Legal Aspects of Business
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Chapter I
Indian Contract Act, 1872

Aim
The aim of this chapter is to:

• introduce the Indian Contract Act, 1972
• explain the essential elements of valid contracts and proposals
• enlist different types of contracts

Objectives
The objectives of this chapter are to:

• elucidate the importance and scope of the Indian Contract Act, 1972
• explain the conditions and rules that are applicable to a contract, proposal or agreement
• explicate the essentials and types of contracts

Learning outcome
At the end of this chapter, you will be able to:

• understand the Indian Contract Act, 1972
• comprehend the various rules or conditions for a legal and valid acceptances
• discuss legal remedies in case of breach of a certain contract
1.1 Introduction to Law

With the evolution of mankind and the gradual formation of society and state, laws have also developed and became essential for the peaceful working of the society. Law is basically existent in the form of various rules, regulations or norms of conduct enforced by the State. The State, i.e., the Government regulates the conduct of its people by a certain system of rules.

Such rules of conduct, recognised by the State and enforced by it on its people are termed as laws. As defined by Salmond, a famous English jurist “Law is the body of principles recognised and applied by the State in the administration of justice.” So, the main purpose of law is to regulate the relationship between person and person, and between State and persons. Law tries to bring uniformity, definiteness, security and stability in the society.

Importance of Law

In today’s world, law is inevitable. It is necessary in day-to-day life, because, today’s state is a Welfare-State. Law has become a ‘living phenomenon.’ It is growing and developing all the time.

Sources of Law

There are various sources or types of laws such as

- Customs or traditions, which are followed for a number of years an by usage, are presumed to be laws.
- Judge-made laws, i.e., precedents. The judicial decisions of the highest courts are binding on the lower courts in similar cases.
- The uncodified laws found in the holy and sacred books of religion are as good as laws for the people belonging to the religion.
- Act is the main source of law. The entire bulk of laws referred by us is found in the form of “Acts”. For example, Indian Contract Act, Negotiable Instruments Act etc. This is a Government-made Law.
Difference between ‘Act’ and ‘Law’

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<td>‘Act’ is a specific type of law which is made either by the Central Government or by the State Government. It is therefore also called as a <strong>codified</strong> law or a <strong>statute</strong> or legislation.</td>
<td>‘Law’ is a generic term, which includes various types of laws such as customs, rules, norms, Acts, precedents etc.</td>
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As a student of this subject, one must know the basic common features of all the Acts. Every Act consists of several sections. Every Act begins with a **Preamble**. The Preamble to the Act states in few lines the object behind making that law. Then the Section 1 states the:

- **Title of the Act**, i.e., the heading given by the Government to that piece of legislation.
- **Commencement**, i.e., date from which the Act has come into force. This year shows you as to how recent or how ancient is, the act.
- **Extent of the Act**, i.e., the geographical boundaries of the Act, which is the called the ‘territorial jurisdiction’ of the Act.
- **Applicability of the Act**, i.e., given within the geographical boundaries, the Act is applicable to whom, or which persons, Institutes, Companies etc.

The Section 2 is the interpretation clause, which gives definitions of various terms, used in the Act. These are the common features of all the Acts.

Table 1.1 Difference between ‘Act’ and ‘Law’

1.2 Contract and ‘Contract Act’

According to Salmond, “a contract is an agreement creating and defining obligations between the parties.”

According to Sir Pollock, "every agreement and promise enforceable at law is contract."

The Indian Contract Act, 1872 defines Contract under Section 2(h) as,

“An agreement enforceable by law is contract.”

In short, every contract is basically an ‘agreement’ or a ‘promise’. But all agreements or all promises are not contracts. If an agreement is legally enforceable then only it is termed as a contract. In equation form we can say that :

\[
\text{Contract} = \text{Agreement} + \text{Enforceability factor}
\]

If this enforceability factor is present in an agreement it becomes a contract. Enforceability means a right to legally force the agreement on another.
Everyday we make many promises, which are social or domestic. For example, promise to go for a party with a friend, promise to go for a movie etc. Even if these promises are not fulfilled, neither party has any legal remedy, i.e., this promise is not enforceable by law and therefore it is not a contract.

Take another interesting example. A promises to pay B Rs. 10 lakhs if B kills C. B agrees and kills C. B demands the money from A. A refuses to pay. Can B recover the money legally by filing a case against A? No, because the agreement between A and B is not enforceable by law. So, it is not a contract.

Agreement is a very wide and generic term which includes every promise, which may be legal, illegal, social, domestic, or just a casual promise also. An agreement is a combination of proposal and its acceptance.

\[
\text{Agreement} = \text{Proposal} + \text{Acceptance}
\]

Therefore, ‘Proposal’ is the first stage in the formation of a contract.

From the above discussion we come to know that an agreement and a contract are not one and the same thing. Important points making clear the distinction between them are stated below.

**History of Contract Act**
Britishers invaded India, basically for spreading their business. They started entering into contracts. Disputes started arising out of few contracts. There were no uniform laws to resolve the disputes. People were governed by their respective religions, rules and customs. If parties belonged to different religions, the Britishers started applying English laws. However, a necessity was felt to make laws regulating contracts in India. Therefore, Britishers framed the Contract Act in 1872 which was based on the English Merchantile Law, Common law of England and principles of equity. It was adapted by the Indian Government after making a few amendments whenever required.

**Importance of the Contract**
Every day each one of us enters into a number of contracts knowingly or unknowingly. It is because no man is self-sufficient. In order to satisfy our needs and requirements we are entering into various contractual relations all the time. For instance, purchasing goods from shop, travelling by bus, train, auto rickshaw etc, filling fuel in vehicles, giving vehicles for servicing, giving clothes to laundry, taking admissions in colleges, operating bank account etc. For instance, if you borrow a pen from your friend and if you return it, it is performance of contract and if you fail to return it, it is a breach of contract.

Therefore, the main object to enter into contract is to satisfy our various needs and requirements. Even companies, corporations, countries enter into a contract for their own development and progress. Thus, contracts are the backbone of entire trade and commerce. The main object of contract is to introduce security, stability and definiteness in the business transactions. Contract law gives an assurance to the parties that the promise shall be performed. In case of breach of promise, the Contract law provides a legal remedy. These rights and remedies assured to contracting parties are provided by the Contract Act. This is called enforceability and certainty objective. The Act also brings about uniformity in business transactions throughout India.

In all the contracts, legal relations are created. These legal relations give rise to certain rights and duties, which must be performed. It is with the enforceability of these rights and duties that the contract law is mainly concerned. In short, contract means that breach of law, which determines the circumstances in which a promise shall be legally binding on the parties.
1.3 Nature of Law of Contracts

With the above background of the nature and scope of the Indian Contract Act, let us start with its foundation. The Indian Contract Act, 1872 is the backbone of the entire bulk of Mercantile laws. Even with the development of E-commerce and introduction of Cyber-laws, the basic law of contract as contained in the Contract Act would not change. The Act is very ancient in origin and was passed in the year 1872 and is applicable to all persons-natural and artificial, i.e., Legal persons such as companies, corporations etc. The Act talks about contracts in general, i.e., not only amongst the businessmen but also amongst the people in general. The Act extends throughout India except the State of Jammu and Kashmir.

The law of Contracts is one of the important branches of Law. It determines the circumstances in which promises given by the parties to a contract shall be legally binding on them. It also throws light on the remedies which are available to an aggrieved person in a court of law against a person who fails to perform his contract. This law affects every person living in a society as everyone of us has to enter into contracts virtually everyday. One enters into contract, when one purchases a commodity either by paying cash or on credit or by depositing his money into his bank account or by keeping his luggage in a State Transports luggage room. Thus, everyday, a person, knowingly or unknowingly, enters into many types of contracts and performs them. The Law of Contract is of great importance to people engaged in trade, commerce, business and industry as bulk of their trade or business transactions are based on the contracts. In India, the law relating to contracts is contained in the Indian Contract Act, 1872, and this Contract Act came into force from 1st day of September, 1872. It extends to the whole of India except the State of Jammu and Kashmir.

The Indian Contract Act, 1872

The Indian Contract Act of 1872 is the most important part of business or Mercantile Law because every business or commercial transaction basically starts from an agreement between two or more persons or parties. It codifies the main principles of contract and as such, it is the legal foundation of all transaction relating to contracts. Following important points should be noted so far as the Indian Contract Act of 1872 is concerned.

- The Indian Contract Act is based on the English Law of Contracts which is unwritten law.
- In India, the law relating to contracts is contained in the Indian Contract Act of 1872 which came into force from 1st day of September 1872 and it extends to the whole of India except the State of Jammu and Kashmir.
- The Indian Contract Act is not applicable only to business community alone but also to others. However, this Act is not exhaustive. It basically deals with the general principles of the law of contracts and with certain special contracts such as contracts of indemnity and guarantee, contract of agency. It does not deal with the contracts relating to sale of goods, partnership, negotiable instruments, bills of lading, insurance, railways etc. As there are separate Acts which deal with such contracts. However, all these separate Acts are based on the rules relating to contracts contained in the Indian Contract Act of 1872 and therefore, without the knowledge of those legal rules, no businessman can enter into a valid business transaction. The object of the Law of Contract is, in fact, to introduce definiteness in commercial and other transactions. How this is done can be illustrated by an example. X enters into a contract to deliver 10 tons of coal of Y on a certain date. Since such a contract is enforceable by the courts, Y can plan his activities on the basis of getting the coal on the fixed date. If the contract is broken, Y will get damages from the court and will not suffer any loss. Thus the Act helps to bring definiteness in the business or other transactions.

- The Indian Contract Act is not retrospective in the sense that it is not applicable to the contracts entered into before 1st September, 1872 which was the date of commencement of the Act.
- The Act does not cover all those obligations which are not contractual in nature and also those agreements which are social in nature. There are many agreements which do not give rise to any legal obligations and hence, they are not treated as contracts. Furthermore, there are certain obligations which are not contractual in nature. For quasi-contracts. Judgement of courts etc. But even then they are legally enforceable. Salmond rightly remarked in this connection that “the law of contracts is not the whole law of contracts, nor is it the whole law of obligations. It is the law of those arguments which create obligations and those obligations which have their sources in agreements”. Therefore, it should be noted that the law of contracts is neither the whole law of agreements nor the whole law of obligations. It is the law of those agreements which create obligations and those obligations which have sources in agreements.
Section 1 to 75 of the Indian Contract Act is generally applicable to all the contracts. Section 1 of the Act makes it clear that, “Nothing herein contained shall affect the provisions of any Statute Act or Regulation not hereby expressly repealed, nor any usage or custom of trade, nor any incident of any contract, nor inconsistent with the provisions of this Act”.

Sections 76 to 123 Chapter VII dealing with the sale of goods had been repealed by the Indian Sale of Goods Act of 1930. Sections 124 to sections 147 (Chapter VIII) deal with particular types or kinds of contracts, i.e., Contracts of Indemnity and Guarantee. Sections 148 to Sections 181 ( chapter IX) lays down the principles of contract of bailment while Sections 182 to Sections 238 (Chapter X) deals with the contract of agency. Sections 239 to Sections 266 (Chapter XI) had been repealed by the Indian Partnership Act of 1932. From the following chart, we come to know the main structure and the scope of Indian Contract Act of 1872 at a glance.

<table>
<thead>
<tr>
<th>I. General Rules pertaining to contracts (Chapters I to VI; Sections 1 to 75)</th>
<th>a. Preliminary- Sections 1 and 2[Short title, extent, commencement and interpretation clause].</th>
</tr>
</thead>
<tbody>
<tr>
<td>b. Proposal, acceptance, communication and revocation of proposals [Chapter I-Sections 3 to 9]</td>
<td></td>
</tr>
<tr>
<td>c. Voidable Contracts and Void agreements, free consent, capacities of parties etc. [Chapter II- Sections 10 to 30]</td>
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<td>d. Contingent Contracts [Chapter III – Sections 31 to 36]</td>
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<td>e. Performance of Contracts [Chapter IV- Sections 37 to 67]</td>
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<td>f. Quasis Contracts [Chapter V- Sections 68-72]</td>
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<td>g. Breach of contracts and remedies for breach of contracts. [Chapter VI- Sections 73 to 75]</td>
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<tr>
<td>II. Special Types of Contracts [Chapters VIII to X; Sections 124 to 238]</td>
<td>(1) Contracts of Indemnity and Guarantee [Chapter VIII- Sections 124 to 147]</td>
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<td>(2) Principles of Contract of Bailment [Chapter IX- Sections 148 to 181]</td>
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<tr>
<td>(3) Contract of Agency (Chapter X- Sections 182 to 238)</td>
<td></td>
</tr>
<tr>
<td>III. Chapter VII dealing with sales of goods [Sections 76 to 123] and chapter XI dealing with partnership had been repealed by the Indian Sale of goods Act of 1930 and the Indian Partnership Act of 1932 respectively.</td>
<td></td>
</tr>
</tbody>
</table>

Table 1.2 The main structure of the Indian Contract Act of 1872
Distinction between an Agreement and a Contract

<table>
<thead>
<tr>
<th>Agreement</th>
<th>Contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>Every promise and every set of Promises, forming the consideration for each other is an agreement. [Section 2 (e)]. For constituting an agreement, an offer by one party and its acceptance by other party are required. In other words an offer and its acceptance together constitute an agreement. Thus, Agreement = Offer + its acceptance</td>
<td>An Agreement enforceable by law is a contract [Section 2 (h)]. Merely an agreement is not a contract but its enforceability at law together constitute. Thus, Contract = Agreement + its enforceability at law.</td>
</tr>
<tr>
<td>For Constituting an agreement, a promise or sets or promises forming consideration for each other are required.</td>
<td>An agreement becomes a contract only when agreement fulfils all the legal conditions of a contract, example, formation of legal relationship, free consent, lawful object, etc.</td>
</tr>
<tr>
<td>AN agreement is a wider concept than that of a contract.</td>
<td>A contract is a specie of an agreement and as such it is a narrower concept. Therefore, it is said that every contract is an agreement but every agreement is not necessarily a contract</td>
</tr>
<tr>
<td>It is not necessary that every agreement must create legal obligation because all agreements do not go to constitute contracts.</td>
<td>Every contract necessarily creates a legal obligation because every contract is basically an agreement.</td>
</tr>
<tr>
<td>An agreement cannot be concluding and binding on the concerned parties.</td>
<td>A contract is always concluding and binding on the concerned parties.</td>
</tr>
</tbody>
</table>

Table 1.3 Difference between agreement and contract

Essential elements of valid contracts
The two elements of a contract are: (1) an agreement; (2) legal obligation. Section 10 of the Act provides for some more elements which are essential in order to constitute a valid contract. It reads as follows: “All agreements are contracts if they are made by free consent of parties, competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void.” Thus, the essential elements of a valid contract can be summed up as follows:
Fig. 1.1 Essential elements of valid contract

**Agreement**
An agreement is composed of two elements, viz, offer and acceptance. The party making the offer is known as the offeror or, the party to whom the offer is made is known as the offeree. Thus, there are essentially to be two parties to an agreement. They both must be thinking of the same thing in the same sense. In other words, there must be consensus-ad-idem.

Thus, where ‘A’ who owns 2 cars x and y wishes to sell car ‘x’ for Rs. 30,000. 'B', an acquaintance of ‘A’ does not know that ‘A’ owns car ‘x’ also. He thinks that ‘A’ owns only car ‘y’ and is offering to sell the same for the stated price. He gives his acceptance to buy the same.

There is no contract because the contracting parties have not agreed on the same thing at the same time, ‘A’ offering to sell his car ‘x’ and ‘B’ agreeing to buy car ‘y’. There is no consensus-ad-idem.

**Intention to create legal relationship**
According to the earlier discussion, there should be an intent on the part of the parties in favour of the agreement to create a legal relationship. An agreement of a purely social or domestic nature is not a contract.

Example: A husband agreed to pay £30 to his wife every month while he was abroad. As he failed to pay the promised amount, his wife sued him for the recovery of the amount.

Held: She could not recover as it was a social agreement and the parties did not intend to create any legal relations [Balfour v. Balfour (1919)2 K.B.571]. However, even in the case of agreements of purely social or domestic nature, there may be intention of the parties to create legal obligations. In that case, the social agreement is intended to have legal consequences and, therefore, becomes a contract. Whether or not such an agreement is intended to have legal consequences will be determined with reference to the facts of the case. In commercial and business agreements the law will presume that the parties entering into agreement intend those agreements to have legal consequences.

However, this presumption may be negative by express terms to the contrary. Similarly, in the case of agreements of purely domestic and social nature, the presumption is that they do not give rise to legal consequences. However, this presumption is rebuttable by giving evidence to the contrary, i.e., by showing that the intention of the parties was to create legal obligations.
Examples:

- There was an agreement between Rose Company and Crompton Company, where of the former were appointed selling agents in North America for the latter. One of the clauses included in the agreement was: “This arrangement is not... a formal or legal agreement and shall not be subject to legal jurisdiction in the law courts”.
- Held that: This agreement was not a legally binding contract as the parties intended not to have legal consequences [Rose and Frank Co. v. J.R. Crompton and Bros. Ltd. (1925) A.C. 445].
- An agreement contained a clause that it “shall not give rise to any legal relationships, or be legally enforceable, but binding in honour only”.
- Held: The agreement did not give rise to legal relations and, therefore, was not a contract. [Jones v. Vernon’s Pools Ltd. (1938) 2 All E.R. 626].
- An aged couple (C and his wife) held out a promise by correspondence to their niece and her husband (Mrs. and Mr. P.) that C would leave them a portion of his estate in his will, if Mrs. and Mr. P would sell their cottage and come to live with the aged couple and to share the household and other expenses. The young couple sold their cottage and started living with the aged couple. But the two couples subsequently quarrelled and the aged couple repudiated the agreement by requiring the young couple to stay somewhere else. The young couple filed a suit against the aged couple for the breach of promise.
- Held: That there was intention to create legal relations and the young couple could recover damages [Parker v. Clark (1960) 1 W.L.R. 286].

**Free and genuine consent**

There must be a free and genuine consent from both the parties. The consent of the parties should not be obtained by misrepresentation, fraud, undue influence, coercion or mistake. If the consent is obtained by any of these flaws, then the contract is not valid.

**Parties competent to contract**

The parties to a contract should be capable of entering into a contract. According to Section 11, every person is competent to contract if he (i) is of the age of majority, (ii) is of sound mind, and (iii) is not disqualified from contracting by any law to which he is subject. Thus, there may be a flaw in capacity of parties to the contract. The flaw in capacity may be due to minority, lunacy, idiocy, drunkenness or status. If a party to a contract suffers from any of these flaws, the contract is unenforceable except in certain exceptional circumstances.

**Lawful consideration**

The agreement must be supported by contemplation on both sides. Each party to the agreement must give or promise something and receive something or a promise in return. Consideration is the price for which the promise of the other is sought. However, this price need not be in terms of money. In case the promise is not supported by consideration, the promise will be nudum pactum (a bare promise) and is not enforceable at law. Moreover, the consideration must be real and lawful.

**Lawful object**

The object of the agreement must be legal and not one which the law disapproves.

**Agreements not declared illegal or void.**

There are certain agreements which have been expressly declared illegal or void by the law. In such cases, even if the agreement possesses all the elements of a valid agreement, the agreement will not be enforceable at law.

**Certainty of meaning**

The meaning of the agreement must be definite or competent of being made certain otherwise the agreement will not be enforceable at law.
For instance, A agrees to sell 10 metres of cloth. There is nothing whatever to show what type of cloth was intended. The agreement is not enforceable for want of certainty of meaning. If, on the other hand, the special description of the cloth is expressly stated, say Terrycot (80 : 20), the agreement would be enforceable as there is no uncertainly as to its meaning.

However, an agreement to agree is not a concluded contract [Punit Beriwala v. Suva Sanyal AIR 1998 Cal. 44].

**Possibility of performance**
The agreement terms should be capable of performance. An agreement to do an act impossible in itself cannot be enforced. For instance, A agrees with B to discover treasure by magic. The agreement cannot be enforced.

**Necessary legal formalities**
A contract depending on its context may be oral or in writing. If, however, a particular type of contract is required by law to be in writing, it must comply with the necessary formalities as to writing, registration and attestation, if necessary. If these legal formalities are not carried out, then the contract is not enforceable at law.

1.3.1 Proposal

A proposal is defined 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.” [Section 2 (a)]. An offer is synonymous with proposal.

The offeror or proposer expresses his willingness “to do” or “not to do” (i.e., abstain from doing) something with a view to obtain acceptance of the other party to such act or abstinence. Thus, there may be “positive” or “negative” acts which the proposer is willing to do.

Examples:
A offers to sell his book to B. A is making an offer to do something, i.e., to sell his book. It is a positive act on the part of the proposer.

A offers not to file a suit against B, if the latter pays A the amount of Rs. 200 outstanding. Here, the act of A is a negative one, i.e., he is offering to abstain from filing a suit.

In short, there are 3 ingredients for a proposal-
- Proposal is an expression of one’s desire to do or not to do something.
- It must be made or addressed to another person
- The object must be to obtain the consent of another for such act or abstinence.

For example,
- A proposes, by letter, to sell a house to B at a certain price. This is an offer by an act by written words (i.e., letter). This is also an express offer.
- A and B are owners of adjoining properties. B used to take water from A’s well. A asks B, “If I pay you Rs.5000, will you stop taking water from my well?” This is also an offer.

Now let us consider few other examples.
- A asks B, “will you come with me for a dinner?”
- A asks B,”If you kill C, I shall pay you Rs.5 lakhs”.
- A offers B Rs.5000 if B finds out treasure with the help of magic.

In the above examples, there is definitely an offer as per the definition. But these examples will not ultimately form a contract because they are either social initiations, illegal proposals, are of illegal nature etc.
A proposal under Contract Act must be one which is capable of resulting into a contract, i.e., it must be a legal and valid proposal. We must therefore rule out from our minds all those proposals which will not lead us to a contract. Therefore to be a legal proposal it must satisfy all the following conditions.

**Rules or conditions of a legal and valid proposal**

Rules of a legal and valid proposal are:
- Express or Implied Proposal
- Creating Legal Relationship
- Certain, Definite, not vague
- Intention to obtain assent
- Positive or Negative assent
- General or Specific Proposal
- Conditional Proposal
- Communication or Proposal
- Anything
- Revocation of Proposal

### 1.3.2 Acceptance

The Indian Contract Act, 1872 defines an acceptance as follows:

> "When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted" [Section 2 (b)].

Thus, acceptance is the act of giving consent to the proposal. A proposal when accepted becomes a contract.

Acceptance of an offer is the act which completes one of the basic requirements for the formation of a contract. Therefore it can be said that:

\[
\text{Proposal} + \text{Acceptance} = \text{Promise}
\]

Section 2(c) states that

> “The person making the proposal is called the “promisor” and the person accepting the proposal is called the “promisee”.

Once the proposal is accepted the earlier proposer now becomes the promisor and the proposee becomes the promisee. For example, ‘A’ offers to sell his vehicle to ‘B’ for Rs. 20 thousand. If B accepts it, A becomes promisor and B becomes promisee for A’s offer.

Acceptance of a proposal therefore converts a proposal into a binding promise. It is therefore said by the English Author Anson that, “Acceptance to a proposal is like a lighted match-sticks to a trial of a gun-powder.” When the lighted match is bought near the gun-powder it gives the final result and now neither of them remain in the earlier state. Similarly if acceptance is given to proposal, neither of them remain in their earlier state.

However, the acceptance under the Contract Act must be one which is capable of resulting into a contract, i.e., it must be a legal and valid acceptance. To be legal acceptance it should satisfy all the following conditions.
**Rules or conditions of a legal and valid acceptances**

Following are the rules of a legal and valid acceptance

- Absolute, unqualified Acceptance
- Manner of acceptance-Usual or prescribed
- Express or Implied Acceptance
- Communication of Acceptances
- Proper Time
- Proper Acceptor
- Act in ignorance-of no use
- Mere Answer to a question-no Acceptance
- Revocation of Acceptance

**Rules regarding communication of proposal, acceptance and revocation**

As discussed previously, in order for an offer and acceptance to be valid,

- the offer must be communicated to the offeree, and
- the acceptance must be communicated to the offeror.

Similarly, revocation of offer by the offeror to the offeree and revocation of the acceptance by the offeree to the offer or must be communicated. According to Section 4, the communication of a proposal is complete when it comes to the knowledge of the person to whom it is made.

Example:
A proposes by letter, to sell a house to B at a certain price. The communication of the proposal is complete when B receives the letter.

The completion of communication of acceptance has two aspects, viz,
- as against the proposer and
- as against the acceptor

The communication of acceptance is complete:
- as against the proposer, when it is put into a course of transmission to him, so as to be out of the power of the acceptor;
- as against the acceptor, when it comes to the knowledge of the proposer.

Example
A proposes, by letter, to sell a house to B at a certain price. B accepts A’s proposal by a letter sent by post. The communication of acceptance is complete:
- as against A, when the letter is posted by B;
- as against B, when the letter is received by A.

The communication of a revocation (of an offer or an acceptance) 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 his knowledge.

Example:
A proposes by letter, to sell a house to B at a certain price. B accepts the proposal by a letter sent by post.
A revokes his proposal by telegram. The revocation is complete as against A, when the telegram is despatched. It is complete as against B, when B receives it. B revokes his acceptance by telegram. B’s revocation is complete as against B, when the telegram is despatched, and as against A, when it reaches him.

Revocation of proposal and acceptance
Section 5 provides that a proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards.

Also an acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

Example:
A proposes, by a letter sent by post, to sell his house to B. B accepts the proposal by a letter sent by post.

A may revoke his proposal at any time before or at the moment when B posts his letter of acceptance, but not afterwards.

B may revoke his acceptance at any time before or at the moment when the letter communicating it reaches A, but not afterwards.

