainable growth.

5.2.5 Applicability of the Companies Act, 2013

The provisions of the Act shall apply to-

- ◊ Companies incorporated under this Act or under any previous company law.
- ◊ Insurance companies (except where the provisions of the said Act are inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999)
- ◊ Banking companies (except where the provisions of the said Act are inconsistent with the provisions of the Banking Regulation Act, 1949)
- ◊ Companies engaged in the generation or supply of electricity (except where the provisions of the above Act are inconsistent with the provisions of the Electricity Act, 2003)
- ◊ Any other company governed by any special Act for the time being in force.
- ◊ Such body corporate which are incorporated by any Act for time being in force, and as the Central Government may by notification specify in this behalf.

5.2.6 Types of companies (New amendments)

i. Associate company (sec.2 (6)):

An example scenario: ABC Ltd. holds 2000 shares of XYZ Ltd. out of a total of 10,000 shares issued by XYZ Ltd. In this case, XYZ Ltd. can be considered the associate company of ABC Ltd. When a company holds at least 20% of another company's shares, those companies are referred to as Associate Companies. According to section 2 (6) of the Companies Act, "Associate Company in relation to another company means a company in which that other company has a significant influence." Significant influence indicates a minimum 20% control (share capital) of another company.

ii. Listed company (sec.2 (52)):

A listed company refers to a company whose shares are listed on any of the stock exchanges in India. Listing involves the registration of securities in the stock market. The stock market serves as a platform for the sale and purchase of securities. In India, the primary stock exchanges are the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). Only listed companies can trade shares in the stock exchange and thereby raise funds from the public.

iii. Dormant company (sec. 455):

A dormant company is registered under the Companies Act but does not engage in "significant accounting transactions." Significant accounting transactions involve monetary transactions. It might be established for future projects or to hold assets or intellectual property (such as patents or copyrights) but has no significant accounting transactions. Such companies can register as dormant.

iv. Defunct company:

Air India Cargo, once a subsidiary of Air India Ltd, ceased operations as a subsidiary in 2002 and became a defunct company. A defunct company refers to a company that is no longer active or engaged in business. When a business closes due to insufficient profits, it falls under the category of a defunct company. Additionally, if a company files for bankruptcy (insolvency), it is also considered a defunct company.

v. One Person Company (OPC):

A one-person company refers to a company where a single person holds all the shares. Akhan Dairy (OPC) Private Limited is an unlisted private company incorporated on August 28, 2017.

vi. Producer Company:

A producer company describes a group of people involved in the production of primary produce such as milk, vegetables, fruits, etc.

5.2.7 Key Highlights of the Companies (Amendment) Act, 2019

The Companies (Amendment) Ordinance, 2018, issued on November 2, 2018 brought about significant changes to certain provisions of the Companies Act, 2013. The 2018 Ordinance was passed by Lok Sabha but could not be taken up by the Rajya Sabha and was to expire on January 21, 2019. In order to give continuity to the amendments introduced by the 2018 Ordinance, it was re-promulgated on January 12, 2019 by another Ordinance i.e, the Companies (Amendment) Ordinance, 2019 with its provisions effective from 2 November, 2018. Again, since the Companies (Amendment) Ordinance, 2019 was to cease to operate on 13 March 2019, to give effect to the Ordinance 2018 and 2019, the Companies (Amendment) Bill, 2019 was introduced and passed in Lok Sabha on 26 July and in Rajya Sabha on 31 July. The Companies (Amendment) Act, 2019 received the assent of the President on 1 August and was also notified. Most of the provisions of the Companies (Amendment) Act, 2019 shall be deemed to have come into effect from 2 November, 2018.

Following is the summary of the key-changes introduced by the Companies (Amendment) Act, 2019:

i. **Section 2- Definition of "financial year"**

The authority to make application for adopting a different year as "financial year" has been shifted from "Tribunal" to "Central Government".

ii. **Section 10A- Insertion of a new section- Commencement of Business, etc.**

Section 10A of the Act, restricts a company which is incorporated after the Commencement of the Amendment and having a share capital, from commencing any business or exercise any borrowing powers unless a declaration is filed by director of such company with the Registrar of Companies (the "RoC").