The English Law on communication of proposal, acceptance and revocation through post office differs in some respects from the Indian Law. In England, post office is the agent of the party making the proposal to take the proposal to the offeror and to bring back the acceptance from the offeree. But in India post office is the agent of both offeror and offeree. Therefore, acceptance cannot be revoked in the English Law. In this context Sir William Anson observes that “Acceptance to an offer is what a lighted match is to a train of gun-powder. It produces something which cannot be recalled or undone.”

1.3.3 Consideration
In literal legal definitions Consideration can be defined as “something of value given by both parties to a contract that induces them to enter into the agreement to exchange mutual performances.”

Consideration is an important ingredient for the formation of a contract. It may comprise a promise to perform a desired act or a promise to refrain from doing an act that one is legally entitled to do. In a bilateral contract—an agreement by which both parties exchange mutual promises—each promise is regarded as sufficient consideration for the other. In a unilateral contract, an agreement by which one party makes a promise in exchange for the other’s performance, the performance is consideration for the promise, while the promise is consideration for the performance.

Consideration must have a value that can be objectively determined. A promise, for example, to make a gift or a promise of love or affection is not enforceable because of the subjective nature of the promise.

Traditionally, courts have distinguished between unilateral and bilateral contracts by determining whether one or both parties provided consideration and at what point they provided the consideration. Bilateral contracts were said to bind both parties the minute the parties exchanged promises, as each promise was deemed sufficient consideration in itself. Unilateral contracts were said to bind only the promisor and did not bind the promisee unless the promisee accepted by performing the obligations specified in the promisor’s offer. Until the promisee performed, he or she had provided no consideration under the law.

For example, if someone offered to drive you to work on Mondays and Tuesdays in exchange for your promise to return the favour on Wednesdays and Thursdays, a bilateral contract would be formed binding both of you once you provided consideration by accepting those terms. But if that same person offered to pay you $10 each day you drove him to work, a unilateral contract would be formed, binding only upon the promisor until you provided consideration by driving him to work on a particular day.
Consideration is therefore rightly defined by Pollocks as “a price paid by one party to purchase the promise of the other”.

Modern courts have de-emphasized the distinction between unilateral and bilateral contracts. These courts have found that an offer may be accepted either by a promise to perform or by actual performance. An increasing number of courts have concluded that the traditional distinction between unilateral and bilateral contracts fails to significantly advance legal analysis in a growing number of cases where performance is provided over an extended period of time.

Suppose you promise to pay someone $500.00 to paint your house. The promise sounds like an offer to enter a unilateral contract that binds only you until the promisee accepts by painting your house. But what constitutes lawful performance under these circumstances? The act of beginning to paint your house or completely finishing the job to your satisfaction?

Most courts would rule that the act of beginning performance under these circumstances converts a unilateral contract into a bilateral contract, requiring both parties to fulfill the obligations contemplated by the contract. However, other courts would analyze the facts of each case so as not to frustrate the reasonable expectations of the parties. In neither of these cases are the legal rights of the parties ultimately determined by courts by applying the concepts of unilateral and bilateral contracts.

In still other jurisdictions, courts have simply expressed a preference for interpreting contracts as creating bilateral obligations in all cases where no clear evidence suggests that a unilateral contract was intended. The rule has been stated that in case of doubt an offer will be presumed to invite the formation of a bilateral contract by a promise to perform what the offer requests, rather than the formation of a unilateral contract commencing at the time of actual performance. The bottom line across most jurisdictions is that as courts have been confronted by a growing variety of fact patterns involving complicated contract disputes, courts have turned away from rigidly applying the concepts of unilateral and bilateral contracts and moved towards a more ad hoc approach.

There are following five kinds of consideration:

- **Present or Executed Consideration**: If one party makes a promise in exchange for an act by the other party, when that act is completed, it is executed consideration, for example, in a unilateral contract where A offers Rs. 500 reward for the return of her lost handbag, if B finds the bag and returns it, B’s consideration is executed.

- **Past Consideration**: If one party voluntarily performs an act, and the other party then makes a promise, the consideration for the promise is said to be in the past. The rule is that past consideration is no consideration, so it is not valid and cannot be used to sue on a contract. For example, A gives B a lift in his car. On arrival B promises to give A Rs. 100 towards the petrol. A cannot enforce this promise as his consideration, giving B a lift, is past.

- **Future or Executory Consideration**: It is an exchange of promises to perform acts in the future, example, a bilateral contract for the supply of goods whereby A promises to deliver goods to B at a future date and B promises to pay on delivery. If A does not deliver them, this is a breach of contract and B can sue. If A delivers the goods his consideration then becomes executed.

- **Unlawful Consideration**: Following Considerations are unlawful considerations.
  - When forbidden by law
  - When defunct the provisions of law
  - When they are fraudulent
  - When they cause injury to other persons or their property
  - When opposed to public policy.

- **Illusory or Unreal Consideration**: When a consideration subsist in words only and its performance is physically or legally impossible, such consideration is known as illusory or unreal.
Essential requirements for valid consideration

Essential requirements for valid consideration are as follows:

- Consideration must move at the desire of Promisor: Example X polished Y’s shoes without obtaining any permission of Y. In this case, Y is not liable to pay anything to X, as the action of polishing was not done at the desire of X.

Consideration may move from the promise or any other person on his behalf: Example: A agreed to transfer his property to son B upon fulfilment of certain conditions like that he will pay Rs.20,000 annually to his mother.

Important Case:
Facts of Case Chinnaya V. Ramaya (1818)
A father, by a gift deed, made over certain property to his daughter, with the direction that the daughter should pay an annuity to the father’s brother. On the same day, the daughter entered into an agreement with her uncle and agreed to pay the annuity. Later, the daughter declined to fulfil her promise on the ground that no consideration was paid by father’s brother to her.

Decision of the Case: The Court held that the consideration was paid by the father on behalf of her uncle. So the uncle was entitled to recover the annuity.

Consideration may be Past, Present or Future:

- Past Consideration: If a person has already done something for another, and then comes a promise from the other, the consideration is said to be past consideration. Example: A found B’s lost watch and returned to B. After a month, B announced to give Rs.1000 to A, as reward for the services rendered by him. In this case, B is paying Rs.1000 for past consideration.
- Present/ Executed Consideration: When consideration is given simultaneously with promise, it is called present consideration. Example A promise to give Rs.1000 to B for bringing a bag from the market, B brings and A gives him Rs.1,000 as per promise.
- Future Consideration: When the consideration is to move at some future date. Example: A promises to pay Mr.B after one month, if he sends him the goods now.

Consideration must be real and illusory: It should exist in the eyes of law. A promised to give Rs.1,00,000 to a doctor (over and above his fees), who performs a successful heart operation of his father. The consideration is illusory, as it was the duty of the doctor to do his best. Therefore, in this case, A is not legally bound to pay money.

- Consideration need not to be adequate: Example: A agrees to sell his Car for Rs.10,000. The Car could be sold for Rs.50,000. Later on, A cannot refuse to sell his car to C on the ground that the consideration is not adequate. Consideration must not be illegal, impossible, Uncertain, Ambiguous, Fraudulent, Immoral or Opposed to Public Policy. It must be voluntary with no additional consideration for rendering services.

No Consideration- No Contract

The General Rule is that an agreement without consideration is a void agreement and not a contract. Purley gratuitous or unilateral or bare promise (nudum pactum) creates no right to action. The parties must get some benefit, advantage at the cost of something in an agreement. In short, a contract must have some valid consideration. If there is no consideration then there is no contract.

For instance, A promise to pay Rs.1000/- to B. It is a unilateral promise without any consideration, and therefore it is merely a promise but not a contract.

To this General Rule, however there are a few exceptions. So in the following exceptions, an agreements without consideration is perfectly a contract.
Exceptions to the Rule-(Section 25)

- Written and registered agreement out of natural love and affection between the parties;
- Promise to compensate a person who has voluntarily done something for the promisor;
- Promise to pay time-barred debt;
- Completed gift;
- Creation of agency

Types of Agreement and Contract

1.3.4 Void Agreement

Sec 2(g) defines a void agreement as –
“An agreement not enforceable by law is said to be void”

An agreement which does not give rise to any legal rights is therefore a void agreement. Such agreements are void-ab-initio, i.e., void right from the beginning.

An agreement is void when there is an absence of one or more essential elements of a contract.

For instance, an agreement with or by a minor is void, an agreement without lawful consideration is void, an agreement by bilateral mistake of fact is void etc.

An agreement should not be a void agreement for the purpose of formation of contract. Sections 24 to 30 give a list of agreements expressly declared as void. Besides, there are few other void agreement which are enlisted in this topic and explained under the relevant topics.

- Agreement void if Consideration & Object is unlawful partly (Sec. 24)
- Agreement without Consideration is void
- Agreement in restraint of marriage is void
- Agreement in restraint of Trade, is void
- Agreement in restraint of Legal proceeding is void
- Agreement void for Uncertainty

Agreement void if consideration and object is unlawful partly (Sec. 24)

If any part of a single consideration for one or more objects, or any one or any part of any one of several consideration of a single object, is unlawful, the agreement is void.
Illustration
A promises to superintend, on behalf of B, a legal manufacturer of indigo, and an illegal traffic in other articles. B promises to pay to A a salary of 10,000 rupees a year. The agreement is void, the object of A’s promise, and the consideration for B’s promise, being in part unlawful.

Agreement without consideration is void
An agreement made without consideration is void, unless

• It is expressed in writing and registered under the law for the time being enforce for the registration of (documents), and is made on account of natural love and affection between parties standing in a near relation to each other, or unless.
• It is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promissory was legally compellable to do, or unless.
• It is a promise, made in writing and signed by the person to be charged therewith, or by his agent generally or specially authorized in the behalf, to pay wholly or in part a debt of which the creditor might have enforced payment but for the law for the limitation of suits.

In any of these cases, such an agreement is a contract.

Explanation 1–Nothing in this section shall affect the validity, as between the donor and donee, of any gift actually made.

Explanation 2- An agreement to which the consent of the promisor is freely given is not void merely because the consideration may be taken into account by the court in determining the question whether the consent of the promisor was freely given.

Illustrations
• A promises for no consideration, to give to B Rs. 1000; this is a void agreement.
• A, for natural, love and affection, promises to give his son, B Rs. 1000. A puts his promise to B into writing and registers it. This is a contract.
• A finds be B’s purse and gives it to him. B promises to give A Rs. 50. This is a contract.
• A supports B’s infant son. B promises to pay A’s expenses in so doing. This is a contract.

Agreement in restraint of marriage is void
Every individual enjoys the freedom to marry and so according to section 26 of the contract act “every agreement is restraint of the marriage of any person, other than a minor, is void.” The restraint may be general or partial but the agreement is void, and therefore, an agreement agreeing not to marry at all, or a certain person or, a class of persons, or for a fixed period, is void. However, an agreement restraint of the marriage of a minor is valid under the section.

It is interesting to note that a promise to marry a particular person does not imply any restraint of marriage and is, therefore, a valid contract.

This section enact that agreement in restraint of the marriage of any person, other than a minor is void. In the interest of the society, contracts for marriage are scrutinized with a close and vigilant suspicion of undue influence, fraud or imposition. The law presumes constrictive fraud, on grounds of public policy, in agreements respecting marriages since marriages of a suitable nature are of the deepest importance of the wellbeing of the society, as upon the equality and mutual affection much of their happiness, sound morality, and mutual confidence, hence every temptation of the exercise often undue influence, or a seductive interest in procuring a marriage is suppressed, for there is infinite danger that it may, under the guises of friendship, confidence, flattery or falsehood, accomplish the ruin of person especially females. So the law—
Legal Aspects of Business

- prevents improvident, ill-advised, and often fraudulent matches;
- Avoid all such contracts as tend to the deceit and injury, or encourage artifices and improper attempts to control the exercise of free judgment;
- Discountenances secret contracts made with prevents and guardians, whereby on a marriage, they to receive a benefits
- Renders invalid certain agreements in restraint of marriage.

Agreement in restraint of trade
The constitution of India guarantees that the freedom of trade and commerce to every citizen and therefore section 27 declares “every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.” Thus no person is at livery to deprive himself of the fruit of his labor, skill or talent, by any contracts that he enters into.

It is to be noted that whether restraint is responsible or not, if it is in the nature of restraint of trade, the agreement is void always, subject to certain exceptions provided for statutorily.

Illustration
An agreement whereby one of the parties agrees to close his business in consideration of the promise by the other party to pay a certain some of money, is void, being an agreement is restraint of trade, and the amount is not recoverable, if the other party fails to pay the promised some of money. (Mad hub Chander vs. Raj Kumar).

But agreements merely restraining freedom of action necessary for the carrying on of business are not void, for the law does not intend to take away the right of a trade to regulate his business according to is own discretion and choice.

Illustration
An agreement to sell all produce to a certain party, with stipulation that the purchaser was bound to accept the whole quantity, was held valid because it aimed to promote business did not restrained it (Mackengie vs. Striramiah). But where in a similar agreement, the purchaser was free to reject the goods (i.e., he or she was not bound to accept the whole quantity tendered) it was held that the agreement was void as being in restraint of trade (Sheikh Kalu vs. Ram Saran)

Agreement in restraint of legal proceedings
Every agreement, by which any party thereto is restricted absolutely from enforcing his right under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent. Section 28 declares the following two kinds of agreements void:

- An agreement by which a party is restrained absolutely from taking usual legal Proceeding, in respect of any rights arising from a contract.
- An agreement which limits the time within which one may enforce his contract Rights, without to the time allowed by the limitation act.

Illustration
In a contract of fire insurance, it was provided that if a claim is rejected and a suit is not filed within three months after such rejection, all benefits under the policy shell be forfeited. The provision was held valid and binding and the suit filed after three months was dismissed. (Baroda spinning Ltd. vs. Satyanarayan Marine and Fire Ins. Com. Ltd.)

Exception 1: This section shell not render illegal a contract by which two or more persons agree that any dispute which may arise between them in respect of any subject or class of subjects shell be referred to arbitration and that only the amount awarded in such arbitration shell be recoverable in respect of the dispute so referred.
Exception 2: Nor shall this section render illegal any contract in writing, by which two or more persons agree to refer to arbitration any question between them which has already arisen, or affect any provision of any law in force for the time being as to references to arbitration.

Uncertain agreements
“Agreements, the meaning of which is not certain, or capable of being made certain, are void” (Sec-29). Through Sec-29 the law aims to ensure that the parties to a contract should be aware of the precise nature and scope of their mutual rights and obligation under the contract. Thus, if the word used by the parties are or indefinite, the law cannot enforce the agreement.

Illustration
- A agrees to sell to B “a hundred tons of oil.” There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.
- A who is dealer in coconut oil only, agrees to sell to B “a hundred tons if oil.” The nature of A’s trade affords an indication of the meaning of the words, and A has entered into a contract for the sale of one hundred tons of coconut oil.
- A agrees to sell to B “one thousand mounds of rice at a price to be fixed by C.” As the price is capable of being made certain, there is no uncertainty here to make the agreement void.
- A agrees to sell to “his white house for rupees five hundred or rupees one thousand.”

There is nothing to show which of the price was to be given. The agreement is void.

Further, an agreement “to enter into an agreement in future” is void for uncertainty unless all the terms of the proposed agreement are agreed expressly or implicitly. Thus, an agreement to engage a servant some time next year, at a salary to be mutually agreed upon is a void agreement.

Other void agreements
Other void Agreements Besides the above 6 types of agreements expressly declared void (from Sec. 21 to 30), there are following agreements which are also void and are explained under the relevant topics.
- Agreements by incompetent persons are void (Sec 11)-
- Agreements by bilateral Mistake of fact is Void(Sec.20)
- Agreement with the unlawful consideration or unlawful objects are void (Sec.23)
- Agreements contingent on impossible events are void (Sec.36.)
- Agreements to do an impossible act are void (Sec.56.)
- Reciprocal promises to do things legal and other things illegal(Sec.37.)

1.3.5 Wagering Agreement
Literally the word ‘wager’ means ‘a bet’ something stated to be lost or won on the result of a doubtful issue, and, therefore, wagering agreements are nothing but ordinary betting agreements. Thus where A and B mutually agree that if it rains today A will pay B Tk.100 and if it does not rain B will pay A Tk.100 or C and D entered into agreement that on tossing up a coin, if it fall head upwards C will pay D Tk.50 and if falls tail upwards D will pay C Tk.50, there is a wagering agreement.

In Tracker vs. Hardy Cotton, L.J., described a ‘wager’ ad follows: “The essence of gaming and wagering is that one party is to win and the other to lose upon a future event which at the time of the contract is of an uncertain nature-that is to say, if the event turns out the other way he will win.”

Agreement by way of wager, void. Section 30 lays down that “agreements by way of wager are void; and no suit shall be brought for recovering anything alleged to be won on any wager, or entrusted to any person to abide the result of any game or other uncertain event on which any wager is made,” Thus, where A and B enter into an
agreement which provides that if England’s cricket team wins the match, A will pay B Rs. 100, and if it loses B will pay Rs. 100 to A, nothing can be recovered by the winning party under the agreement, it being a wager. Similarly, whether C and D enter into a wagering agreement and each deposits Rs.100 with Z instructing him to pay or give the total sum to the winner, no suit can be brought by the winner for recovering the bet amount from Z, the stake-holder. Further, if Z had paid the sum to the winner, the looser cannot bring a suit, for recovering his Rs.100, either against the winner or against, the stake-holder, even if Z had paid after the loser’s definite instructions not to pay. Of course the looser can recover back his deposit if he makes the demand before the stake-holder had paid it over to the winner (Ratnakallli vs. Vochalapu). But even such a deposit cannot be recovered by a loser in the States of Maharashtra and Gujarat where such an agreement is void and illegal.

**Essentials of a wagering Agreement :**

- There must be only 2 parties or 2 sides to a wagering agreement.
- Each party should have an equal chance of winning or losing the wager.
- There must be promise to pay money or money’s worth by the loser to the winner of the bet.
- The wager should depend on an uncertain future event If the event has taken place then its result must be uncertain.
- No control on the event – The event should be of independent, uncontrollable nature. Neither party should have any control over the happening or non-happening of the event.
- No party should have any interest in the subject-matter of the agreement other than gaining the agreed sum, or for the gambling purpose.

1.3.6 Minor’s Agreement

A person who has not completed his or her 18 years of age signifies as minor. Law acts as the guardian of minors and protects their rights, because their mental facilities are not mature- they do not possess the capacity of judge what is good and what is bad for them. Accordingly, where is a minor charged with obligations and the other contracting party seeks to enforce those obligations against the minor, the agreement is deemed as void.

Illustration

a. A, 15 years old boy, made an agreement with B to give him Tk.1000. This is a void agreement.

**Contracts**

Contracts may be classified in terms of their (1) validity or enforceability, (2) mode of formation, or (3) performance.

**Classification according to validity or enforceability**

Contracts may be classified according to their validity as (i) valid, (ii) voidable, (iii) void contracts or agreements, (iv) illegal, or (v) unenforceable.

A contract to constitute a valid contract must have all the essential elements discussed earlier. If one or more of these elements is/are missing, the contract is voidable, void, illegal or unenforceable.

As per Section 2 (i) a voidable contract is one which may be repudiated at the will of one of the parties, but until it is so repudiated it remains valid and binding. It is affected by a flaw (example, simple misrepresentation, fraud, coercion, undue influence), and the presence of anyone of these defects enables the party aggrieved to take steps to repudiate the contract. It shows that the consent of the party who has the discretion to repudiate it was not free.

Example

A, a man enfeebled by disease or age, is induced by B’s influence over him as his medical attendant to agree to pay B an unreasonable sum for his professional services. B employs undue influence. A’s consent is not free; he can take steps to set the contract aside.
An agreement which is not enforceable by either of the parties to it is void [Section 2(i)]. Such an agreement is without any legal effect *ab initio* (from the very beginning). Under the law, an agreement with a minor is void (Section 11).*

A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable [Section 2(i)].

**Examples**

1. A and B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract becomes void.
2. A contracts to take indigo for B to a foreign port. A’s government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

In the above two examples, the contracts were valid at the time of formation. They became void afterwards. In example (1) the contract became void by *subsequent impossibility.*

In example (2) the contract became void by *subsequent illegality.*

It is misnomer to use ‘a void contract’ as originally entered into. In fact, in that case there is no contract at all. It may be called a void agreement. However, a contract originally valid may become void later.

An illegal agreement is one the consideration or object of which (1) is forbidden by law; or (2) defeats the provisions of any law; or (3) is fraudulent; or (4) involves or implies injury to the person or property of another; or (5) the court regards it as immoral, or opposed to public policy.

**Examples**

1. A, B and C enter into an agreement for the division among them of gains acquired or to be acquired, by them by fraud. The agreement is illegal.
2. A promises to obtain for B an employment in the public service, and B promises to pay Rs. 1,000 to A. The agreement is illegal.

Every agreement of which the object or consideration is unlawful is not only void as between immediate parties but also taints the collateral transactions with illegality. In Bombay, the wagering agreements have been declared unlawful by statute.

**Example**

A bets with B in Bombay and loses; makes a request to C for a loan, who pays B in settlement of A’s losses. C cannot recover from A because this is money paid “under” or “in respect of a wagering transaction which is illegal in Bombay.

An *unenforceable contract* is neither void nor voidable, but it cannot be enforced in the court because it *lacks some item of evidence* such as writing, registration or stamping. For instance, an agreement which is required to be stamped will be unenforceable if the same is not stamped at all or is under-stamped. In such a case, if the stamp is required merely for revenue purposes, as in the case of a receipt for payment of cash, the required stamp may be affixed on payment of penalty and the defect is then cured and the contract becomes enforceable. If, however, the technical defect cannot be cured the contract remains unenforceable, example, in the case of an unstamped bill of exchange or promissory note.
Contracts which must be in writing. The following must be in writing, a requirement laid down by statute in each case:

a. A negotiable instrument, such as a bill of exchange, cheque, promissory note (The Negotiable Instruments Act, 1881).

b. A Memorandum and Articles of Association of a company, an application for shares in a company; an application for transfer of shares in a company (The Companies Act, 1956).

c. A promise to pay a time-barred debt (Section 25 of the Indian Contract Act, 1872).

Other examples of contracts becoming void are:

- A contingent contract to do or not to do anything if an uncertain future event happens becomes void if the event becomes impossible (Section 32).
- A contract voidable at the option of the promisee, becomes void when the promisee exercises his option by avoiding the contract. (Sections 19; 19A).
- A lease, gift, sale or mortgage of immovable property (The Transfer of Property Act, 1882).

Some of the contracts and documents evidencing contracts are, in addition to be in writing, required to be registered also. These are:

- Documents coming within the purview of Section 17 of the Registration Act, 1908.
- Transfer of immovable property under the Transfer of Property Act, 1882.
- Contracts without consideration but made on account of natural love and affection between parties standing in a near relation to each other (Section 25, The Indian Contract Act, 1872).

Classification according to mode of formation

There are different modes of formation of a contract. The terms of a contract may be stated in words (written or spoken). This is an express contract. Also the terms of a contract may be inferred from the conduct of the parties or from the circumstances of the case. This is an implied contract (Section 9).

Example

If A enters into a bus for going to his destination and takes a seat, the law will imply a contract from the very nature of the circumstances, and the commuter will be obliged to pay for the journey.

We have seen that the essence of a valid contract is that it is based on agreement of the parties. Sometimes, however, obligations are created by law (regardless of agreement) whereby an obligation is imposed on a party and an action is allowed to be brought by another party. These obligations are known as quasi-contracts. The Indian Contract Act, 1872 (Chapter V Sections 68–72) describes them as “certain relations resembling those created by contract”.

Examples

- A supplies B, a minor, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B’s property.
- A supplies the wife and children of B, a minor, with necessaries suitable to their condition in life. A is entitled to be reimbursed from B’s property.
- A, a tradesman, leaves goods at B’s house by mistake. B treats the goods as his own. B is bound to pay A for them.

In all the above cases, the law implies a contract and a person who has got benefit is under an obligation to reimburse the other.
Classification according to performance
Another method of classifying contracts is in terms of the extent to which they have been performed. Accordingly, contracts are: (1) executed, and (2) executory or (1) unilateral, and (2) Bilateral.

An executed contract is one wholly performed. Nothing remains to be done in terms of the contract.

Example
A contracts to buy a bicycle from B for cash. A pays cash. B delivers the bicycle. An executory contract is one which is wholly unperformed, or in which there remains something further to be done.

Example
On June 1, A agrees to buy a bicycle from B. The contract is to be performed on June 15. The executory contract becomes an executed one when completely performed. For instance, in the above example, if both A and B perform their obligations on June 15, the contract becomes executed. However, if in terms of the contract performance of promise by one party is to precede performance by another party then the contract is still executory, though it has been performed by one party.

Example
On June 1, A agrees to buy a bicycle from B. B has to deliver the bicycle on June 15 and A has to pay price on July 1. B delivers the bicycle on June 15. The contract is executory as something remains to be done in terms of the contract.

A Unilateral Contract is one wherein at the time the contract is concluded there is an obligation to perform on the part of one party only.

Example
A pays for bus fare for his journey from Bombay to Pune. He has performed his promise. It is now for the transport company to perform the promise.

A Bilateral Contract is one wherein there is an obligation on the part of both to do or to refrain from doing a particular thing. In this sense, Bilateral contracts are similar to executory contracts.

An important corollary can be deduced from the distinction between Executed and Executory Contracts and between Unilateral and Bilateral contracts. It states that a contract is a contract from the time it is made and not from the time its performance is due. The performance of the contract can be made at the time when the contract is made or it can be postponed also. See examples above under Executory Contract.
From the point of view of enforceability
(a) Valid contracts
(b) Voidable contracts
(c) Void contracts or agreements
(d) Illegal agreements
(e) Unenforceable Agreements (Certain contracts must be in writing)

2. According to Mode of Formation
(a) Express contract
(b) Implied contract
(c) Quasi-contracts

3. According to Performance
(a) Executed
(b) Executory
(c) Uni-lateral
(d) Bi-lateral

Fig. 1.3 Contract enforceability

Types of contract on the basis of the forms of contracts
According to this classification, contracts can be formed or simple.

Formal contracts and simple contracts:
Formal contracts have been recognized under English Law. The Indian Law does not recognise this type of contracts. The validity of formal contracts depends upon their form and no consideration is required in such contracts. In order to be valid and binding, these contracts are required to satisfy certain legal formalities. All contracts other than formal contracts are required to satisfy certain legal formalities. All contracts other than formal contracts are termed as simple contracts. They are valid only when they are supported by the consideration and are made by words, spoken or written. Indian law recognises simple contracts which are supported by consideration except in circumstances specifically laid down in the Act.

1.4 Essentials of Contract

Fig. 1.4 Essentials of Contract
For a contract there must be minimum two parties. Normally the contracts have two parties, i.e., bilateral contracts. But a contract can be multiplied also.

1.4.1 Competent Parties
Each party to a contract must be competent to contract. Sec.11 of the Act states, who is competent to contract.

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.

To simplify Sec. 11, we can say that it lays down following essentials. A party is competent to contract if –

- He is a major person-
- He is a sound mind and
- He is not disqualified from contracting by any other Law.

Minor’s agreement – Every person entering into a contract should be major person, i.e., a minor person cannot enter into a contract.

Who is minor? According to the Indian Majority Act, 1875, a minor is a person who is under 18 years of age. Therefore, when a person completes his 18 years he is capable to enter into a contract.

But in the following situation a person becomes major only after completing 21 years of age:

Exception 1: Where a guardian of a minor’s person or property is appointed under the Guardian’s and Wards Act, or
Exception 2: Where a minor’s property is placed under the superintendence of the Court of Wards.

Then such minor become major only after 21 years of age.

Position of a minor under Contract Act-

- Effect of minor’s agreement
- Restitution not applicable
- Limited liability for Necessities
- Minor can be a beneficiary
- Ratification after Majority
- No specific Performance remedy
- Minority is a good defence
- as a partner
- as an agent
- Cannot be a shareholder
- Never an insolvent
- Through his parent/Guardian

Party should be of sound mind
The second requirement for a competent party is that he should be of sound mind.
Section 12 of the Contract Act defines sound mind for the purpose of contracting, as follows –

“A person is said to be of sound mind for the purpose of making a contract, if at the time when he makes it, he is capable-
- of understanding it and
- of forming a rational judgement as to its effect upon his interests.”

The Concept of sound mind under Contract Act is explained only from the point of view of making the contract. This law is concerned with the sound mind of each party, only at the time of making the contract and not at any other time.

Test of Sound mind – The person is said to be of sound mind if at the time of contracting he satisfies 2 conditions-
- He is able to understand what he is doing, and
- He is able to understand the effect or impact of his act on his own interests.

Thus Contract Act is very clear about its purpose of sound mind at the time of contracting. The test of sound mind should be made applicable to the following categories of persons such as-
- Lunatic or insane persons.
- Person under influence of Drinks or other intoxicants.
- Seriously ill patients or person delirious from fever etc.

**Person should not be disqualified from contracting by any law to which he is subject.**
Besides minors and unsound mind persons, there are others who are disqualified from contracting under the provisions of some other laws.

Effect- If persons disqualified from contracting enter into agreements, they are void agreements and not contracts
Following are the persons disqualified from contracting by law -
- Alien enemies
- Foreign Sovereigns and Ambassadors
- Convicts
- Insolvents
- Companies and Corporations

**1.4.2 Free Consent**
It means an act of assenting to an offer. According to section 13, “Two or more persons are said to consent when they agree upon the same thing in the same thing in same sense.” Thus, consent involves identity of minds in respect of the subject matter of the contract. In English Law, this is called ‘consensus-ad-idem’.

Effect of Absence of consent:
When there is no consent at all, the agreement is void ab-initio, i.e., it is not enforceable at the option of either party.

**Example:** X has one Maruti car and one Fiat car. He wants to sell Fiat car. Y does not know that X has two cars. Y offers to buy X’s Maruti car Rs. 50,000. X accepts the offer thinking it to be an offer for his Fiat car. Here, there is no identity of mind in respect of the subject of the subject matter. Hence there is no consent at all and the agreement is void ab-initio.
• **Meaning of Free consent:** It is one of the essential elements of a valid contract as it is evidenced by section 10 which provides that all agreements are contracts if they are made by the free consent of the parties according to section 14, consent is said to be free when it is not caused by (a) Coercion, or (b) Undue influence, or (c) Fraud, or (d) Misrepresentation, or (e) Mistake.

• **Effect of Absence of free consent:** When there is consent but it is not free (i.e., when it is caused by coercion or undue influence or fraud or misrepresentation), the contract is usually voidable at the option of the party whose consent was so caused.

**Coercion**

**Meaning of coercion** [section 15]: It means compelling a person to enter into a contract, by use of physical force/activities forbidden by Indian penal code, OR threatens to do activities forbidden by I.P.C, OR threatens to damages the property.

**Effect of coercion:** Voidable and can be canceled at the option of aggrieved party. OR A ‘suicide and a ‘threat to commit suicide’ are not punishable but an attempt to commit suicide is punishable under the Indian penal code. X threatens to kill Y if he does not sell his house for Rs. 1,00,000 to X. Y sells his house to X and receives the payments. Here, V’s consent has been obtained by coercion. Hence, this contract is voidable at the option of Y. If Y decides to avoid the contract, he will have to return Rs. 1,00,000 which he had received from X.

“Y” (aggrieved party) will return Rs. 1,00,000

“X” (defendant party) will return the house and any benefit from the goods.

When voidable contract cannot be canceled:
When the third party become interested into a voidable contract. For instance, A obtain the car of B through coercion. Let, A sold it to “C” an innocent buyer, now B cannot get the contract canceled. When the aggrieved party ratify/confirm/affirm then contract can not be cancel.

**Undue Influence:**

**Meaning of Undue influence** [section 16(1)]: The term ‘undue influence’ means dominating the will of the other person to obtain an unfair advantage over the other. According to section 16(1), a contract is said to be induced by undue influence

• where the relations subsisting between the parties are such that one of them is in a position to dominate the will of the other, and
• the dominant party uses that position to obtain an unfair advantage over the other.
• When two-partner are in relation, and one of them is dominant and other is in weaker position and dominant person takes undue-Advantage, then it is called “Undue- influence.”

No presumption of domination of will According to judicial decisions held in various cases, there is no presumption of undue influence in the following relationships:

• Husband and wife
• landlord and tenant
• Creditor and debtor

Effect of undue influence [section 19A]: when consent to an agreement is caused by undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused.

Comparison between coercion and undue influence:

Similarities: In case of both coercion and undue influence, the consent is not free and the contract is voidable at the option of the aggrieved party.
Fraud
Meaning and essential elements of fraud [section 17]: The term ‘fraud’ means a false representation of fact made wilfully with a view to deceive the other party. Fraud includes following:

- **Wrong suggestion about a fact, knowing that it is not-true**: For example, X sells to Y locally manufactured goods as imported goods charging a higher price, it amounts to fraud. OR A seller claimed that his projector is made in Singapore, and sold it for Rs. 100,000/- However the fact is that “Projector was made in south India”.

- **Active concealment (Hide) of defect in goods**: For example, “A car-painter, uses paint to hide the scratches over the old furniture and sold it claiming that is Now”. This is fraud. OR X a furniture dealer, conceals the cracks in furniture sold by him by using some packing material and polishing it in such a way that the buyer even after reasonable examination can not trace the defect, it would tent amount to fraud through active concealment.

- **Promise made without intention to perform**: For example, “A man and a woman underwent a ceremony of marriage with the husband not regarding it as a real marriage. Held, the husband had no intention to perform the promise from the time he made it and hence the consent of the wife was obtained under fraud. OR “A farmer agrees to supply 100kg potato that will be produced by him out of his field, after three month”. Two months has been lapsed, but the farmer neither implant seeds, nor does cultivation. This is case of fraud.

- **Any activity declared fraud as per other law**: under companies act and insolvency acts, certain kinds of transfers have been declared to be fraudulent. Note: In case of fraud, the seller is always liable even though buyer has an opportunity to check the fraud.

- **Any activity fitted (supported) to deceive**: It covers those acts which deceive but are not covered under any other clause.

**Effect of Fraud [section-19]**
The effects of fraud are as follows:

- The party whose consent was caused by fraud can rescind (cancel) the contract but he cannot do so in the following cases:
  - Where silence amounts to fraud, the aggrieved party cannot rescind the contract if he had the means of discovering the truth with ordinary diligence;
  - Where the party gave the consent in ignorance of fraud;
  - Where the party after becoming aware of the fraud takes a benefit under the contract;
  - Where an innocent third party before the contract is rescinded acquires for consideration some interest in the property passing under the contract.
  - Where the parties cannot be restored to their original position.

- The party whose consent was caused by fraud may, if he thinks fit, insist that the contract shall be performed and that he shall be put in the position in which he would have been if the representation made had been true.

The party whose consent was caused by fraud, can claim damage if he suffers some loss.

**Weather silence is fraud?**

**General concept**: According to explanation to section 17, “Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud”.

In other words, Silence is not fraud. It is buyer, who must check the goods & suitability. For example, X purchased a used computer from Z thinking it as a computer imported from USA, Z failed to disclose the fact to X. On knowing the fact X wants to repudiate the contract. So, here X cannot repudiate/rescind/cancel the contract.
Exceptions to the general rule:
The general rule that silence does not amount to fraud has the following exceptions. Where the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak. Such duty arises in the following two cases:

- **When silence is equivalent to speech:** For instance, “A student of BBA select a Business law-book and asks the seller”. If seller don’t stop me from buying this book, I will assume that “it is best”. The seller remained silent here the student will treat “silence” as speech. If the book was inferior, then it is a case of fraud.

- **Disclosure of dangerous nature:** For instance, Shyam sold his horse to Ram a buyer for Rs. 11000/- Shyam knows that horse was “wicked” but fails to disclose it to buyer. Here seller has committed fraud by remaining silent.

1. **Misrepresentation:** The term “misrepresentation” means a false representation of fact made innocently or non-disclosure of a material fact without any intention to deceive the other party. Section 18 defines the term “misrepresentation” as follows

   “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;

   - Any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or anyone claiming under him, by misleading an other to his prejudice or to the prejudice of anyone claiming under him;

   - 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.

**Essential elements of misrepresentation:**

- By a party to a contract: The representation must be made by a party to a contract or by anyone with his connivance or by his agent. Thus, the misrepresentation by a stranger to the contract does not affect the validity of the contract.

- False representation: There must be a false representation and it must be made without the knowledge of its falsehood i.e. the person making it must honestly even it is to be true.

- Representation as to fact: The representation must relate to a fact. In other words, a mere opinion, a statement of expression or intention does not amount to misrepresentation.

“Innocent misstatement made into good faith OR without any intention to cause loss”

Example, A farmer says that his land is very productive and produces 100 quintal per acre. This is misrepresentation and buyer can cancel the contract.

**Note:** When the buyer has an opportunity to check the misrepresentation, but he fails then buyer cannot cancel the contract. For instance An owner of factory, while selling his factory, express his opinion as my factory produces 1000 kg per ann-um and requested the buyer to find out exact production by checking “production-record”. If the buyer fails to check the production record then buyer cannot blame seller.

**Effect of misrepresentation[section 19]**
The effects of misrepresentation are as follows:

- **Right to rescind the contract** The party whose consent was caused by misrepresentation can rescind (cancel) the contract but he cannot do so in the following cases:
  - where the party whose consent was caused by misrepresentation had the means of discovering the truth with ordinary diligence;
  - where the party gave the consent in ignorance of misrepresentation;
  - where the party after becoming aware of the misrepresentation, takes a benefit under the contract;
where an innocent third party, before the contract is rescinded, acquires for consideration some interest in
the property passing under the contract;
where the parties cannot be restored to their original position.

- **Right to insist upon performance** The party whose consent was caused by misrepresentation may
  if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position
  in which he would have been if the representation made had been true.

- **Comparison between fraud and misrepresentation**

  **Similarities:** There are basically two similarities in case of fraud and misrepresentation as follows:
  - In both the cases, a false representation is made by a party;
  - In both the cases, the contract is voidable at the option of the party whose consent is obtained by fraud or
    misrepresentation.

- **Mistake**
  **Meaning of mistake [section 20]**
  A mistake is said to have occurred where the parties intending to do one thing by error do something else.
  Mistake is “erroneous belief” concerning something.

  **Classification of mistake of law:**
  Mistake of Indian Law(In sense of penalty): The contract is not voidable because everyone is supposed to know
  the law of his country, example, disobeying traffic rules”

  Mistake of Foreign Law(void-ab-initio): A mistake of foreign law is treated as mistake of fact, i.e. the contract is void if
  both the parties are under a mistake as to a foreign law because one cannot be expected to know the law of other country.

- **Mistake of fact**
  Mistake of fact be *either* Unilateral mistake or Bilateral mistake.

  **Unilateral mistake [section 22]:** The term ‘unilateral mistake’ means where only one party to the agreement is
  under a mistake. According to section 22, “A contract is not voidable merely because it was caused by one of the
  parties to it being under a mistake as to matter of fact.”

  **Bilateral mistake [section 22]:** The term ‘bilateral mistake’ means where both the parties to the agreement are
  under a mistake. According to section 20, “where both the parties to an agreement are under a mistake as to a
  matter of fact essential to the agreement, the agreement is void.” thus, the following three conditions must be
  satisfied before declaring a contract void under this section:
  - Both the parties must be under a mistake
  - Mistake must be of fact but not of law.

  According to explanation to section 20. “An erroneous opinion as to the value of the thing which forms the subject
  matter of agreement is not to be deemed a mistake as to a matter of fact.”

- **Note: Mistake about price is valid.**

1.4.3 Lawful Consideration and Lawful Object

In accordance with Section 10 (Indian Contracts Act), all agreements are contracts if made for lawful considerations
and with lawful object. Considerations should be lawful, as otherwise, it would vitiate the whole contract and make
it void. For example, A promises to pay B Rs. 500/- if he commits a theft in C’s house. Such a promise will not be
enforced by law even if B has committed a theft because the object of consideration of the promise is unlawful.
Even Section 23 also states that every agreement of which the object or consideration is unlawful is void. It, therefore, follows that every contract, in order to be valid must be made for lawful consideration with a lawful object.

Illustrations of lawful considerations:

- A agrees to sell his house to B for Rs. 10,000. Here, B’s promise to pay the sum of Rs. 10,000 is the consideration for A’s promise to sell the house, and A’s promise to sell the house is the consideration for B’s promise to pay Rs. 10,000. These are lawful considerations.
- A promises to pay B Rs. 10,000 at the end of six months, if C who owes that sum to B, fails to pay it. B promises to grant time to C accordingly. Here the promise of each party is the consideration for the promise of the other party and they are lawful considerations.
- A promises for a certain sum paid to him by B to make good to B the value of his ship if it is wrecked on a certain voyage. Here A’s promises is the consideration for B’s payment and B’s payment is the consideration for A’s promise and these are lawful considerations.
- A promises to maintain B’s child, and B promises to pay A Rs. 1,000 yearly for the purpose. Here the promise of each party is the consideration for the promise of the other party. These are lawful considerations.

Lawful considerations and lawful object distinguished:
Object of an agreement should be differentiated from consideration for an agreement. Object is different from consideration. Object means purposes or design. However, certain difficulties are faced in practice to distinguish between the two, particularly when considerations consist in a promise to do or not to do something.

The following illustrations will make the distinction clear between object and consideration: Illustrations:
A promises to obtain or B an employment in the public services and B promises to pay A Rs. 100/- The agreements is void as the consideration being A’s promise to procure an employment in the public services is opposed to public policy and hence unlawful.

Illustrations of unlawful object:

- A promises to drop a prosecution which he has instituted against B for robbery and B promises to restore the value of things taken. The agreement is void as its object to save a robber from punishment is unlawful.
- A, B and C enter into an agreement for the division among them of the gains to be acquired by them by fraud. Because object of the agreements is to practice fraud on others, it is unlawful.

**Essentials of lawful consideration and object**
The essentials of Lawful Consideration and Object are considered to be those agreements which are lawful
In the following cases, the consideration or object of an agreement is unlawful, i.e.,

- it is forbidden by law; or
- is of such a nature that, if permitted, it would defeat the provisions of any law; or
- is fraudulent; or
- involves or implies injury to the person or property of another; or
- the court regards it as in moral or opposed to public policy.

An act promised to be done may be either unlawful to perform (illustrations (1) and (3) below); or the act may be lawful but law will not enforce it for reasons of public policy like wagering agreements. Law means the law for the time being in force in India and includes Hindu and Muslim laws

**1.4.4 Not a Void Agreement**
A **void agreement/contract** is one "which is destitute of all legal effects. In the eyes of law such an agreement is no agreement at all from its very inception".

A void agreement does not create any legal rights and obligations. It confers no rights on either party.
ab initio (ie void from the very beginning) and without any legal effect. with a minor, agreements without consideration, agreements which are in restraint of trade or marriage or of legal proceedings, wagering agreement.

A voidable agreement/contract is one
- Which a party can put to an end. He or she can exercise his/her option.
- The voidable contract is however binding if he does not exercise his option to avoid it within a reasonable time.

An illegal agreement/contract is one
- which like void agreement has no legal effect as between the immediate parties further, transaction collateral to it also become tainted with illegality and are therefore not enforceable.
- Every illegal agreement is void but every void agreement may not amount to illegal agreement. Parties to an unlawful agreement cannot get any help from a court of law. “For no polluted hands shall touch the pure fountain of justice.” On the other hand, a collateral transaction can be supported by a void agreement
- Other requirements of contract

A contract can be oral or written. Written contract is not the requirement as per the Indian Contract Act. But if some other Law requires a contract to be in writing or in the presence of witnesses or registered as per the Registration Law in India, then only such a contract is required to be in writing. In order to become a contract, an agreement should also have a possibility of establishing legal relationship between the parties and a possibility of performance.

AN agreement becomes a contract only when it satisfies all the essentials as written above. Agreement is therefore a generic term and contract is a specific term or a specific type of agreement.

Hence all contracts are agreements, but all agreements are not contracts.

### 1.5 Discharge of Contracts

The duties under a contract are discharged when there is a legally binding termination of such duty by a Voluntary Act of the parties or by operation of law. Among the ways to discharge a contractual duty are impossibility or impracticability to perform personal services because of death or illness; or impossibility caused by the other party.

However a contract may be discharged in a number of ways like :-
- By Performance
- By Exemption from Performance
- By Non-acceptance of Tender
- By Breach of Contract
- By Frustration of Contract
- By Mutual Consent
- By Remission or Waiver
- By Accord and Satisfaction
- By Neglect of Promise to provide Facility
- By Operation of Law

**By performance**
The obvious mode of discharge of a contract is by performance, that is, where the parties have done whatever was contemplated under the contract, the contract comes to an end.
Thus where ‘A’ contracts to sell his car to ‘B’ for Rs. 85,000 as soon as the car is delivered to ‘B’ and ‘B’ pays the agreed price for it, the contract comes to an end by performance.

**Tender**
The offer of performance or tender has the same effect as performance. If a promisor tenders performance of his promise but the other party refuses to accept, the promisor stands discharged of his obligations.

**By exemption from performance**
As per 37 of the Act, the parties to a contract must perform unless performance is excused under the provision of this Act, or any other Law.

Sometimes a party may be exempted from performance and is therefore freed from his contractual obligations. For example, in Contracts of personal skill, if the promisor does, his legal representatives are exempted from completing promisor’s promise, and are freed from the performance of contract.

**By non-acceptance of tender**
As per the Sec.38, if a promisor makes a legal and valid tender, then it is performance of a promisor which is completed. Now it is promisee’s duty to accept legal tender. If the promise does not accept such legal tender then there is a breach committed by promise by non-acceptance of Tender. Such contract comes to an abrupt end.

**By breach of contract**
Breach of contract means committing a default in performance. If the promisor in a contract fails or neglects or refuses to perform the contract, there is a breach of contract committed by non-performance.

In short, a contract terminates by breach of contract. Breach of contract may arise in two ways: (a) Anticipatory breach, and (b) Actual breach.

(a) **Anticipatory Breach of Contract**
Anticipatory breach of contract occurs, when a party repudiates it before the time fixed for performance has arrived or when a party by his own act disables himself from performing the contract.

Examples

- A contracts to marry B. Before the agreed date of marriage he married C. B is entitled to sue A for breach of promise.
- A promised to marry B as soon as his (A’s) father should die. During the father’s life time, A absolutely refused to marry B. Although the time for performance had not arrived, B was held entitled to sue for breach of promise [Frost v. Knight L.R. 7 Ex. 111].
- A contracts to supply B with certain articles on 1st of August. On 20th July, he informs B that he will not be able to supply the goods. B is entitled to sue A for breach of promise.

Consequences of anticipatory breach
Where a party to a contract refuses to perform his part of the contract before the actual time arrives the promisee may either: (a) rescind the contract and treat the contract as at an end, and at once sue for damages, or (b) he may elect not to rescind but to treat the contract operative and wait for the time of performance and then hold the other party liable for the consequences of non-performance. In the latter case, the party who has repudiated may still perform if he can.

Thus, from the above discussion it follows that ‘anticipatory breach’ of contract does not by itself discharge the contract. The contract is discharged only when the aggrieved party accepts the repudiation of the contract, i.e., elects to rescind the contract, *Notice that if the repudiation is not accepted and subsequently an event happens, discharging the contract legally, the aggrieved party shall lose his right to sue for damages.*
Example
A agreed to load a cargo of wheat on B’s ship at Odessa by a particular date but when the ship arrived A refused to load the cargo. B did not accept the refusal and continued to demand the cargo. Before the last date of loading had expired the Crimean War broke out, rendering the performance of the contract illegal.

Held: The contract was discharged and B could not sue for damages [Avery v. Bowen (1856) 6 E. & B. 965].

(b) Actual Breach of Contract
Actual Breach occurs when a party fails to perform his/her promise on the due date of performance. It takes place only on the day when the performance is due and not before it. Thus Actual Breach is caused actually at the time of performance when the promisor does not perform.

For instance, A Promises to sell his car to B on a certain date for a certain price. However, A does not sell his car on the specified date. It means that there is an actual breach of contract caused by A.

By frustration of contract (Sec. 56)
Sometimes circumstances change so much after a contract is made that it is impossible to carry it out. For instance, the subject matter of the contract may be destroyed, as where there is a contract to buy a painting, but before it can be handed over, it is stolen or destroyed by fire. If this happens without the fault of either party a court may find that the contract has automatically ceased (‘become frustrated’). In that case neither party will be bound. The court must be satisfied that there is no provision in the contract that the contract should continue to bind even if such an event should occur.

The Frustrated Contracts Act 1988 states that in some circumstances, partial frustration of a contract need not result in the failure of the whole contract. For example, when the circumstances constituting frustration make it impossible to fulfil a particular part of the contract, only that part is frustrated and there remains a part of the contract which can be fulfilled and which continues to bind the parties.

The section talks about contracts which are legal and valid when you are made, but due to some reasons, the act promised becomes impossible or unlawful and therefore the contract becomes void.

Here the contract becomes:
• Unlawful due to change in laws or
• Impossible due to change in the circumstance, beyond the control of the parties.

Under such circumstances, though the contract is good and enforceable in law and its origin, it becomes enforceable and impossible in its performance subsequently. The contract is then said to frustrate and become void. This is known as frustration of contract.

Frustration of contract takes place only in such circumstances where neither party has any control over the supervening circumstances,

Effect of Frustration on Contract
• Void Contract
• No Compensation
• Restitution shall apply
Reasons for Frustration of Contract

- **Destruction of subject matter** – For example, an instance when there is a contract to buy a painting, but before it can be handed over; it is stolen or destroyed by fire. In such a situation, the contract gets void.

- **Change in Law** – For instance, A promises to sell certain liquor bottles to B after 2 months. Both had the necessary licenses as well. Meanwhile the Government puts a total ban on sale and purchase of liquor. The contract between A and B becomes void.

- **By Death or incapacity of Promisor** – Example- A agrees to marry B. A dies before the marriage. Now the contract becomes void.

- **By Non-Existence of favourable state of things** - When certain things necessary for performance cease to exist the contract becomes void on the ground of impossibility.

Examples

- **A** and **B** contract to marry each other. Before the time fixed for the marriage, **A** goes mad. The contract becomes void.

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

**Outbreak of war** - If war is declared between two countries subsequent to the making of the contract, the parties would be exonerated from its performance.

Example

**A** contracts to take indigo for **B** to a foreign port. **A**’s Government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

**Exceptions**

Apart from the cases mentioned above, impossibility does not discharge contracts. He that agrees to do an act should do it, unless absolutely impossible which may happen in any one of the ways discussed above. Some of the circumstances in which a contract is not discharged on the ground of subsequent impossibility are stated hereunder:

- **Difficulty of performance**
  
  The mere fact that performance is more difficult or expensive or less profitable than the parties anticipated does not discharge the duty of performance.

  Example

  **X** promised to send certain goods from Bombay to Antwerp in September, In August war broke out and shipping space was not available except at very high rates.

  Held : The increase of freight rates did not excuse performance.

- **ii. Commercial impossibility**

  It means that if the contract is performed, it will result in a loss to the promisor. Commercial impossibility to perform a contract does not discharge the contract.

  Example

  A contract to lay gas mains is not discharged because the outbreak of war makes it expensive to procure the necessary materials [M/s. Alopi Pd. v. Union of India (1960)S.C. 589].