Such declaration has to be filed with the RoC within 180 days from the incorporation of the company, stating that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him on the date of filing such declaration and such company shall have filed a verification of its registered office in accordance with Section 12(2) of the Act. Further, any default in complying with the requirements of this provision shall make the company liable to a penalty of ₹50,000 and every officer in default (the "OID") shall be liable to a penalty of ₹1,000 for each day during which such default continues, subject to a maximum amount of ₹1,00,000.

iii. **Section 12- Registered office of company**

The amendment to Section 12 of the Act empowers the RoC to cause physical verification of the registered office of company, where the RoC has reasonable cause to believe that the company is not carrying on any business or operations in contravention of Section 10A of the Act, and is now empowered to initiate action for the removal of the name of such defaulting company from the register of companies.

iv. **Section 14- Alteration of Articles**

Authority to approve application for conversion of a public company to private has been shifted from Tribunal to Central Government.

v. **Section 53- Prohibition on issue of shares at discount**

Where a company contravenes a provision of Section 53, sub-section (3), as amended, lays down that the company and every officer-in-default shall pay a penalty which may extend to an amount raised through issue of shares at discount or ₹500000, whichever is less. Further, the company shall be liable to refund the amount with interest at the rate of 12% p.a. from the date of issue of shares to the respective persons to whom the shares were issued.

vi. **Section 64- Notice to be given to Registrar for alteration of share capital**

When a company changes its share capital, increases its authorised capital by government order, or redeems redeemable shares, it must inform the RoC.

Existing law provided for fine on the company and officer-in-default whereas the (Amendment) Act lays down for penalty on the Company and every officer-in-default with ₹1000 for each day during default or ₹500000, whichever is less.

vii. Section 77- Duty to register charges, etc.

Charges created after commencement of Ordinance- RoC to register charges within 60 days of such creation.

In case the charge is not registered within this time, then RoC may on application, allow the registration of the charge within a period of further 60 days on payment of ad-valorem fees.

viii. Section 164 - Disqualifications of Director

In sub-section (1) a new sub-clause (i) has been inserted.

If a director does not comply with the number of directorships i.e. maximum ten public companies and maximum twenty in other companies, he/she shall be disqualified under section 164 of the Act.

ix. Section 165- Number of Directorships

A person appointed as a director will perform all the duties and functions of a director as per the provisions of the Companies Act, 2013 ("Act"). A person is appointed as a director for the Board of a company. The Board or Board of Directors of a company means the collective body of directors of a company. The company operates through the Board of Directors. The Board of Directors is responsible for the management of the company. They make decisions regarding company affairs.

The Act lays down the provisions regarding the appointment, rights and duties of the directors. Any person appointed as a director of a company has the freedom to be a director in another company. However, Section 165 of the Act states the provisions relating to the number of directorships a person can hold at a given time.

Section 165(1) of the Act states that a person can hold the office of director simultaneously in 20 companies. The number of 20 companies includes the office of alternate directorship. A person cannot be a director in more than 20 companies at a given time. However, the maximum number of public companies in which a person can be a director simultaneously is 10. An individual cannot be appointed as a director in more than 10 public companies at a given time.

Section 165(2) of the Act provides a reduction in the number of directorships held by a person. A company can specify any number less than 20 in which the directors of their company can act as directors in other companies. The members of a company can specify a smaller number of the office of directorship for its directors by passing a special resolution.

Section 165(6) of the Act provides a penalty for a person who holds the office of a director in contravention of this Act. If a person accepts an appointment as a director in more than 20 companies, then he will be liable to a penalty of ₹2,000 for each day during which the violation continues subject to a maximum of ₹2 lakh. This penalty provision was included in the Act from 21.12.2020 to prevent persons from holding the office of directors in more than 20 companies.

Amendment Act 2020 to 2023

i. Producer companies

1. Removal of redundant Provisions:

Amendment removed certain provisions from co. Act, that applied to producer companies, and added a new chapter with similar provisions on producer companies

2. Change to offences

- The amendment removed penalities for certain offences , Such as failure to file annual return or financial statements.
- Imprisonment was removed for certain offences, Such as buy back of shares without complying with the act.
- Fines were reduced for certain offences, Such as failure to file annual returns.