  However, the Madras High Court in Easun Engineering Co. Ltd. v. The Fertilisers and Chemicals Travancore Ltd. and Another (AIR 1991 Mad. 158) has held that the abnormal increase in price due to war conditions was an untoward event or change of circumstances which ‘totally upset the very foundation upon which parties rested their bargain’.
Therefore, in a contract for supply of transformers, an increase of 400 per cent in the price of transformer oil due to war was held to be an impossibility of performance and the supplier not held liable for breach.

iii. The promisor is not exonerated from his liability if the third person, on whose work the promisor relied, fails to perform. Thus, a wholesaler’s contract to deliver goods is not discharged because a manufacturer has not produced the goods concerned.

iv. Strikes, lockouts and civil disturbances
Events like these do not terminate contracts unless there is a clause in the contract to that effect.

Example
A agreed to supply B certain goods to be produced in Algeria. The goods could not be produced because of riots and civil disturbances in that country.

_Held_ : There was no excuse for non-performance of the contract [Jacobs _v._ Credit Lyonnais (1884) 12 Q.B.D. 589].

v. Failure of one of the objects
If the contract is made for several purposes, the failure of one of them does not terminate the contract.

Example
A agreed to let a boat to H to (i) view the naval review at the coronation and (ii) to cruise round fleet. Owing to the king’s illness, the naval review was cancelled, but the fleet was assembled and the boat could have been used to cruise round the fleet.

_Held_ : The contract was not discharged [Herne Bay Steamboat Co. _v._ Hutton K.B. 740].

By mutual consent (Sec. 62)
If the parties to a contract agree to substitute a new contract for it, or to rescind it or alter it, the original contract is discharged. A contract may terminate by mutual consent in any of the followings ways:

Novation
‘Novation’ means substitution of a new contract for the original one. The new contract may be substituted either between the same parties or between different parties.

_Examples_
- A who owes B Rs. 20,000 enters into an arrangement with him thereby giving B a mortgage of his estate for Rs. 15,000. This arrangement constitutes a new contract and terminates the old.
- A owes money to B under a contract. It is agreed between A, B and C that B shall thenceforth accept C as his debtor instead of A. The old debt of A to B is at an end, and a new debt from C to B has been contracted.

Notice that, the contract which is substituted must be one capable of enforcement in law.

Thus, where the subsequent agreement is insufficiently stamped and, therefore, cannot be sued upon, novation does not become effective, that is, the original party shall continue to be liable.

Rescission
Rescission means cancellation of all or some of the terms of the contract. Where parties mutually decide to cancel the terms of the contract, the obligations of the parties there under terminate.

Alteration
If the parties mutually agree to change certain terms of the contract, it has the effect of terminating the original contract. There is, however, no change in the parties.
7. Remission (Section 63)
Remission is the acceptance of a lesser sum than what was contracted for or a lesser fulfilment of the promise made.

Examples
- A owes B Rs. 5,000. A pays to B who accepts in satisfaction of the whole debt Rs. 2,000 paid at the time and place at which the Rs. 5,000 were payable. The whole debt is discharged.
- A owes B Rs. 5,000. C pays to B Rs. 1,000 and B accepts them, in satisfaction of his claim on A. This payment is a discharge of the whole claim. Thus, in India promisee may remit or give-up a part of his claim and promise to do so is binding even though there is no consideration for doing so.

8. Accord and satisfaction
These two terms are used in English Law. In England remission must be supported by a fresh consideration. The ‘accord’ is the agreement to accept less than what is due under the contract. The ‘satisfaction’ is the consideration which makes the agreement operative. In otherwords, satisfaction means the payment or fulfilment of the lesser obligation. An accord is unenforceable, but an accord accompanied by satisfaction is valid and thereby discharges the obligation under the old contract. Thus, in our above example (1) where B agrees to accept Rs. 2,000 in full satisfaction, the agreement is an accord and cannot be enforced under English Law but when Rs. 2,000 are actually paid to B who accepts them in full satisfaction of his claim of Rs. 5,000 it is a valid discharge, that is the balance of Rs. 3,000 can never be claimed.

9. By Neglect of promisee to provide facility for performance(Sec. 67)
If any promise neglects or refuses to afford the promisor reasonable facilities for the performance, then the promisor is excused by such neglect or refusal of promise.

In certain types of contracts, it is required that the promise should provide reasonable facility for performance. If he neglects, then the promisor is excused from non-performance as a result of such neglect.

For example, a contracts to paint B’s house. If B keeps his house locked all the time, then A is excused for the non-performance of the contract, due to B’s neglect.

By operation of law
Discharge under this head may take place as follows:

By death
Death of the promisor results in termination of the contract in cases involving personal skill or ability.

By insolvency
The Insolvency Acts provide for discharge of contracts under certain circumstances. So, where an order of discharge is passed by an Insolvency Court, the insolvent stands discharged of liabilities of all debts incurred previous to his adjudication.

By merger
When between the same parties, a new contract is entered into, and a security of a higher degree or a higher kind is taken, the previous contract merges in the higher security, for example, a right of action on an ordinary debt which would be merged in the right of suing on a mortgage for the same debt.

By the unauthorised alteration of terms of a written document
Where any of the parties alters any of the terms of the contract without seeking the consent of the other party to it, the contract terminates.
1.6 Legal Remedies for Breach of Contracts

As soon as either party commits a breach of the contract, the other party becomes entitled to any of the following reliefs:

- Rescission of the Contract
- Damages for the loss sustained or suffered
- A decree for specific performance
- An injunction
- Suit on Quantum Merit

Fig. 1.5 Legal remedies for breach of contract

Rescission of the Contract
When a breach of Contract is committed by one party, the other party may sue to treat the contract as rescinded. In such a case, the aggrieved party is freed from all his obligations under the contract.

Example
- A promises B to supply 100 bags of rice on a certain date and B promises to pay the price on receipt of the goods. A does not deliver the goods on the appointed day, B need not pay the price.

Party Rightfully Rescinding Contract Entitled to Compensation (Section 75)
A person who rightfully rescinds the contract is entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract.

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

Damages
Damages, generally speaking, are of four kinds:
- Ordinary Damages
- Special Damages
- Vindictive, or Punitive or Exemplary Damages
- Nominal Damages
- Liquidated Damages And Penalty
- Ordinary Damages (Section 73)
Ordinary damages are those which naturally arose in the usual course of things from such breach. The measure of ordinary damages is the difference between the contract price and the market price at the date of the breach. If the seller retains the goods after the breach, he cannot recover from the buyer any further loss if the market falls, nor be liable to have the damages reduced if the market rises.

Examples

• A contracts to deliver 100 bags of rice at Rs. 100 a bag on a future date. On the due date he refuses to deliver. The price on that day is Rs. 110 per bag. The measure of damages is the difference between the market price on the date of the breach and the contract price, viz., Rs. 1,000.

• A contracts to buy B’s ship for Rs. 60,000 but breaks his promise. A must pay to B, by way of compensation, the excess, if any, of the contract price over the price which B can obtain for the ship at the time of the breach of promise.

Notice that ordinary damages shall be available for any loss or damage which arises naturally in the usual course of things from the breach and as such compensation cannot be claimed for any remote or indirect loss or damage by reason of the breach (Sec. 73).

Example
A railway passenger’s wife caught cold and fell ill due to her being asked to get down at a place other than the Railway Station. In a suit by the plaintiff against the railway company, held that damages for the personal inconvenience of the plaintiff alone could be granted, but not for the sickness of the plaintiff’s wife, because it was a very remote consequence.

Special Damages (Section 73)
Special damages are claimed in case of loss of profit, etc. When there are certain special or extraordinary circumstances present and their existence is communicated to the promisor, the non-performance of the promise entitles the promisee to not only claim the ordinary damages but also damages that may result therefrom.

Examples

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

• A delivers to B, a common carrier, a machine to be conveyed, without delay, to A’s mill, informing B that his mill is stopped for want of the machine. B unreasonably delays the delivery of the machine, and A in consequence, loses a profitable contract with the Government. A is entitled to receive from B, 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. Notice that the communication of the special circumstances is a pre-requisite to the claim for special damages.

Examples
In Hadley v. Baxendale, X’s mill was stopped due to the breakdown of a shaft. He delivered the shaft to Y, a common carrier, to be taken to a manufacturer to copy it and make a new one. X did not make known to Y that delay would result in a loss of profits. By some neglect on the part of Y the delivery of the shaft was delayed in transit beyond a reasonable time. As a result the mill remained idle for a longer time than otherwise would have been had the shaft been delivered in time.

Held: Y was not liable for loss of profits during the period of delay as the circumstances communicated to Y did not show that a delay in the delivery of shaft would entail loss of profits to the mill.
• Where A contracts to sell and deliver to B, on the first of January, certain cloth which B intends to manufacture into caps of a particular kind, for which there is no demand, except at that season. The cloth is not delivered till after the appointed time and too late to be used that year in making caps. B is entitled to receive from A only ordinary damages, i.e., the difference between the contract price of the cloth and its market price at the time of delivery but not the profits which he expected to obtain by making caps, nor the expenses which he has put in making preparation for the manufacture.

Vindictive Damages
Vindictive damages are awarded with a view to punish the defendant, and not solely with the idea of awarding compensation to the plaintiff. These have been awarded (a) for a breach of promise to marry; (b) for wrongful dishonour of a cheque by a banker possessing adequate funds of the customer. The measure of damages in case of (a) is dependent upon the severity of the shock to the sentiments of the promisee. In case of (b) the rule is smaller the amount of the cheque dishonoured, larger will be the amount of damages awarded.

Nominal Damages
Nominal damages are awarded in cases of breach of contract where there is only a technical violation of the legal right, but no substantial loss is caused thereby. The damages granted in such cases are called nominal because they are very small, for example, a rupee or a shilling.

Liquidated Damages and Penalty
Sometimes parties themselves at the time of entering into a contract agree that a particular sum will be payable by a party in case of breach of the contract by him. Such a sum may either be by way of liquidated damages, or it may be by way of ‘penalty’.

Liquidated Damages
The essence of liquidated damages is a genuine covenanted pre-estimate of damages. Thus, the stipulated sum payable in case of breach is to be regarded as liquidated damages, if it be found that parties to the contract conscientiously tried to make a pre-estimate of the loss which might happen to them in case the contract was broken by any of them.

Penalty
The essence of a penalty is a payment of money stipulated as in terorem’ of the offending party. In other words, if it is found that the parties made no attempt to estimate the loss that might happen to them on breach of the contract but still stipulated a sum to be paid in case of a breach of it with the object of coercing the offending party to perform the contract, it is a case of penalty. Thus, a term in a contract amounts to a penalty where a sum of money, which is out of all proportion to the loss, is stipulated as payable in case of its breach. English law recognises a distinction between liquidated damages and penalty whereas liquidated damages are enforceable but penalty cannot be claimed. In India, there is no such distinction recognised between penalty and liquidated damages. Section 74 which contains law in this regard states “When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled (whether or not actual damage or loss is proved to have been caused thereby), to receive from the party who has broken the contract, reasonable compensation not exceeding the amount as named or, as the case may be, the penalty stipulated for.” Thus, where the amount payable in case of breach is fixed in advance whether by way of liquidated damages or penalty, the party may claim only a reasonable compensation for the breach, subject to the amount so fixed.

Examples
• A contracts with B to pay B Rs. 1,000, if he fails to pay B Rs. 500 on a given day. A fails to pay B Rs. 500 on that day. B is entitled to recover from A such compensation, not exceeding Rs. 1,000, as the Court considers reasonable.
• A contracts with B that if A practices as a surgeon within Calcutta, he will pay B Rs. 5,000. A practices as a surgeon in Calcutta. B is entitled to such compensation, not exceeding Rs. 5,000 as the Court considers reasonable.
Payment of interest
Whether payment of interest at a higher rate amounts to penalty shall depend upon the circumstances of the case. However, the following rules may be helpful in understanding the legal position in this regard.

A stipulation for increase from the date of default shall be a stipulation by way of penalty if the rate of interest is abnormally high.

Example
A gives B a bond for the repayment of Rs. 1,000 with interest at 12 per cent, at the end of six months, with a stipulation that in case of default, interest shall be payable at the rate of 75% from the date of default. This is a stipulation by way of penalty, and B is only entitled to recover from A such compensation as the court considers reasonable.

- Where there is a stipulation to pay increased interest from the date of the bond and not merely from the date of default, it is always to be considered as penalty.
- Compound Interest- Compound interest in itself is not a penalty. But it is allowed only in cases the parties expressly agree to it. However, a stipulation (clause in the agreement) to pay compound interest at a higher rate on default is to be considered a penalty. In Sunder Koer v. Rai Sham Krishan (1907) 34 Cal. 150, the Privy Council observed that compound interest at a rate exceeding the rate of interest on the principal money being in excess of the ordinary and useful stipulation, may well be regarded as in the nature of a penalty.”
- An agreement to pay a particular rate of interest with a stipulation that a reduced rate will be acceptable if paid punctually is not a stipulation by way of penalty.

Example
Where a bond provides for payment of interest at 12 per cent per annum with a proviso that, if the debtor pays interest punctually at the end of every year, the creditor would accept interest at the rate of 9 per cent per annum. Such a clause is not in the nature of a penalty and hence interest @ 12 per cent shall be payable.

Specific performance
Where damages are not an adequate remedy, the court may direct the party in breach to carry out his promise according to the terms of the contract. This is called ‘specific performance’ of the contract. Some of the instances where Court may direct specific performance are: a contract for the sale of a particular house or some rate article or any other thing for which monetary compensation is not enough because the injured party will not be able to get an exact substitute in the market.

Specific performance will not be granted where:
- Monetary compensation is an adequate relief.
- The contract is of a personal nature, example, a contract to marry.
- Where it is not possible for the Court to supervise the performance of the contract, example, a building contract.
- The contract is made by a company beyond its objects as laid down in its Memorandum of Association.

Injunction
Injunction means an order of the Court. Where a party is in breach of a negative term of contract (i.e., where he does something which he promised not to do), the Court may, by issuing an order, prohibit him from doing so.

Examples
- G agreed to buy the whole of the electric energy required for his house from a certain company. He was therefore, restrained by an injunction from buying electricity from any other person. [Metropolitan Electric Supply Company v. Ginder].
- N, a film star, agreed to act exclusively for a particular producer, for one year. During the year she contracted to act for some other producer.
Held: She could be restrained by an injunction.

**Quantum Meruit**
The phrase ‘Quantum Meruit’ means as much as is merited’ (earned). The normal rule of law is that unless a party has performed his promise in its entirety, it cannot claim performance from the other. To this rule, however, there are certain exceptions on the basis of ‘Quantum Meruit’. A right to sue on a ‘quantum meruit’ arises where a contract, partly performed by one party, has become discharged by the breach of the other party.
Summary

- Law is basically existent in the form of various rules, regulations or norms of conduct enforced by the State.
- Agreement is a very wide and generic term which includes every promise, which may be legal, illegal, social, domestic, or just a casual promise also.
- Even companies, corporations, countries enter into a contract for their own development and progress.
- In all the contracts, legal relations are created. These legal relations give rise to certain rights and duties, which must be performed.
- The law of Contracts is one of the important branches of Law.
- The Indian Contract Act of 1872 is the most important part of business or Mercantile Law because every business or commercial transaction basically starts from an agreement between two or more persons or parties.
- The party making the offer is known as the offer or, the party to whom the offer is made is known as the offeree.

References

- Geet, S. D., Business Law, Symbiosis Centre for Distance Learning. pp. 5-64.

Recommended Reading

**Self Assessment**

1. An agreement enforceable by law is _________.
   a. contract
   b. promise
   c. proposal
   d. acceptance

2. Every promise and every set of Promises, forming the consideration for each other is an__________.
   a. proposal
   b. acceptance
   c. contract
   d. agreement

3. The term __________ means dominating the will of the other person to obtain an unfair advantage over the other.
   a. fraud
   b. undue influence
   c. misrepresentation
   d. coercion

4. ________ is the cancellation of all or some of the terms of the contract.
   a. Novation
   b. Remission
   c. Rescission
   d. Coercion

5. ________ is the act of giving consent to the proposal.
   a. Acceptance
   b. Promise
   c. Contract
   d. Agreement

6. State which of the following statements is false?
   a. The person making the proposal is called the “promisee” and the person accepting the proposal is called the “promisor.”
   b. Agreements, the meaning of which is not certain, or capable of being made certain, are void.
   c. A proposal when accepted becomes a contract.
   d. The normal rule of law is that unless a party has performed its promise in entirety, it cannot claim performance from the other.
7. Match the following

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ordinary damages</td>
<td>A. claimed in case of loss of profit</td>
</tr>
<tr>
<td>2. Special damages</td>
<td>B. awarded with a view to punish the defendant</td>
</tr>
<tr>
<td>3. Vindictive damages</td>
<td>C. where there is no substantial loss</td>
</tr>
<tr>
<td>4. Nominal damages</td>
<td>D. naturally arise in the usual course of things</td>
</tr>
</tbody>
</table>

a. 1-B, 2-C, 3-D, 4-A  
b. 1-C, 2-D, 3-A, 4-B  
c. 1-D, 2-A, 3-B, 4-C  
d. 1-D, 2-C, 3-A, 4-B

8. Quasi-contracts is a classification of a contract in terms of ____________.
   a. mode of formation  
   b. validity  
   c. mode of performance  
   d. enforceability

9. State which of the statements is false?
   a. If the parties to a contract agree to substitute a new contract for it, or to rescind it or alter it, the original contract cannot be discharged  
   b. Act’ is a specific type of ‘law’ which is also referred to as a codified law.  
   c. There must be a free and genuine consent from both the parties, for the contract to be considered as a valid contract.  
   d. The Indian Contract Act is based on the English Law of Contracts which is unwritten law.

10. In India, the law relating to contracts is contained in the Indian Contract Act of _______.
   a. 1957  
   b. 1999  
   c. 1872  
   d. 1960
Chapter II
Special Contracts

Aim
The aim of this chapter is to:

- introduce various special contracts
- define the responsibilities of a special contracts holder
- describe the essentials of special contracts

Objectives
The objectives of this chapter are to:

- elucidate different kinds of guarantee
- explain the duties of bailee of lost goods
- explicate the role and rights of the special contracts holders

Learning outcome
At the end of this chapter, you will be able to:

- understand various special contracts
- differentiate between contracts and quasi contracts
- identify the duties of the special contracts holders
2.1 Quasi Contracts

‘Quasi Contracts’ are so called because the obligations associated with such transactions could neither be referred as tortious nor contractual, but are still recognised as enforceable, like contracts, in Courts. According to Dr. Jenks, Quasi-contract is “a situation in which law imposes upon one person, on grounds of natural justice, an obligation similar to that which arises from a true contract, although no contract, express or implied, has in fact been entered into by them.”

Example:

X supplies goods to his customer Y who receives and consumes them. Y is bound to pay the price. Y’s acceptance of the goods constitutes an implied promise to pay. This kind of contract is called a tacit contract. In this very illustration, if the goods are delivered by a servant of X to Z, mistaking Z for Y, then Z will be bound to pay compensation to X for their value. This is ‘Quasi-Conract.’ The principle underlying a quasi-contract is that no one shall be allowed unjustly to enrich himself at the expense of another, and the claim based on a quasi contract is generally for money.

2.1.1 Types of Quasi Contracts

Sections 68 to 72 of the Contract Act describe the cases which are to be deemed Quasi contracts.

Claim for necessaries supplied to a person incapable of contracting or on his account

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

Examples

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

• A, who supplies the wife and children of B, a lunatic, with necessaries suitable to their conditions in life, is entitled to be reimbursed from B’s property.

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

• the goods supplied must be necessaries. What will constitute necessaries shall vary from person to person depending upon the social status he enjoys.*

• it is only the property of the incapable person that shall be liable. He cannot be held liable personally. Thus, where he doesn’t own any property, nothing shall be payable.

• Reimbursement of person paying money due by another in payment of which he is interested 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 (Section 69).

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, to prevent the sale and the consequent annulment of his own lease, pays the Government, the sum due from A. A is bound to make good to B the amount so paid.
In order that the Section may apply, it is necessary to prove that:

- The person making the payment is interested in the payment of money, i.e., the payment was made *bonafide*, for the protection of his own interest.
- The payment should not be a voluntary payment. It should be such that there is some legal or other coercive process compelling the payment.
- The payment must be to another person.
- The payment must be one which the other party was bound by law to pay.

- Obligation of a person enjoying benefits 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 [Section 70].

Examples

- A, a tradesman, leaves goods at B’s house by mistake. B treats the goods as his own. He is bound to pay for them.
- A saves B’s property from fire. A is not entitled to compensation from B, if the circumstances show that he intended to act gratuitously.

In order that Section 70 may apply, the following conditions must be satisfied:

- The thing must be done lawfully;
- The intention must be to do it non-gratuitously; and
- The person for whom the act is done must enjoy the benefit of it.

**Responsible of finder of goods**

Ordinarily speaking, a person is not bound to take care of goods belonging to another, left on a road or other public place by accident or inadvertence, but if he takes them into his custody, an agreement is implied by law. Although, there is in fact no agreement between the owner and the finder of the goods, the finder is for certain purposes, deemed in law to be a bailee and must take as much care of the goods as a man of ordinary prudence would take of similar goods of his own. This obligation is imposed on the basis of a quasi-contract. Section 71, which deals with this subject, says: “A person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee.”

- Liability of person to whom money is paid, or thing delivered 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.

Examples

- A and B jointly owe Rs. 1,000 to C. A alone pays the amount to C and B not knowing this fact, pays Rs. 1,000 over again to C. C is bound to repay the amount to B.
- A railway company refuses to deliver certain goods to the consignee except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

*Notice that the term mistake as used in Section 72 includes not only a mistake of fact but also a mistake of law.* There is no conflict between the provisions of Section 72 on the one hand, and Sections 21 and 22 on the other, and the true principle is that if one party under mistake, whether of fact or law, pays to another party money which is not due by contract or otherwise, that money must be repaid [*Sales Tax Officer, Benares v. Kanhaiyalal Makanlal Saraf*, (1959), S.C.J. 53].
2.1.2 Difference between Contracts and Quasi Contracts

In Quasi Contracts, obligation between the parties is not contractual but one which is treated as contractual by law. These obligations are therefore, implied by law. Quasi contracts are also called ‘implied’ contracts. These are implied because they are ‘such obligations’ which resemble those created by contracts. The essentials for formation of a contract are absent but, as the results resemble those of a contract, they are called ‘Quasi Contracts’. They are called ‘Construction Contracts’ under English law. Indian law terms Quasi Contracts as “Certain relations resembling those created by contract.”

Law, in such cases, places the parties in the same position as they would have been if there was a contract between them. Second part of section 73 of the Act gives the right to the injured party in the following words:

“When an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure to discharge it, is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it and had broken his contract”.

It will thus, be observed that Quasi Contracts cannot strictly be called contracts but, they create certain obligations and are, therefore, treated as contracts by law. The aggrieved party is placed in the same position as if the actual contract exists, on the footing that such obligations must be fairly compensated.

Thus, on the basis of the points above, Quasi Contract can be differentiated from Contract as illustrated in the following table.

<table>
<thead>
<tr>
<th>Contract</th>
<th>Quasi Contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Contract is a ‘contract by fact’ and the essentials for formation of contract are present in it</td>
<td>1. Quasi-Contract is a ‘Contract by Law’ and the formation procedure is absent</td>
</tr>
<tr>
<td>2. The Contractual obligations are created by the parties themselves in a contract</td>
<td>2. The contractual obligations are imposed by law in a quasi-contract</td>
</tr>
<tr>
<td>3. The remedy for aggrieved party in case of breach is claim for damages</td>
<td>3. The aggrieved party can claim on the principles of quantum meruit.</td>
</tr>
</tbody>
</table>

Table 2.1 Contract and Quasi Contract

2.2 Contract of Indemnity (Sec. 124)

A contract by which one party promises to save the other from loss caused to him by the conduct of the Promisor himself, or by the conduct of any other person, is called a Contract of indemnity.

Illustration 1:
Mr. Yasir purchased demand draft of Rs 50,000 from a bank. The draft was lost in transit. Mr. Yasir requested the concerned branch to issue a duplicate demand draft. He had to furnish an indemnity bond that in case of any claim on the bank, Mr. Yasir (indemnifier) shall be liable to make good the loss suffered by the bank (Indemnity holder/Indemnified).

All Contracts of Insurance are contracts of indemnity except life insurance:
In such contracts an insurance company (insurer) undertakes to indemnify the respective party (assured), of the losses suffered by the assured in the manner and to the extent agreed in the contract.
A contract of indemnity is a type of contingent contract or conditional contract. The contingency upon which the whole contract depends is the “happening of loss to the promisee”. The contract is formed with the object of protecting the promisee from a contingent anticipated loss. The promisor promises to compensate the loss if it caused by the promisor’s conduct or by the conduct of any other person.

2.2.1 Parties to Indemnity Contract

From the definition, it is very clear that there are two parties in a contract of Indemnity.

- **Indemnifier (Promisor).**
- **Indemnity Holder/Indemnified (Promisee).**

**Indemnifier (Promisor)** - The person who promises to make good the loss is called indemnifier or promisor. He is under a duty, obligation, liability to be fulfilled of required.

**Indemnity Holder/Indemnified (Promisee)** - The person whose loss is too be made good is called Indemnity Holder or promisee or person indemnified. He enjoys a right to be compensated in case of loss.

Example

A contracts to indemnify B against the consequences of any legal proceedings which may take against B with respect to a certain sum of Rs 1 lakh. This is a contract of Indemnity. Here let us suppose that B owed C, the sum of Rs. 1 lakh on a promissory note. Suppose C lost the document but on the due date demanded the due money from B. B was not ready to pay. Hence A requested B ti make the payment and assured him that no suit shall be subsequently filed by C in respect of the promissory note. Here A is the indemnifier and B is the indemnified from the loss if caused to him by C’s conduct of filing a suit against B for recovering Rs 1 lakh.

2.2.2 Essentials of Contract of Indemnity

The following are the various essentials of indemnity contract:

- **No. of Parties**
- **Mode of Contract**
- **Other essentials of Contract**
- **Loss caused to indemnity holder**
- **Commencement of liability of indemnifier**

2.2.3 Rights of Indemnity Holder When Sued

As per the Sce.125 of the Act, the promisee is entitled to recover the following from the promisor:

- Can **recover all damages** incurred /Paid by him.
- Can **recover costs** incurred.
- Can **recover sums** paid under compromise, if any.

**Rights of Indemnifier:**

- **Settled principle of law**: After compensating the loss to indemnity holder, indemnifier is entitled to all the ways and means by which person indemnified might have protected himself for the loss.
- **Time of Commencement of Indemnifier’s Liability**: When indemnity holder incurs an absolute liability though not actual loss.
2.3 Contract of Guarantee (Sec 126)

A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the **surety**; the person in respect of whose default the guarantee is given is called the **principal debtor**, and the person to whom the guarantee is given is called the **creditor**. A guarantee may be either oral or written.

For example, ‘A’ lends money to ‘B’ and ‘C’ promises ‘A’ that if ‘B’ fails to repay he will pay the money.

Examples:
1. **Objects: Enabling a person:**
   To avail loan--Mr. Aslam availed a loan of Rs 1 million from XYZ Bank. The said bank asked the loanee, Mr. Aslam to furnish a guarantee from a credit worthy party. Mr. Aslam requested Mr. Akram to furnish guarantee for the said loan in favor of XYZ Bank.

   Mr. Akram furnished the guarantee as desired by the bank. In case of default by the loanee (Mr. Aslam), the guarantor/surety (Mr. Akram) shall be liable to pay the amount in default.

2. **To make credit purchases:**
   M/S AQ brothers make credit supplies to Hilton enterprises. Under the agreement, M/S Hilton enterprises furnished guarantee of Mr. Suhail. Mr. Suhail shall be liable to make payments to M/S AQ brothers in case of default by Hilton enterprises.

3. **To get employment (furnishing guarantee to employer):**
   Furnishing Guarantee to employer for seeking employment-M/S XYZ bank hired the services of Mr. Salman as cashier and asked him to furnish a guarantee of a third party for a sum of Rs 100,000. Mr. Salman furnished guarantee of Mr. Kamal.

2.3.1 Essentials of a Contract of Guarantee

Essential elements of a contract of guarantee are explained below.

**Tripartite Contract:**
It is an agreement between the principal debtor, creditor and surety. The three separates contracts exist between them. If the promise by principal debtor is not fulfilled, the liability for the surety arises.

In a contract of guarantee the principal debtor is liable and the surety will be liable on principal debtor’s default. The principal contract exists between the principal debtor and the creditor and the contract between creditor and surety is a secondary contract.

**Consideration:**
A contract guarantee like other contracts must fulfill essentials of a valid contract. It must be supported by some consideration. It is not necessary that there must be direct consideration between the surety and the creditor. The consideration received by the principal debtor is sufficient for the surety. (Section 127)

**Misrepresentation:**
A guarantee obtained by means of misrepresentation made by the creditor or with his knowledge and assent, concerning a material part of the transaction is in valid. If the consent of surety will be obtained by misrepresentation, the surety is discharged from his liability. (Section 142)
Concealment:
Any guarantee which the creditor obtains by means of keeping silence to material circumstances is invalid. The expression keeping silence means intentional concealment of the facts. The creditor should disclose to surety the facts which are likely to affect the surety’s liability. (Section 143)

Express Contract:
It is not necessary that the contract of guarantee must be in writing. It may be either oral or written. It may be express of implied from the conduct of parties. (Section 126)

2.3.2 Difference between Indemnity and Guarantee

<table>
<thead>
<tr>
<th>Point</th>
<th>Indemnity</th>
<th>Guarantee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of parties</td>
<td>Two Parties-</td>
<td>Three Parties.</td>
</tr>
<tr>
<td></td>
<td>a) Indemnifier</td>
<td>a) Creditor</td>
</tr>
<tr>
<td></td>
<td>b) Indemnity holder</td>
<td>b) Principal Debtor</td>
</tr>
<tr>
<td></td>
<td></td>
<td>c) Surety</td>
</tr>
<tr>
<td>Number Of contracts</td>
<td>One Contract</td>
<td>Three Contracts:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>a) P.D &amp; Creditor</td>
</tr>
<tr>
<td></td>
<td></td>
<td>b) P. D &amp; Surety</td>
</tr>
<tr>
<td></td>
<td></td>
<td>c) surety &amp; creditor</td>
</tr>
<tr>
<td>Liability of indemnifier</td>
<td>is primary and independent from</td>
<td>Surety’s liability is secondary and conditional.</td>
</tr>
<tr>
<td></td>
<td>Principal debtor</td>
<td></td>
</tr>
<tr>
<td>Request</td>
<td>Indemnifier gives indemnity at his own not on the request of third party.</td>
<td>Surety furnishes/gives guarantee on the request of the principal debtor</td>
</tr>
<tr>
<td>Purpose</td>
<td>Reimbursement of loss.</td>
<td>To Secure performance of a contract (debt etc) by principal debtor.</td>
</tr>
<tr>
<td>Existence of liability</td>
<td>Liability of indemnifier arises only on the happening of a contingency/liability.</td>
<td>Liability already exists performance is guaranteed by the surety, for example, loan already exists - Guarantor promises performance of repayment of loan if P. D defaults.</td>
</tr>
<tr>
<td>Filing of suit</td>
<td>Indemnifier cannot sue (in his name) except when there is an assignment of claim in his favor.</td>
<td>Surety after discharging his obligations can sue principal debtor.</td>
</tr>
<tr>
<td>Nature of undertaking</td>
<td>Indemnifier undertakes to save indemnity-holder from any future loss.</td>
<td>Surety undertakes for the payment of debts of the principal-debtor in case of his default.</td>
</tr>
</tbody>
</table>

Table 2.2 Difference between indemnity and guarantee
2.3.3 Kinds of Guarantee

Simple guarantee
A guarantee which extends to a single debt or transaction is called ordinary, simple or specific guarantee. It comes to an end as soon as the liability under the transaction ends.

Specific and continuing guarantee
Specific Guarantee or (Ordinary Guarantee)- This guarantee is restricted to a specific transaction or engagement. For example availing a loan from a bank.

A guarantee, which extends to a series of transactions is called continuing guarantee. In other words a guarantee which covers a number of transactions over a period of time is called continuing guarantee. It’s like a standing offer which is accepted by the creditor every time a subsequent transaction takes place. Such a guarantee covers a series of transactions. For example guarantee furnished to a supplier for making supplies during the next one year. (Section 129)

Oral and written guarantee
The Contract Act recognizes only express types of guarantee, i.e., either oral or written. A creditor should always prefer to get the guarantee in writing to avoid any disputes in future. Oral guarantee is very difficult to prove in case of dispute.

Retrospective and prospective guarantee
If a guarantee is given for an existing debt it is called as retrospective guarantee. If it is given for a future debt; it is called as a prospective guarantee.

A continuing guarantee with respect to future to future transactions can be revoked by any of the following methods.

By notice of revocation
The surety may revoke at any time a continuing guarantee as to the future transactions by notice to the creditor. However, he remains liable for all transactions prior to the notice.

By death of surety
The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.

By modes of discharging the surety
A continuing guarantee is also revoked under the same circumstances under which surety’s liability is discharged by following modes:

1. **By mutual consent**- when the parties agree to substitute a new contract for the old contract or rescind or alter the old contract, the old contract stands cancelled.

2. **By variance in contract**- Any variance, made without the surety’s consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

   **Illustrations**
   (a) A becomes surety to C for B’s conduct as a manager in C’s bank. Afterwards B and C contract, without A’s consent, that B’s salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his surety ship by the variance made without his consent, and is not liable to make good this loss. Sec.133

3. **By release of principal-debtor**- The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. Sec 134
Illustrations
(a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his surety ship.

4. By Creditor’s act or omission- If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

Illustrations
(a) B contracts to build a ship for C for a given sum, to be paid by installments as the work reaches certain stages. A becomes surety to C for B’s due performance of the contract. C, without the knowledge of A, prepays to B the last two installments. A is discharged by this prepayment.

5. By loss of security – A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of surety ship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

Illustrations
(a) C advances to B, his tenant, 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 rupees by a mortgage of B’s furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

2.3.4 Rights of Surety
The surety enjoys various rights which can be classified as follows:
Rights against creditor
Rights against principal-debtor
Rights against co-sureities
Let us consider them one by one:

A. Rights Against The Creditor
1. Right to securities:
The security at the time of payment can demand the securities which creditor has received from principal debtor at the time of creation of contract, whether surety is aware of such securities or not. If creditor by negligence loses any security held by him, the surety is discharged to that extent from the payment of guaranteed sum. But if security is lost due to unavoidable act, the surety would not be discharged. (Section 141)

2. Right to claim Set-off:
If the principal debtor has some claims against the creditor, the debtor can ask for adjustment of his debts to the extent of his claims. If the creditor sues surety for repayment, the surety can claim set off, if any which principal debtors had against creditor.

B. Rights Against The Principal Debtor
1. Right of Subrogation:
When surety has paid the guaranteed debt on default of principal debtor he is entitled to all the rights, which creditor had against principal debtor. The surety is entitled to all the remedies which are available to creditor against principal debtor. (Section 140)

2. Right of Indemnity:
In every contract of guarantee there is an implied promise by principal debtor to indemnify surety. The surety is entitled to recover from principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully. (Section 145)
C. Rights Against Co-Sureties

Similar Amount:
Where there are sureties for the same debt and the principal debtor has committed a default, each party is liable to contribute equally to the extent of the default.

Different Amount:
Where there are sureties for the same debt for different sums, they are bound to contribute equally subject to the limit fixed by their guarantee. They will not contribute proportionately.

2.3.5 Rights of a Creditor Against Surety

Right to sue
Where the liability of the surety arises, the creditor can sue surety without suing the principal debtor. The liability of surety is immediate and need not be postponed until the creditor has exhausted his remedies against the principal debtor.

Right to proceed before utilizing debtor’s securities
Unless otherwise agreed, a creditor may proceed against the surety before utilizing the debtor’s securities for recovering the amount due.

Right to proceed simultaneously
A creditor may sue principal debtor and surety concurrently recovering his debt.

Right in case of surety’s insolvency
If the surety becomes insolvent, the creditor has the right to recover the dues from the property of the insolvent surety.

Right in case of co-sureties
In case of co-sureties, the creditor is free to proceed against any one of the sureties for recovering the whole debt. This is because the liability of co-sureties is joint and several also.

2.3.6 Discharge of Surety

A surety is said to be discharged when he is freed from his obligations. As a result, his liability as a surety comes to an end. This can happen in various ways, either by the conduct of the surety himself or of the creditors or of the principal debtor or by operation of law

The various methods of discharge of contract are as follows:

1. By payment by principal debtor
If the principal debtor pays off his debt to the creditor, the surety will be discharged. This is the most ideal method of discharging a contract of guarantee.

2. By notice of revocation
The surety may revoke at any time a continuing guarantee as to the future transactions by notice to the creditor. However, he remains liable for all transactions prior to the notice.

3. By death of surety
The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.

4. By novation of contract
When the parties mutually agree to substitute a new contract for the old contract, the old contract of guarantee comes to an end and the surety is discharged under the old contract.
5. By variance in contract
Any variance, made without the surety’s consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

Illustrations
(a) A becomes surety to C for B’s conduct as a manager in C’s bank. Afterwards B and C contract, without A’s consent, that B’s salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss. Sec. 133

6. By release of principal-debtor
The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. Sec. 134

Illustrations
(a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.

7. By Creditor’s act or omission
If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

Illustrations
(a) B contracts to build a ship for C for a given sum, to be paid by installments as the work reaches certain stages. A becomes surety to C for B’s due performance of the contract. C, without the knowledge of A, prepaids to B the last two installments. A is discharged by this prepayment.

8. By loss of security
A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

Illustrations
(a) C advances to B, his tenant, 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 rupees by a mortgage of B’s furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

2.4 Bailment Contract

A Bailment is delivery of goods by one person to another person for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the direction of the person delivering them.

The person delivering goods is called ‘bailor’. The person to whom they are delivered is called the ‘bailee’.
From the definition, it is understood that bailment is a very simple contract which empowers the temporary placement of control over, or possession of personal property by one person, the bailor, into the hands of another, the bailee, for a designated purpose upon which the parties have agreed. It is generally considered to be a contractual relationship since the bailor and bailee, either expressly or impliedly, bind themselves to act according to particular terms. The term bailment is derived from the French bailor, “to deliver”

Examples
1. Delivering vehicle to service station for servicing
2. Giving clothes to a laundry for ironing.
3. Delivering goods to carrier for the purpose of carrying them from one place to another.

Essential features of Bailment Contract
- Delivery: It is delivery of goods by one person to another. For example, delivering a vehicle to workshop for repairs is an actual delivery.
- Purpose: The goods are delivered for some purpose.
- Return: It is agreed, that when the purpose is accomplished the goods are to be returned or otherwise disposed of according to the direction of the bailor.
- Contract: Bailment arises from express or implied contract. In case of bailee of goods bailment arises by implication tit' law.
- Ownership: In bailment the bailor continues to be the owner of the goods. Therefore bailment does not cause any change of ownership.
- Movable goods: Bailment is concerned with only movable goods. Money is not included in the category in movable goods. A deposit of money is not bailment.

Deposit of money in a bank does not constitute bailment. Its relationship between depositor and the bank is that of borrower and the lender.
- Possession: A person already in possession of the goods may become a bailee by a subsequent agreement, express, or implied.

Example:
X is a seller of motor car, having several cars in his possession. Y buys a car and leaves the car in the possession of X After the sale is complete, X becomes a bailee, although originally he was the owner.

Delivery to bailee
“The delivery of goods to the bailee may be made by doing anything which has the effect of putting the goods in the possession of the intended bailee or of any person authorised to hold them on his behalf. -Sec. 149.

Types of Bailment Contract
Bailment is of various types. It can be classified as follows on the basis of:
- Benefit
- Reward to parties

Based on benefit
Bailment for the exclusive benefit of:
- Bailor: In such contracts, only the bailor is benefited but the bailee does not derive any benefit from it. For example, leaving goods in safe custody without paying.
- Bailee: A bailment in which the bailee is exclusively benefited but bailor is not, is of this type. For example, a loan of some article like a pen.
- Mutual benefit: When the bailor delivers his articles to another for repair or gives his goods to carrier for carriage, it is known as bailment for mutual benefit. For example, contracts for hiring, repair, etc.
Based on reward

- Gratuitous bailment: neither bailor nor bailee is entitled for remuneration, example: lending a book to a friend
- Non-gratuitous bailment: bailment of reward: either bailee or bailor is entitled to a remuneration, example: hire, tailor, etc

2.4.1 Duties of Bailor

Bailor is the person who delivers goods to another in a bailment. His duties are as follows:

Bailor’s duty to put bailee into possession (sec. 149)

The very basis of bailment contract is the delivery of goods by bailor to bailee. So the first and foremost duty of bailor is to deliver possession of goods to bailee. Possession of goods can be given by ‘actual’ or ‘constructive’ delivery.

Bailor’s duty to disclose faults in goods bailed

“The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware, and which materially interfere with the use of them, or expose the bailee to extra ordinary risk, and, if he does not make such disclosure, he is responsible for damage arising to the bailee directly from such faults.

If the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the good bailed.”-Sec. 150.

Examples:

- A lends a horse which he knows to be vicious to B. He does not disclose the fact that the horse is vicious. The horse runs away, B is thrown and injured. A is responsible to B for damage sustained. A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury.

Payment of expenses in Gratuitous Bailments

“Where by the conditions of the bailment, the bailee is to receive no remuneration, the bailor shall repay to the bailee the necessary expenses incurred by him for the purpose of the bailment.”-Sec. 158.

Responsibility for breach of warranty of title

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 direction respecting them.-Sec. 164.

Example:
A gives B’s car to C for use without B’s knowledge of permission. B sues C and receives compensation. C is entitled to recover his losses from A.

Bailor’s duty in premature termination of gratuitous bailment (Sec. 159)

Sometimes the goods are delivered by bailor to bailee gratuitously for a certain period or certain purpose. If such bailment is terminated by bailor before the agreed time or before the purpose is accomplished, then the bailor shall indemnify the bailee for any loss caused to the bailee thereby.

Bailor’s duty to receive back the goods

The bailor, who has delivered the goods to bailee, should also take back the goods after bailment. If the bailor refuses to receive back the goods, the bailee will incur expenses for the safe custody of goods. It is the bailor’s duty to repay such additional expenses incurred by bailee.
2.4.2 Duties of Bailee

Following are the duties of a bailee:

**To take reasonable care of the goods bailed**
- According to section 151, in all cases of bailment the bailee is bound to take care of the goods as much as it is his own goods of the same bulk, quality and value.
- Despite reasonable care, if the goods are damaged or destroyed in any way, the bailee is not liable for the loss, destruction or deterioration (Sec. 152) destruction or deterioration. Example: A, who was going out of town, delivered his pet dog to his friend B. Dog gets sick and dies. A was liable as he failed to exercise reasonable care.

**Not to make any unauthorised use of goods**
- If the bailee uses the goods bailed in a manner which is inconsistent with the terms of the contract, he shall be liable for any loss even though he is not guilty of negligence, and even if the damage is the result of an accident (Sec. 154)

Example
A hires B’s car to drive from Mumbai to Pune but drives it to Goa instead. A is liable to compensate B in case it gets damaged in such a scenario.

**Not to mix goods bailed with his own goods**
- The bailee must not mix the goods of the bailor with his own goods
- If bailee mixes the goods with the bailor’s consent both shall have a proportionate interest in the mixture (Sec. 155)
- Without the bailor's consent, if the goods are separated or divided, the bailee is bound to bear the expenses on separation or division as well as damage arising from the mixture (Sec. 156)
- If the mixture is beyond separation, the bailor is entitled to be compensated by the bailee for the loss of the goods (Sec. 157)

Example:
- A bails 100 chocolates bearing a particular mark to B. B, without A’s consent mixes this marked 100 chocolates with his own, bearing a different mark. A is entitled to bear all the expenses incurred in the separation of the chocolates, and any other incidental damage.

**To return the goods**
It is the duty of the bailee to return or deliver, according to the bailor's directions, the goods bailed, without demand, as soon as the time has expired or the purpose of the bailment is accomplished (Sec.160)

If bailee fails to deliver the goods, he is responsible to bailor for any loss (Sec. 161) For example, A hires a horse for 4 days, fails to return and subsequently the horse dies. In such a case, A has to pay price of the horse.

Example:
‘A’ hires ‘B’’s car for 2 days. B does not return the car even after 2 days. The car is damaged by floods thereafter. B is liable for the damages due to delay, in addition to the actual loss caused to A.

**To return any accretion to the goods**
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 (Sec. 163)
Example:
A leaves his 5 hens in the custody of B for taking care of them. The hens give birth to 10 chickens. B is bound to deliver back the hens with the chickens.

2.5 Rights of the Bailor

The duties of bailee are in fact the rights of bailor. Enforcement of Bailor’s rights- Bailor can enforce all the duties of bailee.
The various rights of a bailor are as follows:

**Rights of taking back the goods bailed**
The bailor has right to take back the goods bailed as soon as the purpose of bailment is completed. If the bailee defaults in so returning, the bailor has right to receive compensation.

**Right in case of unauthorised use of goods**
The bailor is entitled to terminate the contract of bailment if the bailee makes the unauthorized use of the goods bailed.

**Right to goods bailed before stated period**
The bailor may get back his goods before the time stated in the contract of bailment with the consent of the bailee.

**Right to dissolution of contract**
The bailor may dissolve the contract if the conditions of bailment are disobeyed by the bailee.

**Right to gratuitous goods**
The bailor has right it terminate the contract of gratuitous bailment at any time even before the specified time, subject to the limitation that where such a termination of bailment causes loss in excess of benefit, the bailor must compensate the bailee.

**Right in share of profit**
The bailor has share in the increase or profit gained from the goods bailed if there is provision in the contract

**Compensation from a wrongdoer**
If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, the bailor or the bailee may bring a suit against the third person for such deprivation (Sec. 180)

**Return of goods lent gratuitously**
The bailor can demand the return of goods whenever he pleases even though he lent them for a specified time or purpose (Sec. 159)

2.5.1 Rights of the Bialee

The duties of bailor are in fact the rights of bailee,

Enforcement of Bailee’s rights- Bailee can enforce all the duties of bailor, by filing a suit.

The various rights of a bailee are as follows:

**Right to recover damages**
A bailee has right to recover damages from the bailor if he suffers any loss due to defects of the goods bailed.

**Right to receive compensation**
A bailee is entitled to receive compensation from the bailor for any loss resulting from the defect in the bailor’s title.
Right of legal action
A bailee may take necessary legal action against the person who wrongfully deprives him of the use of goods bailed or does them any injury (Sect. 180)

Right to recover bailment expenses
Bailee is entitled to be reimbursed for all legitimate expenses incurred for any purpose of bailment.

Right of lien
Where the lawful charges of the bailee in respect of the goods bailed are not paid, he may retain the goods. This right of the bailee is known as ‘particular lien’ (Sect. 170)

Right of indemnity
The bailee has right to receive the amount of indemnity from bailor for any loss which he 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. (Sect. 164)

Delivery of goods to one of several joint bailors of goods
If several joint owners of the goods bailed, the bailee may deliver the goods back to one joint owner without the consent of all, unless there is no contrary agreement (Sec. 165)

Delivery of goods to bailor without title
If bailor does not hold the title of the goods, bailee is not responsible to the owner of the goods (Sec. 166)

Right to apply to court to stop delivery
If a person other than the bailor claims the goods bailed, the bailee may apply it to court to stop the delivery of the goods to bailor and to decide the title to the goods (Sec. 167)

Right of action against trespassers
If a third person wrongfully deprives the bailee of the use or possession of the goods bailed to him he has the right to bring an action against that party (Sec. 180)

2.5.2 Rights of Bailor and Bailee against Wrongdoers
Rights of Bailor and Bailee against Wrongdoer [Section 180] If a third party wrongfully deprives a bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.

Apportionment of Relief or Compensation Obtained by Such suits [Section 181]
Whatever is obtained by way of relief or compensation in any such suit shall as between the bailor and the bailee, be dealt with according to their respective interests.

Example
X delivered a TV to Y for repairs. Z forcefully takes the possession of TV from Y’s shop. In this case, either X or Y may sue Z. If Y files the suit, he shall hand over the amount received after deducting his repair charges to X.

2.5.3 Types of Lien
Lien

Lien means the right of a person to retain possession of some goods belonging to another until some debt of or claim of the person in possession is satisfied
Possession is essential for exercising the right of lien. Thus, Lien can be defined as a right 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 of them.

- In order to create a lien, the possession must be:
  - Rightful
  - Not for a particular purpose
  - Continuous

- **Extinguishment of Lien**
  A lien is extinguished or lost by:
  - Abandonment
  - Payment or tender of the amount due
  - Loss or surrender of possession of the goods

There are two types of lien, which are as follows:

![Diagram of Types of Lien](https://via.placeholder.com/150)

**Fig. 2.1 Types of lien**

**A particular lien**

Lien which is available to the bailee against only those goods in respect of which he has rendered some service involving the exercise of labour or skill.

According to 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 service he has rendered in respect of them.

- If the bailee does not complete the work within the agreed time, or a reasonable time, he cannot exercise his right of lien.
- If the bailee voluntarily permits the bailor or regains possession of the goods without payment of the charges, he cannot exercise the right of lien.
- If without any fault of the bailee, the goods are destroyed or stolen, the bailee is entitled to be paid for services performed upon the goods before they were destroyed or stolen.

**Example**

A gives his clothes to a laundryman B for dry-cleaning. B can retain the clothes till his bill is paid. But he cannot withhold if he has given a credit period.
A general lien

It is a right to retain all the goods or any property of another until all the claims of the holder are satisfied

- According to section 171, general lien is available to bankers, factors, wharfingers, attorneys of High Court and policy brokers.
- These individuals are entitled to retain possession of the goods bailed to them as security until their claims are fully satisfied.

Example
A has taken two distinct loans from a bank B, against two securities. A repays one of these loans. The banker B retain both the securities until the other loan is repaid.

Difference between Particular Lien and General Lien
From the above discussion we can conclude the following difference between particular lien and general lien

<table>
<thead>
<tr>
<th>Point</th>
<th>Particular Lien</th>
<th>General Lien</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Goods</td>
<td>It can be exercised only against the goods on which some remuneration is due</td>
<td>It can be exercised against all goods in possession of bailee whether in respect of which claims are due or not</td>
</tr>
<tr>
<td>2. Object/Purpose</td>
<td>It can be exercised only for recovery of remuneration for services rendered.</td>
<td>It can be exercised for a general balance of account due.</td>
</tr>
<tr>
<td>3. Which bailee entitled?</td>
<td>Available to any bailee in absence of contract to contrary</td>
<td>Available only to bailees specified in sec. 171, unless there is an express contract to that effect.</td>
</tr>
<tr>
<td>4. Purpose of Delivery</td>
<td>Goods are delivered to confer an additional value on the goods bailed</td>
<td>Goods are delivered as security to bailee usually.</td>
</tr>
</tbody>
</table>

Table 2.3 Difference between particular lien and general lien

2.5.4 Finder of Lost Goods
Responsibility of Finder of goods-According to 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. Such a person is termed as the Finder of goods.