3. Direct listening in foreign Jurisdictions

The amendment empowers the central Government to allow certain public companies to list classes of Securities in foreign jurisdictions.

4. CSR – Corporate Social Responsibility

- Companies with a CSR liability of ₹ 50lakh per year are are exempt from settings up CSR committees
- Companies can set off excess CSR spending in subsequent financial years.

5. Renumeration to Non- executive Directors

The amendment extends the provisions for payment of remuneration to non-executive directors , including independent directors.

6. Other Amendment

- The amendment empowers the central government to exempt any class of person from complying with requirements for beneficial shareholding.
- The amendment establishes benches of the National company Law Appellate Tribunal.

7. ***Introduction of the concept of "beneficial Owner'***

   The definition of "beneficial Owner was introduced to clarify the requirements for disclosure of beneficial Ownership

8. ***Amendment to the provisions related to auditors***

   The bill proposed to make amendments to the provisions related to auditors , including their appointment tenure and liability

9. ***Amendments to incorporation Rules***

   The Co-Incorporation Third amendment Rule 2023, were notified, making changes to the incorporation process

10. ***Changes to prospectus &Allotment of Securities***

    Affecting the rules for the prospectus and allotment of securities

11. ***Updates to Accounting Roles:***

    Make changes to the accounting & reporting requirments

12. ***MOI Amendments***

    Amendments to a company's Memorandum of incorporation will take effect on business from receipt of the amendments by the Companies and Intellectual Property commission (CIPC), unless endorsed or rejected by CIPC earlier

13. ***Social & ethics committee***

    The members of this committee of a Public , or state Owned co. must now be elected by shareholders at the Annual General Meeting.

6.2.8 Documents of a Company

When embarking on the journey of establishing a company, certain foundational documents play an indispensable role in defining its essence, structure, and future endeavors. At the forefront of these pivotal documents stand the Memorandum of Association (MOA) and the Articles of Association (AOA), serving as the bedrock upon which the company's identity and operational framework are constructed. In addition to these fundamental documents, the prospectus plays a crucial role, especially in public offerings. This legal document serves as a gateway, presenting the company's financial health, operational performance, future strategies, and growth prospects to potential investors. It acts as a transparent window, inviting external stakeholders to participate in the company's journey while complying with regulatory requirements, thereby influencing investment decisions and fostering trust among prospective shareholders.

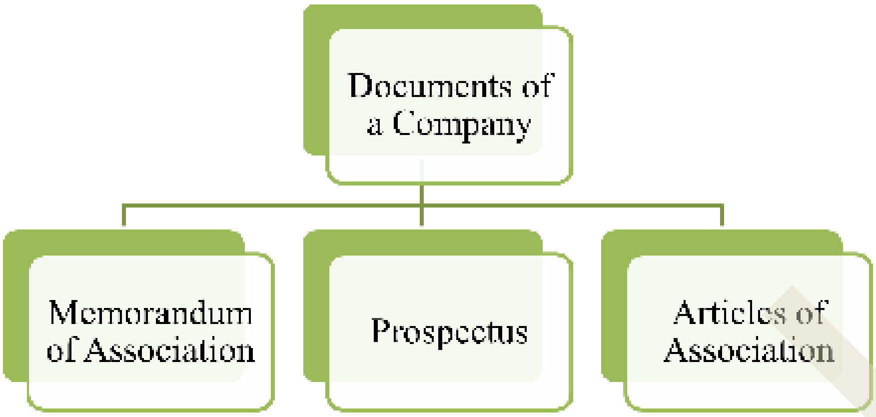

Fig 5.2.1 Documents of a Company

5.2.8.1 Memorandum of Association:

Memorandum is the fundamental document that specifies the powers and rights of a company concerning outsiders, encompassing all stakeholders or society as a whole. It is also known as the charter of the company. Section 2 (56) of the Companies Act defines a memorandum to mean the memorandum of association of a company as originally framed or altered from time to time in pursuance of any previous company law of this Act.