Rights of finder of goods
- Right of lien
  According to section 168, the finder of lost goods has a right of lien over the goods for his expenses.
- Right to sue for reward
  According to section 168, the finder can sue for any specific reward which the owner has offered for the return of goods.
- Right of sale
According to section 169, finder may sell the goods found

- If the true owner cannot be found after reasonable diligence
- If found, he refuses to pay the lawful charges
- If the goods are in the danger of perishing or of losing the greater part of their value
- If the lawful charges of the finder, amount to two-third of their value

**Duties of finder of lost goods**

**He must take reasonable care of the goods**
Although, there is in fact no agreement between the owner and the bailee of the goods, the bailee is for certain purposes, deemed in law to be a bailee and must take as much care of the goods as a man of ordinary prudence would take of similar goods of his own.

**He must not use the goods for his own purpose**
If the finder uses the goods bailed in a manner which is inconsistent with the terms of the contract, he shall be liable for any loss even though contract, he shall be liable for any loss even though he is not guilty of negligence, and even if the damage is the result of an accident (Sec. 154). Example, A hires B’s car to drive from Mumbai to Pune but drives it to Goa instead. A is liable to compensate B in case it gets damaged in such a scenario.

**He must not mix the goods with his own goods**
The finder must not mix the goods of the owner with his own goods. If finder mixes the goods with the owner’s consent both shall have a proportionate interest in the mixture (Sec. 155) Without the owner’s consent, if the goods are separated or divided, the finder is bound to bear the expenses on separation or division as well as damage arising from the mixture (Sec. 156) If the mixture is beyond separation, the owner is entitled to be compensated by the finder for the loss of the goods (Sec. 157)

**He must try to find out the owner of the goods**
Finder must take reasonable efforts in finding out the true owner of goods. For this purpose he may incur some expenses in publishing notices, advertisements etc which are known as ‘lawful expenses’.

**2.5.5 Termination of Bailment**
A contract of bailment terminates or comes to an end under the following circumstances:

**On the expiry of the period**
Bailment for a specified period terminates as soon as the fixed or stipulated period expires.

**On the achievement of the object**
Bailment for a specified purpose terminates as soon as the purpose for which the goods are bailed is fulfilled.

**Inconsistent use of goods (Sec. 154)**
If a bailee doe any act with regard to the goods bailed, which are inconsistent with the conditions of bailment, then the bailor can terminate the contract.

**Destruction of the subject-matter**
Bailment can be terminated if the subject-matter or the goods are destroyed.

**Gratuitous bailment**
Gratuitous bailment may be terminated by the bailor at any pre-mature time. However the bailor has to indemnify the bailee if the loss due to premature termination exceeds the benefit actually derived by the bailee.

**Death of the bailor or bailee**
A gratuitous bailment is terminated by the death of wither the bailor or bailee.
2.6 Contract of Pledge

The bailment of goods as security for payment of a debt or performance of a promise is called “pledge”. The bailor is in this case called “pawnor”. The bailee is called “pawnee”.

From the definition, it is found that, there are 3 essential features of a pledge
- There must be bailement of goods, i.e., delivery of goods,
- The bailment must be by way of security, and
- The security must be for payment of debt or a performance of promise. There are two parties to a pledge- ‘Pawnor (who delivers the goods)’ and ‘Pawnee (To whom the goods are delivered)’

Example:
A borrows Rs.2 laks from a bank B and keeps his ornaments as security for payment of the debt. It is a contract of pledge, where A is the Pawnor and B is the Pawnee.

2.6.1 Advantages of Pledge
In case of pledge contract the relationship between the Pawnor and Pawnee is that of a debtor and creditor respectively. To a creditor/Pawnee, pledge is perhaps the safest mode of creating a charge on securities, because:
- The goods are in the possession of the creditor. In case of debtor’s default, they can be disposed of with a proper procedure.
- Goods cannot be manipulated because they are under pawnee’s control.
- Incase of insolvency of pawnor, pawnee can sell the goods in his custody and recover his debt.

2.6.2 Difference between Pledge and Bailment
Both Pledge and Bailment are specific types of contracts. Pledge is a specific type of bailment. Both deal with movable goods only. In both, there is transfer of possession only and not transfer of ownership. However there are many differences between them, which are as follows

<table>
<thead>
<tr>
<th>Point</th>
<th>Pledge</th>
<th>Bailment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Purpose of Delivery</td>
<td>Goods are pledged for a specific purpose i.e. repayment of a debt or performance of a promise.</td>
<td>Goods are bailed for any purpose</td>
</tr>
<tr>
<td>2. Object of contract</td>
<td>Goods are pledged as a security</td>
<td>Goods are bailed for a specific purpose or for a particular period of time</td>
</tr>
<tr>
<td>3. Use of Goods</td>
<td>Pawnee cannot use the goods. He has to simply keep them as a security</td>
<td>Bailee may use them or provide some services with respect to goods as per the conditions of bailment.</td>
</tr>
<tr>
<td>4. Right available in case of default</td>
<td>In case of default by pawnor, pawnee can sell the goods.</td>
<td>Bailee has right of lein and right to use bailor for duties.</td>
</tr>
</tbody>
</table>

Table 2.4 Difference between pledge and bailment
2.6.3 Rights and Duties of Pawnee
Rights of Pawnee are as follows:
• Right of retainer (Sec 173,174))
• Right to recover expenses (Sec. 175)
• Right on default by pawnor (Sec. 176)

Pawnee’s right of retainer (Sec 173)
The pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interests of the debt, and all necessary expenses incurred by him in respect to the possession or for the preservation of the goods pledged.

Pawnee cannot retain the goods for debt or promise other than, for which pledged - presumption in case of subsequent advances (Sec 174)
The pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise of other than the debtor promise for which they are pledged; but such contract, in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the pawnee.

Pawnee’s right as to extraordinary expenses incurred (Sec175)
The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged.

Pawnee’s right where pawnor makes default(Sec176)
If the pawnor makes default in payment of the debt, or performance, at the stipulated time, or the promise, in respect of which the goods were pledged, the pawnee may bring as suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or he may sell the thing pledged, on giving the pawnor reasonable notice of the sale. If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater that the amount so due, the pawnee shall pay over the surplus to the pawnor

2.6.4 Rights and Duties of Pawnor
The duties of pawnnee are in fact the rights of pawnor. The various rights of a pawnor are as follows:

Enforcement of Pawnor’s rights
Pawnor can enforce all the duties of pawnee by legal action against him. For example, Right to get back his goods, right to receive accretion to the goods etc.

Defaulting pawnor’s right to redeem (Sec 177)
If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledged is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them; but he must, on that case, pay, in addition, any expenses which have arisen from his default.

The most important duties of the pawnor, are as under:
• Pawnor’s duties are same as bailor’s duties.
• Pawnor’s duty to comply with the terms of pledge.
• Pawnor’s duty to compensate the pawnee for extraordinary expenses.
2.6.5 Pledge by Non-owners
The general rule is that, only the owner of goods can create a valid pledge. This means, it is presumed that, in a pledge, the owner is the owner of the goods. In other words, a pawnor should be the owner of the goods.

But exceptionally, even a non-owner can pledge the goods, and the pledge is still legal and valid. The following non-owners can pledge the goods in the following circumstances:

Pledge by mercantile agent(178)
Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has not authority to pledge.

Explanation : In this section, the expression “mercantile agent” and “documents of title” shall have the meanings assigned to them in the Indian Sale of Goods Act, 1930 (3 of 1930).

Pledge by person in possession under voidable contract(Sec178A)
When the pawnor has obtained possession of the other goods pledged by him under a contract voidable under section 19 of section 19A, but the contract has not been rescinded at the time of the pledge, the pawnee acquired a goods title to the goods, provided he acts in good faith and without notice of the pawnor’s defect of title.

Pledge where pawnor has only a limited interest(Sec179)
Where person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest.

Pledge by a co-owner in possession
When there are several joint owners of goods, of which one co-owner is in possession of the goods, he with the consent of the rest, can make a valid pledge of goods.

Pledge by seller in possession after sale
A seller is still in possession of goods after sale if he makes a pledge of goods, it will be a valid pledge provided the pawnee has acted in good faith and without knowledge as to the defective title of the pawnor/seller.
Summary

- Quasi-contract is a situation in which law imposes upon one person, on grounds of natural justice, an obligation similar to that which arises from a true contract, although no contract, express or implied, has in fact been entered into by them.

- A contract by which one party promises to save the other from loss caused to him by the conduct of the Promisor himself, or by the conduct of any other person, is called a Contract of indemnity.

- A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default.

- A Bailment is delivery of goods by one person to another person for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the direction of the person delivering them.

- In a Bailment contract The person delivering goods is called ‘bailor’. The person to whom they are delivered is called the ‘bailee’.

- The duties of bailee are in fact the rights of bailor. Enforcement of Bailor’s rights- Bailor can enforce all the duties of bailee.

- A Lien is the right of a person to retain possession of some goods belonging to another until some debt of or claim of the person in possession is satisfied.

- A Finder of goods is subject to the same responsibility as a bailee. He is responsible for finding goods belonging to another person and taking them into his own custody.

- The bailment of goods as security for payment of a debt or performance of a promise is called “pledge”.

- In case of a pledge, the bailor is called a “pawnor”. The bailee is called “pawnee”.

- The duties of pawnee are in fact the rights of pawnor. Enforcement of Pawnor’s rights- Pawnor can enforce all the duties of Pawnee.

References


Recommended Reading

Self Assessment

1. Sections 68 to 72 of the Contract Act describe the cases which are to be deemed as _________.
   a. Bailment Contract
   b. Pledge’ Contract
   c. Contract of Guarantee
   d. Quasi contracts

2. ________ is the right of a person to retain possession of some goods belonging to another until some debt of or claim of the person in possession is satisfied.
   a. Lien
   b. Pledge
   c. A Guarantee
   d. Indemnity

3. The bailment of goods as security for payment of a debt or performance of a promise is called _________.
   a. Guarantee
   b. Indemnity
   c. Pledge
   d. Surety

4. Which of the following statements is false?
   a. Pawnor’s duties are same as bailor’s duties.
   b. Pawnor’s duty is to comply with the terms of pledge.
   c. The duties of pawnee are in fact the rights of pawnor.
   d. Pawnor is the person to whom the goods are delivered.

5. A ________ is the right to retain all the goods or any property of another until all the claims of the holder are satisfied.
   a. General Lien
   b. Particular Lien
   c. Lien
   d. Guarantee

6. Which of the following statements is false?
   a. The bailor cannot demand the return of goods from the bailee in a case where he lent them for a specified time or purpose.
   b. If bailor does not hold the title of the goods, bailee is not responsible to the owner of the goods.
   c. A bailment contract is delivery of goods by one person to another.
   d. The bailor is entitled to terminate the contract of bailment if the bailee makes the unauthorized use of the goods bailed.

7. Liability of ________ arises only on the happening of a contingency/liability.
   a. indemnifier
   b. bailor
   c. indemnity holder
   d. finder of goods.
8. The number of parties involved in a Contract of guarantee are ________.
   a. Two
   b. Four
   c. Three
   d. Five

9. A ________ bailment is one in which neither the bailor nor the bailee is entitled to any remuneration.
   a. Gratuitous
   b. Non-Gratuitous
   c. Reward
   d. Benefit

10. In a contract of guarantee, the person who gives the guarantee is called the ________.
    a. Principal Debtor
    b. Creditor
    c. Surety
    d. Guarantee
Chapter III
Sales of Goods Act, 1930

Aim
The aim of this chapter is to:

- introduce the Sales of Goods Act, 1930
- define Contract of Sale
- describe Caveat Emptor

Objectives
The objectives of this chapter are to:

- explain the essentials of a contract of sale
- classify different conditions and warranties
- elucidate the formalities for a Contract of Sale

Learning outcome
At the end of this chapter, you will be able to:

- understand the concept of transfer of property
- comprehend conditions and warranties
- differentiate between sale and agreement to sell
3.1 Introduction
Sale of Goods Act is one of the old mercantile laws. Sale of Goods is special type of contract. Initially, this was a part of the Indian Contract Act itself in chapter VII (sections 76 to 123). Later these sections were deleted from the Contract Act and separate Sale of Goods Act was passed on 15 March, 1930. It came into force on 1 July, 1930 as Indian Sales of Goods Act 1930. Later many amendments were made as under:

- The Repealing act, 1938(1 of 1938).
- The Act 41 of 1940.
- The Part B States (Laws) Act, 1951 (3 of 1951).

Definition of contract of sale
“A contract of sale of goods is a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a price, i.e. money consideration”. This contract applies to the sale of the property, which includes every movable property (stock and shares, growing crops, grass and things attached to or forming part of the land that are agreed to be severed before sale or under the contract of sale). This sale is, though, not applicable to actionable claims and money. Under the Contract of Sale, the property in goods is immediately transferred from the buyer.

3.1.1 Salient Features of Sale of Goods Act, 1930
The salient features of the Sale of Goods Act, 1930 are given below.

- The laws relating to the sales of goods, both in India and England, are codified. In India the statue is known as the Sale of Goods Act, 19930 (Act III OF 1930), in England it was known as the Sales of Goods Act, 1893, a successful codification of the English Common Law.
- The (Indian) Sale of Goods Act, 1930 is largely based on the (English) Sales of Goods Act, 1893, which is now repealed by the English Sale of Goods Act, 1979.

3.1.2 Essentials of a Contract of Sale
The essential elements that constitute a valid contract of sale are as follows.

Two parties
The two parties for the contract of sales of good are a seller and a buyer; both should be two different persons. A buyer is a person who buys or agrees to buy and a seller is a person who sells or agrees to sell. There are certain exceptions to this rule. A person may buy his own goods in certain cases like auction sale {Section 64 (3)} , execution of a decree, etc.

Goods
The goods must be a movable property other than actionable claims, money, stock and shares, growing crops, grass and thing attached to or forming part of land which are agreed to be served before sale or under the contract of sale. The transaction involving the purchase of immovable property is out of view of Sales of Goods Act, 1930.

Transfer of property
There must be a transfer of property or agreement to transfer the property at the time of the contract of sale. If the property is transferred to the buyer at the time of contract, it is considered as a sale. If the property in the goods is to be transferred in future or subject to some condition to be fulfilled. It is an agreement to sell. The agreement to sell becomes a sale when the time elapses or the conditions are fulfilled.
Monetary consideration – price
If the goods are exchanged for goods, i.e., no sale is done, it does not come under contract of sale. It is just considered as a gift. Therefore, the consideration for the contract of sale must be money. But where the goods are exchanged partially for money and partially for goods, then it will be a contract of sale.

Essential elements of a valid contract
The sale of contract should also satisfy all the essential elements necessary for a formation of a valid contract, as laid down in Section 10 of the contract Act. For example, an object of a contract should be lawful, all parties must be competent to enter in to contract etc. The contract of sale may be absolute or conditional.

A Contract of Sale includes sale as well as an agreement to sell
A contract of sale may be a sale or an agreement to sell.

3.1.3 Sale and Agreement to Sell
Where under a contract of sale the property in the goods in transferred from the seller to the buyer, the contract is called a sale, but where the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an agreement to sell. [Section 4(3)]. An agreement to sell becomes a sale when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred. [Section 4(4)] Thus, where the transfer of any property (movable) in goods is to take place at a future time or subject to certain conditions thereafter to be fulfilled is nothing but an agreement to sell the goods or property. For example, suppose X agrees today that he will sell his 10 bags of rice to B on the 21st June for Rs. 2000/- on the condition that B should pay 50% of the amount immediately and rest on the 21st June. This is the agreement to sell.

Difference between sale and agreement to sell
As noted earlier, contract of sale is a generic term and includes both sale and an agreement to sell. The two, however, have different legal ramifications. The rights and obligations of the parties vary with the fact that whether the transaction is a sale or an agreement to sell. Distinction between the two is, therefore, of prime importance. The vital point of distinction between the two is that in a sale the buyer becomes the owner of the goods as soon as the contract of sale is made, whereas in an agreement to sell, the seller continues to be the owner of the goods agreed to be sold, till it becomes a sale. An agreement to sell becomes a sale on the expiry of the stipulated time or when the conditions are fulfilled subject to which the property in goods is to be transferred. Other points of distinction between the two may be noted as under:

- A ‘sale’ is an executed contract whereas an agreement to sell is always an executory contract. Executed means that the ownership of the goods has been transferred to the buyer, while executory means that something remains to be done, i.e., ownership shall pass on some future date.

- An agreement to sell is a contract, which is pure and simple, and creates merely “jus in personam”, i.e., gives a right to either buyer or seller against the other for any default in fulfilling his part of the agreement. A ‘sale’ is a contract plus conveyance, and creates “jus in rem”, i.e., gives right to the buyer to enjoy the goods as against the whole world including the seller.

- In a sale, if the buyer wrongfully refuses to accept the goods and pay the price, the seller can sue for the price even if the goods are in his possession, and he can exercise the right ‘of lien, stoppage of goods in transit and of resale. But, in an agreement to sell, only remedy available to the seller is to sue for damages if buyer fails to accept and pay for the goods. For example, A sells ten bags of rice to B for Rs. 3,000. If B refuses to accept the goods, A can file a suit against B for price even though the goods are in A’s possession. But, instead, if it was an agreement to sell, then A’s only remedy is to claim damages from B because the ownership has not yet passed to B.
In an agreement to sell, the seller being still the owner, can dispose of the goods as he likes and the buyer’s remedy against the seller’s breach is a suit for damages. For example, A agreed to sell a particular horse to B for Rs. 5,000. Subsequently A sells the same horse to C for Rs. 6,000. B’s remedy is to claim damages from A. B cannot recover the horse from C. In a ‘sale’, breach by the seller gives the buyer a double remedy; a suit for damages against the seller, and the right to follow property in the hands of the subsequent buyer. Thus, in sale if the goods are resold, the buyer can recover them as the owner from the subsequent purchaser.

If, in the above example where A sells a particular horse to B for Rs. 5,000 and subsequently it is sold to C for Rs. 6,000, B shall have the right to recover the horse from C, because at the time of sale A was no longer the owner of the said horse. B can also claim damages from A for wrongful conversion.

‘Risk follows ownership’ is the golden rule, i.e., whosoever the owner of the goods at the time of loss, will bear the loss.

In case of ‘sale’, if there is any loss to the goods, the loss will fall on the buyer, even though the goods are in the possession of the seller. On the other hand in case of ‘an agreement to sell’, the loss shall be borne by the seller, even though the goods are in the possession of the buyer. It is because; ownership in case of agreement to sell, continues to vest in the seller.

Insolvency of the seller: If in a sale the seller becomes insolvent while the goods are still in his possession, the buyer shall have a right to claim the goods from the official receiver or assignee because the ownership of goods has passed to the buyer. However, in case of an agreement to sell, the buyer cannot claim the goods even when he has paid the price. Buyer’s only remedy in this case is to claim rateable dividend for the money paid from the estate of the insolvent seller.

Insolvency of the Buyer: In case of sale, if the buyer becomes insolvent before paying the price, the ownership having passed to the buyer, the seller shall have to deliver the goods to the official assignee or receiver. For the unpaid price, the seller will rank as an unsecured creditor and thereby entitled to rateable dividend out of the estate of the insolvent buyer. In case of an agreement to sell where the seller continues to be the owner of the goods, the seller can refuse to deliver the goods to the official assignee or receiver unless he is paid full price of the goods.

3.1.4 Sale and Hire-Purchase Agreement

Hire-purchase agreement is an agreement in which the seller agrees to transfer the property in the goods to the hire-purchaser on the payment of the certain sum or installment. But if the hire-purchaser fails to pay the installment, the buyer can terminate the contract and take away the good sold under the hire-purchase agreement. It is merely a bailment as the given installment is taken as the rent for the use of the goods. Even hirer can return the goods without any obligation to pay the balance rent.

3.1.5 Sale and Bailment

In case of sale, the property in goods is bought by the buyer in a contract of sale, whereas in bailment, there is only a transfer of the possession of the property from the bailor to the bailee.

In case of the contact of sale, the buyer may use the good in whichever way he pleases but in bailment, the bailee can deal with the goods according to the bailor’s instruction.

3.1.6 Sale and Barter Exchange

In contract of sales, the property in goods is transferred in exchange of money set by them, whereas, in barter, transfer of goods is for goods only. In both the cases the ownership is transferred from one party to another. Barter transactions are not contract of sales where the sale is done partially in exchange of money and goods, it is taken as sale.
3.2 Formalities of a Contract of Sale

A contract of sale should satisfy all the essentials of the contract offer from one party and the acceptance by the other is also necessary. It may be oral or written or partially in written and partially in oral. In a contract of sale, however, the offer and acceptance must be related to buy or sell movable goods for a price. The contract of sale may provide immediate payment or delivery of goods or my postpone both.

3.2.1 Goods

As stated above, the contract of sale must always be for movable goods. Goods can be further classified into three types:

**Goods**
- **Existing goods**
  - Goods, which are owned and possessed by the seller at the time of the sale, are existing goods. Existing goods are further of three types:
    - **Specific goods**
    - The goods, which can be identified and agreed at the time of sale is made are called specific goods.
    - **Ascertained goods**
    - Goods identified or which become ascertained subsequent to the formation of contract of sale are called ascertained goods.
    - **Unascertained or generic goods**
    - The goods which are not identified and agreed upon at the time of the contract of sale are the ascertained or generic goods. Such goods are defined by description only and may form a part of a lot.

For example, if A decides to sell one of the chair, out of twenty, to B, pointing it out at the time of the sale to B, then such sale is the contract of sale of specific goods. If A decides to sell a chair to B, but does not specify which chair he will sell, then such a sale become sale of contract of unascertained goods. The chair will become ascertained only when A makes up his mind as to which chair he will sell to B and B gives his ascent there.
Future goods
The goods which are yet to be manufactured, produced or acquired are called future goods. The buyer, actually, does not possess the future goods at the contract of the sale. It is operated as the agreement to sell the goods, not as the sale because the buyer can only transfer it after the manufacturing of the product.

Contingent goods
Contingent goods are kind of future goods, whose acquisition by the seller depends on the uncertain contingency. For Example: X agrees to sell 1000 yards of imported coupon to Y, provided the ship which is bringing the goods reaches the port safely. This is agreement of the sale of the contingent goods.

In future goods the parties are not discharged on the non-production or non-acquisition of the production goods, whereas, in case of contingent goods the procurement depends on the contingency, therefore, the parties to the contract of sale are discharged on non-acquisition of goods.

3.2.2 Effects of Destruction of Goods
Section 7 of this act states that the contract voids, if the goods, without the knowledge of the seller, at the time when the contract was made, perished or become damaged as no longer an answer to their description in the contract, for example, X agrees to sell a specific cargo of goods to Y, which was on the way, but on the day of the bargain, the cargo was lost and non of the parties were aware of the loss of cargo. The agreement becomes void.

Section 8 of the Act states that, where there is an agreement to sell specific goods, but the goods perish or get damaged, without the knowledge of the buyer or seller, as no longer to the answer to their description as the agreement before the risk passes to the buyer, the agreement is thereby avoided. Thus, this section deals with the cases where the goods perish after the agreement to sell is made. A contract can be avoided on the ground of the performance of the contract and for that purpose the following conditions must be satisfied:

• The contract must be an agreement to sell and not of actual sale.
• The loss must be specific.
• The loss is not caused by the wrongful act of the either buyer or seller.
• The goods get perished before the risk is passed to the buyer.

This apply to some specific goods only and not to unascertained goods. It means if the agreement to sell is the unascertained goods, the perishing and the destruction of even the whole stock of goods in the possession of the seller will not relieve him of his obligation of delivering the goods.

3.2.3 Ascertainment of Price
According to Section 2 (10), the price forms an essential part of the contract of sale. The price in a contract of sale means the money consideration for the sale of goods. It is mandatory to express the price in the form of money only. Though, it is not important to fix the price at the time of the sale only.

Section 9 states that the price can be fixed by the contract or left to be fixed in a manner thereby agreed or may be determined by the course of dealing between the parties. It further states that if the price is not determined in accordance with the forgoing provision, then the buyer will pay the reasonable price to the seller. The reasonable price depends on the circumstances of each particular case {Section 9 (2)}.

Section 10 states that where there is an agreement to sell goods on the terms such that the price is to be fixed by the valuation of the third party, such third party cannot make such valuations. The agreement is, therefore, avoided. Thus, this Section is related to an agreement to sell at valuation. Where such party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault maintains a suite of damage against the party at fault. For example, A agrees to sell goods to B at the price fixed by M. If M refuses to value the goods and fix the price, then such agreement is avoided. But if M is ready to do the same, but is prevented to do so by the wrongful act of any party to the contract or by the fault of A or B, the party at fault is then responsible to pay the damage to the party not at fault. Thus, the party not in fault is entitled to sue the party at fault, for damage
3.3 Conditions and Warranties

Many a times a seller of goods makes certain claims about the goods he offers for sale. These claims may relate to the quality, use, suitability, utility, etc., of those goods. The seller and buyer may also agree upon various terms relating to the subject-matter of the contract. These assurances may be a mere expression of opinion of the seller and may not form pat of the contract. But, sometimes they may form part of the contract and the buyer buys the goods on the faith of such assurances. In such a case they have legal effect on the contract. An assurance or representation which forms part of the contract of sale is termed as ‘stipulation’. All such stipulators cannot be treated at the same footing. Some may be intended to be of a fundamental nature whereas others may be subsidiary or merely an expression of an opinion. Depending upon whether a representation is fundamental or subsidiary, it ranks as a ‘condition’ and ‘warranty’. If a stipulation forms the very basis of the contract, it is a ‘condition’. On the other hand, if the stipulation is collateral to the main purpose of the contract, i.e., is of a lesser importance, then it is known as a ‘warranty’.

Besides, as a measure of consumer protection, Sale of Goods Act, 1930, assumes every contract of sale of goods (unless agreed to between the parties) to be subject to certain stipulation. These stipulations are called implied conditions and warranties.

3.3.1 Definition of Condition

The term ‘Condition’ is defined under Section 12(2) of the Sale of Goods Act, 1930. According to this Section, “a condition is 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”.

Thus, a condition is that stipulation which goes to the root of the contract and forms the basis of the contract. It is essential to the main purpose of the contract. It is that obligation, the non-fulfilment of which may fairly be considered as a substantial failure to perform the contract at all. Therefore, if a condition is not fulfilled, the buyer has a right to put an end to the contract and also recover damages for the breach of contract.

The aforesaid description of condition is well illustrated by the following case. As per the case, ‘B’ consulted ‘M’, a motor car dealer, for a car suitable for touring purposes. M suggested a ‘Ferrari’ car and B accordingly bought it. The car turned out to be unfit for the touring purpose. It was held that the term that ‘car should be suitable for touring purposes’ was a condition of the contract. It was so vital that its non-fulfilment defeated the very purpose for which B bought the car. He was, therefore, entitled to reject the car and have refund of the price.

3.3.2 Definition of Warranty

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

In other words, warranty is a stipulation which is not essential to the main purpose of the contract, i.e., it is of a subsidiary or collateral nature. If there is a breach of warranty, the buyer cannot repudiate the contract, but he can only claim damages from the seller. In the case discussed above if the buyer had asked for a good car and while selling the car the dealer said that it could run for 15kms per litre of petrol. But, it was discovered that it could run only 12kms per litre of petrol. Here, the statement made by the seller would amount to a warranty and the buyer could not terminate the contract and he was entitled to claim damages only.

3.3.3 Distinction between Condition and Warranty

From the aforesaid discussion, you must have noted that the difference between the two terms viz., ‘Condition’ and ‘Warranty’ is not that of a degree and not that of kind. The crux of the decision shall lie on the fact as to whether a stipulation forms the Basis of the contract or is only a collateral promise. Thus, where the buyer wouldn’t have purchased those goods but for that stipulation, it shall be construed as a condition. On the other hand, if the buyer would have so purchased and the stipulation is only designed to provide an assurance as to the quality or suitability of the goods, it shall be a warranty. The distinction between the two stipulations is to be measured from the point of view that if the stipulation is such that its breach would make the rights of the aggrieved party nugatory, then such
a stipulation is condition and where the stipulation is only auxiliary, it is a warranty. One may, therefore, say that whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract as a whole. The court is not to be guided by the terminology used by the parties to the contract, but is to be guided by the intention of the parties which can be gathered from the terms of the contract and circumstances. Section 12 (4) endorses this view and provides that “a stipulation maybe a condition, though called a warranty in the contract.”

The above mentioned point may be clarified with the help of the following example: ‘A’, who desires to purchase a horse, goes to a horse dealer and asks the horse dealer to give him a quiet and non-vicious horse. The horse which the dealer supplies him turns out to be a hostile horse and on the very first ride throws him down resulting in broken limbs. In this case, the statement made by the buyer that he wants a quiet horse was a condition essential to the main purpose of the contract. Therefore, A can reject the horse and get back the price. The buyer can also claim damage for the injuries suffered by him.

But, if ‘A’, himself selects a particular horse and then seeks the seller’s assurance as to its being quiet and non-vicious, the stipulation shall be a ‘warranty’ and the only remedy of the buyer shall be a claim for damages, he cannot return the horse and claim the price.

On the basis of the above discussion, the points of distinction between the two can be summarised as follows:

<table>
<thead>
<tr>
<th>Condition</th>
<th>Warranty</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. A condition is a stipulation (in a contract), which is essential to the main purpose of the contract</td>
<td>1. A warranty is a stipulation which is only collateral to the main purpose of the contract.</td>
</tr>
<tr>
<td>2. A breach of condition gives the aggrieved party a right to sue for damages as well as the right to terminate the contract.</td>
<td>2. A breach of warranty gives only the right to claim damages. The contract cannot be terminated.</td>
</tr>
<tr>
<td>3. In the event of the breach of a condition, the aggrieved party may choose to treat the breach of condition as a breach of warranty. A buyer may for instance, like to retain the goods and claim only damages.</td>
<td>3. A breach of warranty cannot be treated as a breach of condition.</td>
</tr>
</tbody>
</table>

Table 3.1 Distinction between condition and warranty

**When condition is treated as warranty:**
Section 13 provides for certain circumstances where a condition may be reduced to the status of a warranty. Consequently, the buyer loses his right to reject the goods. His only remedy in such case shall be to claim damages. This shall happen in the following cases:

**Waiver by buyer:**
Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may: (i) waive the condition; or (ii) elect to treat the breach of condition as a breach of warranty. You know that the conditions, express or implied, are for the benefit of the buyer. He has, therefore, the option to waive the breach of a condition and accept the performance short of it. In that case, he remains liable for the price but may only recover damages if there is a breach. Once the buyer exercises his option, he cannot later on compel the seller for its fulfilment.

**Compulsory treatment of breach of condition as breach of warranty:**
When the contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty. As per Section 42 of the Act, a buyer is deemed to have accepted the goods:
When he intimates to the seller that he has accepted them, or

When the goods have been delivered to him and (a) he does any act in relation to them which is inconsistent with ownership of the seller (say, pledges the same), or (b) when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them,

But if the contract is severable, and the buyer has accepted part of the goods, he can still exercise his right to reject the remaining goods.

**Express and implied conditions and warranties:**

Condition and warranties may either be express or implied.

**Express condition and warranties:**

Condition and Warranties are said to be express when the terms of the contract expressly provide for them. Thus, where a buyer desires to buy ‘While Maruti Car’, the colour of the car becomes an express condition. If the two contracting parties desire they may put the contents of any specific statement or promise which has taken place between them at par as the description of the thing contracted for. This then shall be treated as express condition. The parties are at liberty to impose any condition or warranty by an express agreement in a contract of sale.

Similarly, you must have noticed companies advertising their products carrying guarantee for a certain period, for instance, Del Computers - Guaranteed for Two Years’. ‘Sony TVs - Three Years Guarantee on Picture Tube’. All these are example of express warranties.

**Implied conditions:**

Conditions and Warranties are said to be implied when the law infers their existence as implicit in the contract even without their actually having been put in the contract. Hence, unless otherwise is agreed upon between the parties, every contract of sale of goods shall be subject to these implied conditions and warranties. But the parties do have the right to exclude any of the implied conditions or warranties by specifically and expressly providing otherwise. The implied conditions and warranties are enforced because the law deem: that in the circumstance of the contract the parties desired to add these stipulations to their contract but did not put them expressly. These implied conditions and warranties are contained in Sections 14 to 17 of the Act and are as follows:

**Conditions as to title (ownership):**

Sale involve transfer; of ownership and possession. Therefore, Section 14 (a) provides that in a contract of sale, unless the circumstances of the contract are, such as, to show a different intention, there is an implied condition on the part of the seller that he has a right to sell the goods, and that in the case of an agreement to sell, he will have a right to sell the goods at the time when the property (ownership) is to pass. The aforesaid provision, you should note, is based upon a simple logic that only an owner has the right to effect a valid sale of goods, since only he (subject, however, to certain exceptions which you will study later under ‘Sale by Non-owners’) can confer ownership. ? The rule of law is Nemo dat quod non-habat, i.e., one cannot give what one does not have’. In every contract of sale there is an implied condition that the seller has a valid title to the goods. This condition is very essential to protect the interest of innocent buyers.

The following example will clarify the point further.

A purchased a car from B who had no title to it. A used the car for several months. After that, C, the true owner, spotted the car and demanded it from A. Held, that A was bound to hand over the car to its true owner. A’s remedy is to sue B, the seller without title, for the recovery of the price and damages even’ though several months had passed.

However, this condition like other implied conditions, may be negated by an express terms. Thus, if a thief goes to a ‘Chor Bazar’ to sell the stolen goods to the knowledge of the buyer thereof, the buyer may not get the refund of sale price if those goods are to be restored to its real owner. Similarly, when the custom authorities, sell any confiscated items they are absolved from any responsibility with respect to the owner’s title. It should further be noted that the seller should have the right to sell the goods. The term ‘right to sell’ is wider than ‘right to pass ownership’. Thus, a seller has no right to sell, if he infringes the trade mark of another person.
Sale by description:
Sometimes, the goods are sold by description. In such a case, Section 15 lays down that “where there is a contract of sale of goods by description, there is an implied condition that the goods shall correspond with description”. The term ‘correspond with ‘description’ means that the goods supplied must be same as were described by the seller. If it is found that the goods supplied do not correspond with the description, the buyer has a right to reject the goods and claim damages. The term ‘sale of goods by description’ is wide and shall include many situations.

- It will include a case where the buyer has never seen the goods and buys them only on the basis of the description given by the seller. For example, in a sale of a reaping machine, the seller described it to be only one year old and used only to cut 50 to 60 acres. On delivery, the buyer found that the machine was extremely old. The buyer was entitled to reject the machine as it did not correspond with the description given by the seller.

- Similarly, where a person orders for 2 ‘Philips Juicer-made in Japan’ it will not be a sufficient compliance if a ‘Philips Juicer-made in Hongkong is ‘supplied to him’,

- Even where the buyer has seen the goods, it may be treated a sale by description, if he purchases those goods not on what he has seen but what was stated to him. Thus, where a person orders 100 bags of a particular variety of ‘Punjab Wheat’ and the wheat supplied to him is found to be ‘Gujarat Wheat’, condition as to ‘description’ oil shall be deemed to have been violated in spite of the fact that buyer was shown the wheat to be delivered.

Sale by sample:
Sale by sample means that the seller has shown a sample of the goods to the buyer and has agreed to supply the goods according to the sample. It cannot be assumed that in all cases, where sample is shown, the sale shall be a sale by sample. In cases where there is no term to that effect, it is assumed that the sample is not shown as a warranty, but only to enable the buyer to form a reasonable judgement about the goods to be bought. The goods supplied may marginally differ. They may be inferior or superior to the sample shown. In case of a contract of sale by sample; law assumes the sale to be subject to the following three implied conditions:

- The goods must correspond in quality with the sample, i.e., the buyer shall have a right to reject goods inferior or superior to the sample.

- The buyer shall have a reasonable opportunity of comparing the goods with the sample. ‘Thus, the seller will have to take the goods back, if they are not found to be according to the sample. In fact, depending upon the nature and volume of the goods involved, opportunity to compare the goods with the sample shall be available to the buyer. For example, in a sale of 100 bags of wheat, the buyer is given an opportunity to examine the contents of three bags only. The buyer can terminate the contract.

- The goods shall be free from any defects rendering them unmerchantable, which would not be apparent on reasonable examination of the sample, i.e., latent defects. Such defects are discovered when the goods are put to use. However, seller will not be liable for apparent or visible defects which could be easily discovered by an ordinary prudent person.

For example, A sold to B certain quantity of worsted coating equal to sample. The coating was equal to sample but had a latent defect as a result of which the cloth was found to be unfit for making coats. It was held that the buyer could reject the goods. The reason for this was that though the sample also contained the defect was not apparent on an examination of sample.

Sale by sample as well as by description:
If the sale is by sample as well as by description, Section 15 requires that the goods must not only correspond with the sample but should also correspond with the description. The following examples explain the point:
Foreign refined rape-seed oil’ was sold which was warranted to be equal to sample. The oil which was supplied by the seller was according to the sample. The sample was actually not ‘foreign rape-seed oil’ but contained a mixture of rape oil and hemp oil. Held, the buyer could reject the oil.

**Implied warranties:**
There are only two implied warranties under the Act and both of them are in fact necessary corollaries to the ‘implied condition as to title’. These are:

**Warranty as to quiet possession:**
In every contract of sale, unless contrary intention appears from the circumstances of the contract, there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. Thus, if the right of enjoyment or possession of the buyer is disturbed by the seller or any other person, the buyer shall be entitled to sue the seller for damages. Breach of this warranty shall arise where the title of the seller is not exclusive and he has not been conferred a clear right to effect the sale or where his title is defective.

For example: This implied warranty can be understood by referring to the following case:
In a certain XYZ company certain products bearing a label of a different company altogether, were sold by A to B. In order to save himself from any liability under the trade mark laws, B had to remove the labels and sold the unlabelled products at loss. A was held liable for breach of implied conditions that he had a right to sell.

In this case the seller will be held responsible for two things. Firstly since he committed a breach of implied condition to their title and secondly, for committing breach of implied warranty that the buyers would have quite a possession of the goods sold.

**Warranty of freedom from encumbrances:**
Under his warranty, the buyer is entitled to assume that the goods are free from any charge or encumbrance in favour of any third person, not-declared to or known to him before or at the time when the contract is made. Thus, this clause will not be applicable where the buyer has been informed of the encumbrances or has notice of the same. Further, it was held in Collinge. v. Heywood case that the claim under this warranty shall be available only when the buyer discharges the amount of encumbrance. If the possession of the buyer is disturbed due to such charge in favour of a third person, he can claim damages from the seller. For example, A sells certain good to B. A had already taken a loan of Rs 500 from X on the security of those goods- B was not aware about this charge on the goods. B had to pay Rs 500 to X in order to enjoy the goods. Now B can claim this amount from A.

### 3.4 CAVEAT Emptor

‘Caveat Emptor’ is a fundamental principle of the law relating to sale of goods. It means ‘Caution Buyer’, i.e., let the buyer beware’. In other words, it is no part of the Seller’s duty to point out defects of the goods he offers for sale. The buyer must examine the goods and find out their suitability for the purpose he buys them for.

Examples

- A person buys a readymade shirt for his son, he will not have a right to return or exchange the same if the shirt doesn’t exactly fit his son, i.e., too tight or loose.
- Pigs were sold ‘subject to all faults’, and these pigs, being infected, caused typhoid to other healthy pigs of the buyer. It was held that the seller was not bound to disclose that the pigs were unhealthy.
- **Condition as to quality or fitness:** The general rule in respect of the sale of goods is that a buyer is supposed to satisfy himself about the quality as well as the suitability of the goods. Thus, later on, if the goods turn out to be unsuitable or unfit for the purpose he purchased them for, he shall not be entitled to return or exchange them or seek compensation. There are, however, certain exceptions to this rule. It is in these exceptional circumstances that implied condition as to fitness applies. Where the buyer, expressly or by implication, makes known to the seller, the particular purpose for which the goods are required so as to show that the buyer relies on the seller’s skill or judgement, and the goods are of a description which it is in the course of the seller’s business to supply (whether he is the manufacturer or producer or not) there is an implied condition that the goods shall
be reasonably fit for such purpose [Section 16(1)]. Thus, to avail of the condition as to fitness, all the three conditions must be satisfied, viz.,
- the exact purpose for which the goods are being bought must have been disclosed (expressly or impliedly) by the buyer to the seller,
- the buyer must have relied upon the seller’s skill or judgement with respect to the fitness of the goods for any particular purpose, and
- the seller’s business must be to sell such goods (the condition cannot be invoked against a casual seller).

Thus, in Priest v. Last, a draper went to a chemist shop and asked him to give a hot water bottle. He told him the purpose also for which it was required. The chemist gave the hot water bottle but told him only to use hot water because the bottle would not stand the boiling water. While the bottle was being used, it burst and injured her. Held, breach of condition as to fitness was committed and the chemist was liable for refund of price as well as damages because the bottle was unfit for being used as a hot water bottle.

When the goods can be used only for one particular purpose, the buyer need not tell the seller the purpose which the goods are being bought. Thus, a refrigerator that failed to make ice would be rejected on grounds of breach of this condition (Evens v. Stelle Benjamin). A set of false teeth bought from a dentist may be rejected if they do not fit the buyer’s mouth (D r. Baretto v. T.R. Price).

The problem may arise where the goods are capable of being put to multiple uses. In such a case, to avail the relief under the aforesaid condition, the buyer must show that he had explained to the seller the exact purpose for which the goods were purchased. For example, in Re: Andrew Yule & Co., hessian cloth, which is generally used for packing purposes, was supplied to buyer in accordance with his order. The buyer found it unfit for his purpose of packing foodstuffs because this cloth has a peculiar smell, although it was good as a packing cloth. Held, the buyer cannot reject it because he had not disclosed to the seller, the particular purpose for which he required the cloth. The buyer need not disclose the exact purpose for which he is buying the goods when the goods are fit only for a specific purpose or where the nature of the goods itself by implication tells the purpose for which they are being bought. In those conditions the purpose is deemed to have been impliedly told. For example, if the buyer demands a cold drink from the seller, it is implied that the buyer needs it for consumption and subsequently, if it is found to contain BVO or some other unhealthy contents, it is a breach of implied condition as to fitness and makes the seller liable to pay damages.

However, condition as to fitness shall not be applicable in the following cases:
- Where the buyer fails to disclose to the seller any abnormal circumstances. For instance, in Griffith v. Peter Conway Ltd., a woman with abnormally sensitive skin asked for a warm tweed coat and was supplied a ‘Harris Tweed Coat’. She got rashes on wearing the coat. Her claim for return of price and damages was struck down because there was nothing in the Harris tweed which would have affected the skin of a normal person and she had failed to inform the seller about her abnormally sensitive skin.
- ii) When the buyer buys the goods by a patent or other trade name. Thus, where a person goes to a chemist and purchases ‘Bournvita’ as a health drink, he cannot claim any compensation if he finds no improvement in his health in spite of its prolonged use.

Condition as to merchantable quality: Section 16(2) of the Act provides that where the goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality. The expression ‘merchantable quality’ in simple words means that the quality of the goods shall be such that they are capable of being used as the goods of that description and should be free from any latent or hidden defects. If the goods are purchased for resale, then they should be resalable in the market under the description by which they are ordinarily known in the market. There should be no defect in the goods which renders them unfit for sale. For example, if sugar becomes syrup (Sharbat) it is no longer merchantable. The term ‘merchantability’ also means that the goods must be properly packed.
For example, A purchased wine from B. While opening its cork in the normal manner, the bottle broke off and injured A’s hand. It was held that the bottle was not of merchantable quality and A could recover damages from B.

**Examples**

- A person purchases a 3 metre suit length to make it into a three-piece suit and gives it to the tailor for stitching. The tailor after stitching coat and waist-coat finds that the balance of the cloth is sufficient to make only half-pants instead of full pants-the cloth having a texture defect, i.e., it is not uniform throughout its width. The buyer shall have a right to claim compensation.
- ‘A’ purchases Black Yarn from ‘13’ and finds it to be damaged by white ants, the condition as to merchantability shall be said to have been breached.
- A sold a plastic catapult to B. While B’s son was using it in the usual manner, the catapult broke due to the fact that the material used in its manufacture was unsuitable. As a result, the boy was blinded in one eye. It was held that A, the seller was liable as the catapult was not of merchantable quality (Godley v. Perry).

It should be noted here that when the buyer buys the goods after examining them, the implied condition as to merchantability shall not be applicable as regards those defects which the buyer by an ordinary examination could have discovered.

For example, A purchased glue from B, which was packed in barrels. A was given every facility to examine the goods, but the buyer A did not bother to examine the contents. Here A cannot reject the goods by saying that they are not merchantable. Had he taken the trouble of examining the goods, he would have easily discovered the defect (Thornett v. Beers).

**Condition as to wholesomeness**

In case of items which are supposed to be physician consumed, example, provisions or foodstuffs, condition as to merchantability assumes another form, viz., condition as to wholesomeness. Condition as to wholesomeness means that the goods shall be fit for human consumption, that is, they shall not be stale or contaminated. In Frost v. Aylesbury Daj. Co. Ltd. F bought milk from A’s dairy. The milk contained typhoid germs.; F’s wife consumed the milk, became infected and died. A was held liable for damages because the milk was not fit for human consumption. Thus, an action shall lie if a ‘house fly’ is found in a bottle of cold drink or a ‘lizard’ in a bottle or pack of milk and the consumer, therefore, suffers.

**Usage of trade (Section 16 (3))**

An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

**Consent by fraud**

The principle of Caveat Emptor is not applicable to all those cases wherein the consent of the buyer is obtained by the seller by fraud or where seller purposely conceals the defects which could not be discovered or found out on a reasonable examination. A seller, who is guilty of fraud or who purposely hides the defects shall have no protection of the principle of Caveat Emptor.

### 3.5 Transfer of Property

A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer property in goods to the buyer for a price. Transfer of property is, thus, the essence of a contract of sale of goods. However, in the Sale of Goods Act, the word property is used for the ‘ownership’. When the goods are sold, it is the property in the goods which is transferred to the buyer. The term ‘property in the goods’ should not be confused with the physical ‘possession of goods’. A person may be in possession of goods but he may not be the owner of those goods.
For example, an agent, or servant or a bailee may be in possession of goods, but is not the owner because the property in the goods does not vest in him, he is holding the goods for his principal master or the bailor. Similarly, a person may be the owner of the goods but he may not be in possession of goods.

For example, the principal, master or bailor, may not be in possession of the goods but the property in goods vests in him. Thus, the transfer of possession of goods is almost the same thing as the transfer of ownership, you will notice that the ownership of the goods may pass with or without the transfer of possession. In a contract of sale of goods when the goods are sold to the buyer, the buyer becomes the owner of the goods irrespective of the fact whether the buyer has taken the delivery of goods or not. Thus, it should be clear to you that transfer of property or ownership means the legal ownership and not the physical possession of goods.

3.5.1 Passing of Property from Seller to Buyer

Section 18 of the Act states that where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained.

Passing of property in a contract for sale of specific or ascertained goods

- **Intention of the parties [Section 19]:** With regards to the passing of property in goods in the case of specific or ascertained goods; Section 19(1) of the Act states that, “Where there is a contract for the sale of specific or ascertained goods the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.” Thus, this sub-section 1 of the Section 19 leaves everything to the intention of the parties to the contract in the case of specific or ascertained goods. Section 19(2) further states that “for the purpose of ascertaining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case” and “Unless a different intention appears, the rules contained in Section 20 to 24 are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer [Section 19(3)]”. Now let us consider the sections from 20 to 24.

- **Passing of the property at the time of contract [Section 20]:** Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of the goods, or both, is postponed. According to Section 2(3) of this Act, deliverable state means goods are in such a state that the buyer would, under the contract, be bound to take the delivery of the goods.

- **Passing of property in the case if specific goods where the goods are to be put into deliverable state [Section 21]:** Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof. For instance, the contract was entered in to the sale of machine which was to be embedded in a concrete floor. A part of the machine was destroyed while being removed. The buyer refused to take the delivery of the machine. It was held that the buyer was entitled to refuse to buy the machine as it was not in a deliverable state.

- **Passing of property when the price is to be ascertained by weighing, etc. [Section 22]:** Section 22 states that where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof. Thus, X sold a pile of grains to Y at a certain price per ton. The pile of grains was to be weighed by the agents of the seller and the buyer. A part of the pile of grains was weighed and given to Y’s agent, but a flood washed out the remainder. It was held that the ownership of the residue was not transferred to Y and therefore X had to suffer the loss.
3.5.2 Passing of Property in the Contract for Sale of Unascertained Goods [Section 23]

Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained [Section 18]. This simply means that no property can pass from the seller to the buyer in the case of uncertain goods until they are ascertained and until the goods are ascertained, there can be only an agreement to sell. Section 23(1) provides that where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.

From the above paragraph, it becomes clear that the ascertainment of goods and their unconditional appropriation to the contract are two very important preconditions for transferring the property from the seller to the buyer in the case of uncertain goods.

Appropriation of goods can be done in any of the following ways:

- By separating the quantity contracted form the other goods or bulk.
- By putting the quantity contracted for, in suitable containers or receptacles.
- By delivery of goods contracted to carrier.

So far as the delivery of the goods to the carrier is concerned, Section 23(2) of the act states that Where, in pursuance of the contract, the seller delivers the good-

For instance, Mr. X sold some tins of vanaspati to Mr. Y who paid the price of vanaspati he purchased. The tins were in possession of Mr. X who subsequently sent the same to Mr. Y by railway and endorsed and delivered the Railway Receipt to Mr. Y. After the endorsement of Railway Receipt to Mr. Y, the tins in transit got burnt. T was held that Mr. Y must bear the loss as the property in tins of vanaspati had passed to him.

3.5.3 Passing of the Property in Goods sent on Approval or ‘On Sale or Return’

When goods are delivered to the buyer on approval or on sale or return or other similar terms, the property therein passes to the buyer-

- When he signifies his approval or acceptance to the seller to does not other act adopting the transaction.
- If he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and, if no time has been fixed, on the expiration of a reasonable time [Section 24(b)]. Of course the question as to, what is a ‘reasonable time’ is a question of fact [Section 63].

Thus, when a buyer purchases goods and signifies his approval or does any act which denotes the adaptation of the transaction, the property thereby passes from the seller to the buyer. If the seller sells the goods on sale or return basis, the goods remains the property of the seller until settled or paid for the same. In one case, Mr. X delivered a horse to Mr. Y on the condition of sale or return within 10 days. The horse died within that period. It was held that the horse was the property of Mr. X and had to suffer the loss.

If the buyer purchases the goods and does not signify his approval to the seller but retains the goods without giving any notice of rejection beyond the time fixed for the rejection or if no such time is fixed, beyond a reasonable time, the property in the goods passes to the buyer.

For example, A sold a machine to B on the approval basis without fixing any period within which B must approve the machine. B used it for six months and then he wanted to return the machine. A refused to take it back and the suit was filed. It was held that a reasonable time to reject the machine having elapsed, the property in the machine had passed to B and so B could not reject.
3.5.4 Reservation of Right of Disposal

The property in the goods, whether specific or appropriated subsequently to the contract, does not pass to the buyer if the seller of the goods reserves the right to dispose the goods until certain conditions are fulfilled. Section 25 makes provisions in this respect. Section 25 is elaborated as follows:

- Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled. In such case, notwithstanding the delivery of the goods to a buyer, or to a carrier or other bailee for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled.[section 25(1)]
- Where goods are shipped or delivered to a railway administration for carriage by railway and by the bill of landing or railway receipt, as the case may be, the goods are deliverable to the order of the seller or his agent, the seller is prima facie deemed to reserve the right of disposal. [Section 25 (2)]
- Where the seller of goods draws on the buyer for the price and transmits to the buyer the bill of exchange together with the bill of lading or, as the may be, the railway receipt, to secure acceptance to payment of the bill of exchange, the buyer is bound to return the bill of lading or the railway receipt if he does not honour the bill of exchange, and, if he wrongfully retains the bill of lading or the railway receipt, the property in the goods does not pass to him. [Section 25 (3)]

Explanation: In this section, the expression “Railway” and “Railway administration” shall have the meanings respectively assigned to them under the Indian Railways Act, 1890.