Importance Memorandum of Association

x. **Fundamental document:** The Memorandum of Association, often referred to as the company's charter, defines the powers and rights vested within the company. It serves as the governing framework dictating all interactions of the company with the outside world.

xi. **Defining the relationship with outsiders:** The Memorandum delineates the company's relationship with external entities by elucidating its objectives and the extent of its functions.

xii. **Safeguarding shareholders' interests:** It safeguards shareholders' interests by detailing the prudent utilization of the share capital collected from them for the company's objectives.

xiii. **Public accessibility:** The Memorandum is a public document accessible to third parties, allowing them to verify its authenticity. It offers a means for those engaging with the company to ensure security in their dealings.

xiv. **Alteration governed by Companies Act:** Alterations to the Memorandum of Association are strictly regulated by the provisions outlined in the Companies Act. Any amendments can only be made under specific circumstances and with the consent of shareholders.

Content of Memorandum of Association

i. **Name Clause (Sec. 4(1a)):** This clause, being the foremost in the Memorandum of Association, specifies the proposed company's name. The chosen name symbolizes the company's legal existence. However, certain provisions govern the selection:

◊ The company's name must not be objectionable to the Government of India.

◊ It should not closely resemble the name of an existing company.

◊ For public companies, the name must include 'limited' at the end; for private companies, 'private limited' must be used.

◊ The company's name must be visibly displayed at its business premises.

ii. **Registered Office Clause: (Sec. 4(1b)):** The second clause details the location of the company's registered office. This specific address must be submitted to the Registrar of Companies within 30 days of incorporation. All subsequent communications will be directed to this registered address, also termed as the Domicile Clause.

iii. **Objects Clause (Sec. 4(1c)):** This clause outlines the company's intended objectives, empowering shareholders to define its purpose. However, these objectives must align with legal provisions and the Companies Act. Key purposes of this clause:

◊ Safeguarding shareholders' funds by specifying their application.

◊ Emphasizing the scope of the company's activities in the public interest.

iv. **Liability Clause (Sec. 4(1d)):** This clause addresses the members' liability nature. A company can be registered in India in two ways:

◊ If registered as a limited liability company, this clause confirms that members' liability is restricted to their share value.

◊ If registered as a company limited by guarantee, members' liability is constrained by the guaranteed amount.

v. **Capital Clause (Sec. 4(1e)):** This clause specifies the company's authorized capital, representing the maximum capital that shareholders can raise by issuing shares.

vi. **Association Clause (Sec. 4(1e, f)):** This clause signifies the subscribers' agreement to form the company and willingness to undertake the shares allocated to them as stated in the Memorandum of Association.

Alteration of Memorandum of Association

i. **Alteration of Name Clause:** A company can change its name post-incorporation in several ways:

◊ Converting the name from private to public or vice versa.

◊ Changing the company's name, e.g., from ABC Limited to XYZ Limited.

Altering the Name clause involves amending the Memorandum of Association under Section 13 of the Companies Act, 2013. This amendment process, applicable to all companies except the Capital clause, requires a special resolution.

ii. **Alteration of Registered Office Clause:** Changing the registered office location involves several scenarios:

◊ For relocation within a city, village, or town, a special resolution and Registrar notification within 30 days are required.

◊ Shifting between towns or villages necessitates a special resolution.

◊ Moving from one state to another mandates a special resolution, confirmation from the National Company Law Tribunal, and registration with the respective Registrar offices.

iii. **Alteration of Objects Clause:** The Objects clause can be altered through a special resolution for various reasons, including business efficiency, expansion, or amalgamation. Permission from the National Company Law Tribunal is necessary to ensure public interest is preserved.

iv. **Change in Liability Clause:** Limited companies cannot alter their liability clause to become unlimited. However, a public company can modify its liability when converting to a private company.

v. **Change in Capital Clause:** Altering the capital clause requires passing an ordinary resolution in a general meeting. Changes may involve share subdivision, consolidation, conversion, or cancellation of unsubscribed capital. The revised Articles and Memorandum need to be submitted to the Registrar within 30 days of passing the resolution.

5.2.8.2 Articles of Association

The Articles of Association of a company represent the second important document, containing regulations governing the management of various company activities. It serves as the company's bye-laws, defining the relationships between the company and its members. The Articles of Association delineate the clear-cut relationships between each manager, the board of directors, and the members.

Contents of Articles of Association

i. ***Share Capital and Voting Rights:*** Directors control share issuance, whether at par, premium, or discount, with different classes of shares having varied voting rights specified in the Articles of Association.

ii. ***Lien on Shares:*** The company holds a lien on shares, acting as security against debts. Shares cannot be transferred until the member settles their debts to the company, especially if shares are only partly paid.

iii. ***Calls on Shares:*** The Board can make different calls to collect unpaid portions of shares, like first call, second call, and final call, detailed in the Articles of Association.

iv. ***Transfer of Shares:*** Shares can be transferred with mutual consent of both transferor and transferee. After transfer, the transferee becomes a member, while the transferor ceases to be one.

v. ***Transmission of Shares:*** Shares can be transmitted to a joint owner, nominee, or legal heir upon the death of the holder, with the new recipient assuming membership and associated benefits.

vi. ***Forfeiture of Shares:*** If a member fails to pay calls or installment amounts, the Board can issue a notice for payment within 14 days. Failure to comply may lead to the cancellation or forfeiture of shares.

vii. ***General Meetings:*** The Board conducts, adjourns, and controls meetings where decisions are made based on majority votes.

viii. ***Voting Rights:*** Members possess either equal or differential voting rights based on their shareholdings.

ix. ***Board of Directors:*** The number and selection of directors are determined in .... with the provisions of Company Act and the Articles of Association

x. ***Key Officers:*** The Board has the authority to appoint and remove the CEO, COO, and CFO through resolutions in board meetings.

xi. ***Company Seal:*** Every company has a common seal, a legal identity that the Board must safeguard.

xii. ***Dividends and Reserves:*** Dividends are declared according to Article provisions, with the Board able to distribute profits as dividends after setting aside reserves.

xiii. ***Accounts:*** The Board authorizes inspection of company account books by non-director members as permitted by law or through a general meeting.

xiv. ***Winding Up:*** The Articles of Association outline the procedures for the company's winding up.

Alteration of articles of association

The alteration of the Articles of Association is based on the following provisions:

i. The alteration must align with the provisions outlined in the memorandum of association and the Companies Act.

ii. The alteration shall not increase the liability of existing shareholders unless the company obtains their written consent.

iii. The alteration must not conflict with orders from the Central Government, court rulings, or public policy.

iv. The alteration must not adversely affect the interests of third parties or breach the trust of any stakeholders.

v. The alteration must not involve fraudulence.

vi. In cases where a public company is converted into a private company, the alteration of articles must receive approval from the Tribunal.

5.2.8.3 Prospectus

A prospectus is a legal document issued by a company offering securities (such as stocks, bonds, or mutual funds) for sale to the public. Think of it as a detailed brochure containing vital information about the company and its offering, designed to help potential investors make informed decisions before investing.

A prospectus contains the following information:

i. ***Company Information:*** This section provides an overview of the company, including its history, business operations, management team, financial performance, and future plans.

ii. ***Offering Details:*** This section describes the specific securities being offered, including the type of security (e.g., common stock, preferred stock, bonds), the price per share or unit, the total amount of money being raised, and the intended use of the proceeds.

iii. ***Risk Factors:*** This section outlines the potential risks associated with investing in the company, such as financial risks, competitive risks, legal risks, and operational risks. It's important for the company to be transparent and disclose all material risks involved.

iv. ***Financial Statements:*** This section presents the company's audited financial statements, including income statements, balance sheets, and cash flow statements. Investors use these statements to assess the company's financial health and profitability.

v. ***Management Discussion and Analysis (MD&A):*** This section provides management's perspective on the company's business and its financial performance. It discusses the factors that have impacted the company's recent results and outlines the company's expectations for the future.

vi. ***Legal and Regulatory Disclosures:*** This section includes various legal disclosures required by regulations, such as information about lawsuits, insider transactions, and executive compensation.

vii. ***Additional Components:*** Depending on the type of offering and the specific regulations, a prospectus may also include other components, such as independent expert reports, tax considerations, and subscription procedures.

Recap

- ◊ Memorandum of association – external affairs of a company
- ◊ Articles of association -internal affairs of a company
- ◊ Companies Act 2013 - legal framework for corporate governance
- ◊ Amendments to Companies Act - evolving regulations and compliance standards
- ◊ Corporate social responsibility (CSR) - ethical and social initiatives by corporates
- ◊ Board of directors - governance and decision-making body
- ◊ Annual general meetings (AGMS) - shareholders' forum for company updates
- ◊ Registrar of companies (ROC) - regulatory oversight and company registration
- ◊ Auditor's role - financial accountability and reporting
- ◊ Name clause - legal identity and company name specification
- ◊ Registered office clause - official address for communication and legal purposes
- ◊ Object clause - defines company's objectives and scope of operations
- ◊ Liability clause - outlines members' liability (limited by shares or guarantee)
- ◊ Capital clause - specifies authorized capital and division into shares

Objective Questions

1. What legal document defines the external affairs of a company?
2. Which document provides offering details for potential investors?
3. Which clause in a Memorandum of Association outlines the company's objectives?
4. Which clause specifies the official address for a company's communication and legal purposes?

5. In corporate governance, what does CSR stand for?
6. Which regulatory framework governs distressed entities' resolution in India?
7. What clause outlines the liability of members in a company?
8. Which document defines the internal affairs of a company?

Answers

1. Memorandum of Association
2. Prospectus
3. Object Clause
4. Registered Office Clause
5. Corporate Social Responsibility
6. Corporate Insolvency and Bankruptcy Code (CIBC)
7. Liability Clause
8. Articles of Association

Self-Assessment Questions

1. Explain the Companies Act, 2013.
2. Explain the key highlights of the Companies (Amendment) Act, 2019
3. Distinguish between the Memorandum of Association and the Articles of Association in a company.
4. Can you identify the key regulatory bodies governing corporate operations and securities markets in your country?
5. Are you familiar with the clauses typically found in a Memorandum of Association? Can you list and explain their significance?

6. Have you explored the legal implications and responsibilities outlined in the Articles of Association regarding the company's internal affairs?
7. Explain the concept of corporate governance and its significance in ensuring ethical business practices within companies?
8. Explain the procedures involved in amending the Memorandum of Association or Articles of Association?

Assignments

1. Conduct a comparative analysis between the Memorandum of Association and the Articles of Association, highlighting their respective roles and key differences.
2. Research and present an overview of the regulatory framework governing corporate governance and securities markets in your country.
3. Prepare a detailed report outlining the clauses typically found in a Memorandum of Association and their implications for a company's operations.
4. Analyze a case study of a company's corporate governance practices, evaluating its adherence to ethical business standards and legal compliance.
5. Choose a recent amendment to the Companies Act 2013. Analyze its objectives, implications, and practical applications within the corporate sector.
6. Compare the Companies Act 1956 with the Companies Act 2013, highlighting the key differences, improvements, and challenges addressed by the new legislation.
7. Create a comprehensive report detailing the mandatory compliances required under the Companies Act 2013 for a specific type of company (public, private, OPC, etc.).

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സർവ്വകലാശാലാഗീതം

വിദ്യയാൽ സ്വതന്ത്രരാകണം
വിശ്വപൗരരായി മാറണം
ഗ്രഹപ്രസാദമായ് വിളങ്ങണം
ഗുരുപ്രകാശമേ നയിക്കണേ

കൂരിരുട്ടിൽ നിന്നു ഞങ്ങളെ
സൂര്യവീഥിയിൽ തെളിക്കണം
സ്നേഹദീപ്തിയായ് വിളങ്ങണം
നീതിവൈജയന്തി പാറണം

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ജാതിഭേദമാകെ മാറണം
ബോധരശ്മിയിൽ തിളങ്ങുവാൻ
ജ്ഞാനകേന്ദ്രമേ ജ്വലിക്കണേ

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