3.5.5 Passing of Risk [Section 26]

The movement of the property in goods-vests with the buyer, the goods are at the buyer’s risk. The delivery of the goods is immaterial. This is made clear in section 26 of the Act which is as follows:

“Unless otherwise agreed, the goods remain at the seller’s risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer’s risk whether delivery has been made or not.

Provided that, where deliver has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault. [Provision to Section 26].

It further provides that nothing in this section shall affect the duties or liabilities of either seller or buyer as a bailee of the goods of the other party.”

3.6 Provisions related to Performance of Contract of Sale

As regard the seller, performance of the contract of sale means the delivery of goods to the buyer. As regard to the buyer, it means the acceptance of the delivery of goods and to make the necessary payment of the goods he purchases according to the terms and conditions of the contract of sale. A contract of sale involves reciprocal promises. The seller promises to deliver the goods while the buyer promises to pay for the goods and to accept the delivery of goods. In accordance with the Section 31, it is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale. Moreover, Section 32 states that unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods.
3.6.1 Rights of Unpaid Seller
The seller of goods is deemed to be an “unpaid seller” within the meaning of this Act [Section 45(1)]:
• When the whole of the price has not been paid or tendered.
• When a bill of exchange or other negotiable instrument has been received as conditional payment and the conditions on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise.

The term “seller” includes any person who is in the position of a seller, as, for instance, an agent of the seller to whom the bill of lading has been endorsed, or a consignor or agent who has himself paid, or is directly responsible for, the price. [Section 45(2)].

Under the Sale of Goods Act, the unpaid seller gets certain rights, which can be broadly classified under the following two heads.

Rights against goods
Where the property in the goods sold has been passed, he has the following rights.[Section 46(1)]

Rights of Lien. [Sections 47 to 49].
A lien is a right to retain possession of them until payment or tender of the price of such goods. If the seller loses the possession of goods, he also loses the right of lien. Right of lien is available to the unpaid seller of goods who is in possession of them
• Where the goods have been sold without any stipulations as to credit.
• Where the goods have been sold on credit, but the term of credit has expired.
• Where the buyer becomes insolvent.

According to Section 47(2), the seller may exercise his right of lien notwithstanding that he in possession of the goods as agent or bailee for the buyer.

Termination of lien [Section 49]
The unpaid seller of goods losses his lien thereon -
• When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods.
• When the buyer or his agent lawfully obtains possession of the goods,
• By waiver thereof.

The unpaid seller of goods, having a lien thereon, would not lose his lien by reason only that he has obtained a decree for the price of the goods.

Right of stoppage of goods in transit. [Section 50 to 52]
Section 50 of the Sale of Goods Act, focuses on the right of stoppage in transit. This section states that,”subject to the provisions of this Act, when the buyer of goods becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them in transit, that is to say, he may resume possession of the goods as long as they are in the course of transit, and may retain them until payment or tender of the price.”

Duration of transit [Section 51]
• [Section 51(1)]: Goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent in that behalf takes delivery of them from such carrier or other bailee.
• Section 51 (2): If the buyer or his agent in that behalf obtains delivery of the goods before their arrival at the appointed destination, the transit is at an end.
• Section 51 (3): If, after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on his behalf and continues in possession of them as bailee for the buyer or his agent, the transit is at an end and it is immaterial that a further destination for the goods may have been indicated by the buyer.

• Section 51 (4): If the goods are rejected by the buyer and the carrier or other bailee continues in possession of them, the transit is not deemed to be at an end, even if the seller has refused to receive them back.

• Section 51 (5): When goods are delivered to a ship chartered by the buyer, it is a question depending on the circumstances of the particular case, whether they are in the possession of the master as a carrier or as agent of the buyer.

• Section 51 (6): Where the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent in that behalf, the transit is deemed to be at an end.

• Section 51 (7): Where part delivery of the goods has been made to the buyer or his agent in that behalf, the remainder of the goods may be stopped in transit, unless such part delivery has been given in such circumstances as to show an agreement to give up possession of the whole of the goods.

• Right of resale [Section 54].

Sale not generally rescinded by lien or stoppage in transit

• Subject to the provisions of this section, a contract of sale is not rescinded by the mere exercise by an unpaid seller of his right of lien or stoppage in transit. [Section 54(1)]

• Where the goods are of a perishable nature, or where the unpaid seller who has exercised his right of lien or stoppage in transit gives notice to the buyer of his intentions to re-sell, the unpaid seller may, if the buyer does not within a reasonable time pay or tender the price, re-sell the goods within a reasonable time and recover from the original buyer damages for any loss occasioned by his breach of contract, but the buyer shall not be entitled to any profit which may occur on the re-sale. If such notice is not given, the unpaid seller shall not be entitled to recover such damages and the buyer shall be entitled to the profit, if any, on the re-sale. [Section 54(2)]

• Where an unpaid seller who has exercised his right of lien or stoppage in transit re-sells the goods, the buyer acquires a good title thereto as against the original buyer, notwithstanding that no notice of the re-sale has been given to the original buyer. [Section 54(3)]

• Where the seller expressly reserves a right of re-sale in case the buyer should make default, and on, the buyer making default, re-sells the goods, the original contract of sale is thereby rescinded, but without prejudice to any claim which the seller may have for damages. [Section 54(4)]

Where the property in the goods has not been transferred, he gets the following two rights [Section 42 (2)].

• Withholding the delivery of goods and 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.

• Stoppage in Transit.

How stoppage in transit is affected. [Section 52]
The unpaid seller may exercise his right to stoppage in transit either by taking actual possession of the goods, or by giving notice of his claim to the carrier or other bailee in whose possession the goods are. Such notice may be given either to the person in actual possession of the goods or to his principal. In the later case the notice, to be effectual, shall be given at such time and in such circumstances, that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time to prevent a delivery to the buyer.[Section 52(1)]. Whether notice of stoppage in transit is given by the seller to the carrier or other bailee in possession of the goods, he shall re-deliver the goods to, or according to the directions of, the seller. The expenses of such re-delivery shall be borne by the seller [Section 52(2)].
Rights against the buyer personally
Following four rights, the unpaid seller gets against the buyer:

- 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. [Section 55(1)].
  - Where under a contract of sale the price is payable on a day certain irrespective of delivery and the buyer
    wrongfully neglects or refuses to pay such price, the seller may sue him for the price although the property
    in the goods has not passed and the goods have not been appropriated to the contract. [Section 55(2)].

- Suit for damages [Section 56]
  - Damages for non-acceptance
    Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for
    damages for non-acceptance.

- Repudiation of Contract [Section 60]
  - Repudiation of contract before due date
    Where either party to a contract of sale repudiates the contract before the date of delivery, the other may either
    treat the contracts as subsisting and wait till the date of delivery or he may treat the contract as rescinded
    and use for damages for the breach.

- Suit for interest [Section 61]
  - Interest by way of damages and special damages
    Nothing in this Act shall affect the right of the seller or the buyer to recover interest or special damages in
    any case whereby law interest or special damages may be recoverable, or to recover the money paid where
    the consideration for the payment of it has failed.

3.6.2 Auction Sale

One of the methods of selling goods is by auction. Auction sale means a public sale where intending buyers assemble
at one place and offer the price at which they are ready to buy the goods. The offer of the price is known as ‘bid’
and the person making the bid is known as the ‘bidder’. The owner of the goods may himself sell them by auction
or appoints an ‘auctioneer’ to sell the goods on his behalf. The relationship between the owner of the goods and the
auctioneer is that of the principal and agent. In an auction, as a rule, the goods are sold to the highest bidder.

When goods are to be sold by auction, the auctioneer gives wide publicity regarding the time, date and place of
sale. The bidders are also given an opportunity to inspect the goods. As you have already learnt in Unit 2 (offer
and acceptance) an advertisement to sell goods by auction is not an offer to sell but it is simply an invitation to the
public to make offers. The auctioneer is not bound to sell the goods on the date, time and place announced earlier,
he can cancel or postpone the sale and the intending buyers have no right to sue the auctioneer since it was only an
invitation and not an offer to the public.

The various rules regarding auction sales are given in Section 64 of the Sale of Goods Act, which are as follows:

- Where the ‘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)]. Right of an Unpaid Seller

- The 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

- When the auctioneer announces the completion of the sale, the sale is complete and the property in goods,
  passes; immediately to the buyer.

- Since offers are invited from the public, before the sale is completed, the bidders have a right to withdraw their
  bid (offer). Until the announcement of the completion of sale is made, any bidder may retract his bid [Section
  64(2)].
A right to bid may be reserved expressly by or on behalf of the seller, and where such right is expressly reserved, the seller or any one person on his behalf, may bid at the auction [Section 64(3)]. This right is given to the seller so that he can protect his interests in case the buyers agree not to outbid each other. Here it should be noted that the seller can appoint only one person to bid on his behalf. If more than one person is appointed, then it amounts to fraud and sale is voidable at the option of the buyer.

Where the 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 himself to bid himself at such sale or to employ any such person on his behalf or for the auctioneer knowingly to accept the bid from such person. Any sale contravening this rule may be treated as fraudulent by the buyer [Section 64(4)].

It is quite usual for the auctioneer to announce a ‘reserve’ price. It is the price below which the auctioneer will not sell. Such a reserve price is fixed by the seller to protect himself from selling the goods at a very low price. Thus, if the highest bid is below the reserve price, the auctioneer by mistake, accepts the bid, which is below the reserve price, he can refuse to deliver the goods. You may note that even where a reserve price is not notified, if the auctioneer feels that the price offered is not up to his expectation, he can refuse to accept the highest bid. This is possible because ‘bid’ is only an offer which may or may not be accepted by the auctioneer.

If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer [Section 64 (6)].

An agreement between the bidders not to bid against each other is called the ‘knock-out’ agreement. Such an agreement is made to avoid competition among themselves. These bidders agree that only one of them will bid, and anything obtained by him shall be shared privately. Knock-out agreements are valid and not illegal. However, if the intention of the parties to the agreement is to defraud a third party, such an agreement shall be termed as ‘illegal’.

Damping is an unlawful act intended to discourage the bidders from bidding. This is done by pointing out ‘defects’ in the goods or scaring them away so that may not participate in the auction. Damping is highly undesirable and is illegal.

Puffers are persons employed by the seller for the purpose of raising the price. A puffer has no intention to buy the goods. The seller can appoint only one puffer and not more.

3.6.3 Rules Regarding Delivery of Goods
Delivery means voluntary transfer of possession from one person to another [Section 2]. Thus, “Delivery of goods means voluntary transfer of possession from seller to buyer.” It is of following types:

![Diagram of delivery of goods](image-url)

**Actual**
**Symbolic**
**Constructive**

Fig. 3.2 Types of delivery of goods
The rules regarding delivery of goods are discussed below:

**Mode of delivery**
Delivery of goods sold may be made by doing anything which the parties agree shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf.

**Delivery of goods and payment of price are concurrent conditions [Section 32]**
Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods.

**Effect of part delivery of goods (Section 34)**
A delivery of part of goods, in progress of the delivery of the whole has the same effect, for the purpose of passing the property in such goods, as a delivery of the whole, but a delivery of part of the goods, with an intention of severing it from the whole, does not operate as a delivery of the remainder. This section does not apply to money or currency notes.

For example, Mr. A purchased ten bags from Mr. Y and received three bags and he also paid for the same. Thereafter he refused to accept remaining seven bags. It was held that it amounted to a part delivery. Yet in another case where Mr. X asked his godown-keeper to deliver goods to Y lying in his godown as Y purchased the goods. Y weighed the goods and took away some part of the goods Thus, purchased. It was held that the delivery of a part of the goods had the same effect as the delivery of the whole.

**Buyer to apply for delivery(Section 35)**
Apart from any express contract, the seller of goods in not bound to deliver them until the buyer applies for delivery.

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

- A contract of sale of goods is a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a price, i.e., money consideration.
- According to this Section 12(2), a ‘condition’ is 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.
- According to Section 12(3) of the Sale of Goods Act, 1930, a ‘warranty’ is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.
- Condition is treated as Warranty when, waiver by buyer and compulsory treatment of breach of condition as breach of warranty.
- Condition and warranties may either be express or implied.
- Caveat Emptor (Caution Buyer) signifies that it is no part of the Seller’s duty to point out defects of the goods he offers for sale. The buyer must examine the goods and find out their suitability for the purpose he buys them for.
- In accordance with the Section 25 of The Sales of Goods Act,1930,” Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled”
- Passing of Risk [Section 26] - “Unless otherwise agreed, the goods remain at the seller’s risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer’s risk whether delivery has been made or not”
- Auction sale means a public sale where intending buyers assemble at one place and offer the price at which they are ready to buy the goods.
- Delivery of goods means voluntary transfer of possession from seller to buyer. It is of 3 types, viz. actual, constructive and symbolic.

References

- Conditions and Warranties [PDF] Available at: <http://www.egyankosh.ac.in/bitstream/123456789/9216/1/Unit-17%28complete%29.pdf>. [Accessed 20 September 2011].
Recommended Reading

Self Assessment

1. _______ sale is a public sale where intending buyers assemble at one place and offer the price at which they are ready to buy the goods.
   a. Auction
   b. Contract
   c. Sample
   d. Description

2. A _______ is a stipulation collateral to the main purpose of the contract
   a. Guarantee
   b. Condition
   c. Warranty
   d. Promise

3. A _______ is a stipulation (in a contract), which is essential to the main purpose of the contract
   a. Warranty
   b. Guarantee
   c. Promise
   d. Condition

4. Match the following.

<table>
<thead>
<tr>
<th>Section(Sales of Goods Act 1930)</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Section 49</td>
<td>A. Passing of Risk</td>
</tr>
<tr>
<td>2. Section 25</td>
<td>B. Termination of Lien</td>
</tr>
<tr>
<td>3. Section 46</td>
<td>C. Right of Disposal of the Goods</td>
</tr>
<tr>
<td>4. Section 26</td>
<td>D. Unpaid Seller’s Rights</td>
</tr>
</tbody>
</table>

   a. 1-D, 2-B, 3-A, 4-C
   b. 1-B, 2-C, 3-D, 4-A
   c. 1-B, 2-C, 3-D, 4-A
   d. 1-C, 2-A, 3-D, 4-B

5. Which statement is false?
   a. Breach of condition gives rise to a claim for return of price as well as damages.
   b. Breach of warranty entitles the buyer to only claim return of price.
   c. A breach of condition can be treated as a breach of warranty.
   d. When the goods are sold by trade mark, there is no implied condition as to their fitness.

6. A contract of sale involves transfer of _________
   a. Ownership
   b. Contract
   c. Rights
   d. Goods
7. Which statement is true?
   a. The right of lien of an unpaid seller depends solely on the possession of goods.
   b. The right of lien can be exercised for the non-payment of the price of goods and other charges.
   c. The right of lien is lost when the unpaid seller obtains a decree for the price of the goods.
   d. The lien is not lost even when the buyer or his agent lawfully obtains possession of the goods.

8. In Accordance with the principle of________, it’s not the seller but the buyer who must examine the goods himself and find out their suitability for the purpose he buys them for.
   a. Right of Disposal of Goods
   b. Right of the Lien
   c. Express Conditions and Warranties
   d. Caveat Emptor

9. A contract of sale of goods is a contract by which the seller transfers or agrees to transfer the_______ in goods to the buyer for a price.
   a. Quantity
   b. Quality
   c. Property
   d. Value

10. _______ means the voluntary transfer of possession from seller to buyer.
    a. Sales of Goods
    b. Transfer of Property
    c. Contact of Sale
    d. Delivery of goods
Chapter IV

Negotiable Instruments Act, 1881

Aim

The aim of this chapter is to:

- define negotiable instruments
- introduce the Sales of Negotiable Instruments Act, 1881
- enlist various provisions of Negotiable Instruments Act, 1881

Objectives

The objectives of this chapter are to:

- elucidate various features of negotiable instruments
- describe the meaning and marketing, crossing and cancellation of crossing of a cheque
- explain capacity and liability parties to a negotiable instruments

Learning outcome

After the end of this chapter you will be able to:

- understand meaning, essential characteristics and types of negotiable instruments
- differentiate between bills of exchange, promissory notes and cheques
- comprehend negotiation and types of endorsements
4.1 Introduction

The Negotiable Instruments Act was enacted, in India, in 1881. Prior to its enactment, the provision of the English Negotiable Instrument Act were applicable in India, and the present Act is also based on the English Act with certain modifications. It extends to the whole of India except the State of Jammu and Kashmir. The Act operates subject to the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. Section 31 of the Reserve Bank of India Act provides that no person in India other than the Bank or as expressly authorised by this Act, the Central Government shall draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand. This Section further provides that no one except the RBI or the Central Government can make or issue a promissory note expressed to be payable or demand or after a certain time. Section 32 of the Reserve Bank of India Act makes issue of such bills or notes punishable with fine which may extend to the amount of the instrument. The effect or the consequences of these provisions are:

- A promissory note cannot be made payable to the bearer, no matter whether it is payable on demand or after a certain time.
- A bill of exchange cannot be made payable to the bearer on demand though it can be made payable to the bearer after a certain time.
- But a cheque (though a bill of exchange) payable to bearer or demand can be drawn on a person’s account with a banker.

4.2 Negotiable Instrument

According to Section 13 (a) of the Act, “Negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the word “order” or “bearer” appear on the instrument or not.”

4.2.1 Meaning Of Negotiable Instruments

In the words of Justice, Willis, “A negotiable instrument is one, the property in which is acquired by anyone who takes it bonafide and for value notwithstanding any defects of the title in the person from whom he took it”.

Thus, the term, negotiable instrument means a written document which creates a right in favour of some person and which is freely transferable. Although the Act mentions only these three instruments (such as a promissory note, a bill of exchange and cheque), it does not exclude the possibility of adding any other instrument which satisfies the following two conditions of negotiability:

- The instrument should be freely transferable (by delivery or by endorsement and delivery) by the custom of the trade; and
- The person who obtains it in good faith and for value should get it free from all defects, and be entitled to recover the money of the instrument in his own name.

As such, documents like share warrants payable to bearer, debentures payable to bearer and dividend warrants are negotiable instruments. But the money orders and postal orders, deposit receipts, share certificates, bill of lading, dock warrant, etc. are not negotiable instruments. Although they are transferable by delivery and endorsements, yet they are not able to give better title to the bonafide transferee for value than what the transferor has.

4.2.2 Characteristics of a Negotiable Instrument

A negotiable instrument has the following characteristics:

- **Property**: The processor of the negotiable instrument is presumed to be the owner of the property contained therein. A negotiable instrument does not merely give possession of the instrument but right to property also. The property in a negotiable instrument can be transferred without any formality. In the case of bearer instrument, the property passes by mere delivery to the transferee. In the case of an order instrument, endorsement and delivery are required for the transfer of property.
- **Title**: The transferee of a negotiable instrument is known as ‘holder in due course.’ A bona fide transferee for value is not affected by any defect of title on the part of the transferor or of any of the previous holders of the instrument.
• **Rights**: The transferee of the negotiable instrument can sue in his own name, in case of dishonour. A negotiable instrument can be transferred any number of times till it is at maturity. The holder of the instrument need not give notice of transfer to the party liable on the instrument to pay.

• **Presumptions**: Certain presumptions apply to all negotiable instruments, example, a presumption that consideration has been paid under it. It is not necessary to write in a promissory note the words ‘for value received’ or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration.

• **Prompt payment**: A negotiable instrument enables the holder to expect prompt payment because dishonour means the ruin of the credit of all persons who are parties to the instrument.

### 4.2.3 Types of Negotiable Instruments

Section 13 of the Negotiable Instruments Act states that a negotiable instrument is a promissory note, bill of exchange or a cheque payable either to order or to bearer. Negotiable instruments recognised by statute are:

- Promissory notes
- Bills of exchange
- Cheques
- Trade Bill and Accommodation
- Fictitious Bill
- Documentary and Clean Bills
- Inchoate Instrument
- Ambiguous Instrument
- Escrow
- Bills in Sets
- Inland and Foreign Instruments
- Instruments payable on Demand

Negotiable instruments recognised by usage or custom are:

- Hundis
- Share warrants
- Dividend warrants
- Bankers draft
- Circular notes
- Bearer debentures
- Debentures of Bombay Port Trust
- Railway receipts
- Delivery orders

This list of negotiable instrument is not a closed chapter. With the growth of commerce, new kinds of securities may claim recognition as negotiable instruments. The courts in India usually follow the practice of English courts in according the character of negotiability to other instruments.

**Promissory notes**

Section 4 of the Act defines, “A promissory note is an instrument in writing (note being a bank-note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to or to the order of a certain person, or to the bearer of the instruments.”
Fig. 4.1 Specimen of a promissory note

Essential elements of promissory notes
An instrument to be a promissory note must possess the following elements:

<table>
<thead>
<tr>
<th>It must be in writing</th>
<th>A mere verbal promise to pay is not a promissory note. The method of writing (either in ink or pencil or printing, etc.) is unimportant, but it must be in any form that cannot be altered easily.</th>
</tr>
</thead>
</table>
| It must certainly an express promise or clear understanding to pay: | There must be an express undertaking to pay. A mere acknowledgment is not enough. The following are not promissory notes as there is no promise to pay.  
  **If A writes:**  
  (a) “Mr. B, I.O.U. (I owe you) Rs. 500”  
  (b) “I am liable to pay you Rs. 500”.  
  (c) “I have taken from you Rs. 100, whenever you ask for it have to pay”.  
  The following will be taken as promissory notes because there is an express promise to pay:  
  **If A writes:**  
  (a) “I promise to pay B or order Rs. 500”  
  (b) “I acknowledge myself to be indebted to B in Rs. 1000 to be paid on demand, for the value received”. |
| Promise to pay must be unconditional: | A conditional undertaking destroys the negotiable character of an otherwise negotiable instrument. Therefore, the promise to pay must not depend upon the happening of some outside contingency or event. It must be payable absolutely. |
| It should be signed by the maker: | The person who promises to pay must sign the instrument even though it might have been written by the promisor himself. There are no restrictions regarding the form or place of signatures in the instrument. It may be in any part of the instrument. It may be in pencil or ink, a thumb mark or initials. The promoote can be signed by the authorised agent of the maker, but the agent must expressly state as to on whose behalf he is signing, otherwise he himself may be held liable as a maker. The only legal requirement is that it should indicate with certainty the identity of the person and his intention to be bound by the terms of the agreement. |
The maker must be certain: The note self must show clearly who is the person agreeing to undertake the liability to pay the amount. In case a person signs in an assumed name, he is liable as a maker because a maker is taken as certain if from his description sufficient indication follows about his identity. In case two or more persons promise to pay, they may bind themselves jointly or jointly and severally, but their liability cannot be in the alternative.

The payee must be certain: The instrument must point out with certainty the person to whom the promise has been made. The payee may be ascertained by name or by designation. A note payable to the maker himself is not promote unless it is indorsed by him. In case, there is a mistake in the name of the payee or his designation; the note is valid, if the payee can be ascertained by evidence. Even where the name of a dead person is entered as payee in ignorance of his death, his legal representative can enforce payment.

The promise should be to pay money and money only: Money means legal tender money and not old and rare coins. A promise to deliver paddy either in the alternative or in addition to money does not constitute a promissory note.

The amount should be certain: One of the important characteristics of a promissory note is certainty—not only regarding the person to whom or by whom payment is to be made but also regarding the amount. However, paragraph 3 of Section 5 provides that the sum does not become indefinite merely because (a) there is a promise to pay amount with interest at a specified rate. (b) the amount is to be paid at an indicated rate of exchange. (c) the amount is payable by instalments with a condition that the whole balance shall fall due for payment on a default being committed in the payment of anyone installment.

Other formalities: The other formalities regarding number, place, date, consideration etc. though usually found given in the promissory notes but are not essential in law. The date of instrument is not material unless the amount is made payable at a certain time after date. Even in such a case, omission of date does not invalidate the instrument and the date of execution can be independently ascertained and proved. On demand (or six month after date) I promise to pay Peter or order the sum of rupees one thousand with interest at 8 per cent per annum until payment.

Table 4.1 Essential elements of promissory notes

**Bill of Exchange**

Section 5 of the Act defines, “A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument”.

A bill of exchange, therefore, is a written acknowledgement of the debt, written by the creditor and accepted by the debtor. There are usually three parties to a bill of exchange drawer, acceptor or drawee and payee. Drawer himself may be the payee.
Rs. 10,000/-

May 2, 2001

Five months after date pay Tarun or (to his) order the sum of Rupees Ten Thousand only for value received.

To
Sameer
Address

Accepted
Sameer
S/d
Rajiv

Stamp

Fig. 4.2 Bill of exchange

Essential conditions of a bill of exchange

- It must be in writing.
- It must be signed by the drawer.
- The drawer, drawee and payee must be certain.
- The sum payable must also be certain.
- It should be properly stamped.
- It must contain an express order to pay money and money alone.

For example, in the following cases, there is no order to pay, but only a request to pay. Therefore, none can be considered as a bill of exchange:

- “I shall be highly obliged if you make it convenient to pay Rs. 1000 to Suresh”.
- “Mr. Ramesh, please let the bearer have one thousand rupees, and place it to my account and oblige”

However, there is an order to pay, though it is politely made, in the following examples:

- “Please pay Rs. 500 to the order of ‘A’.
- ‘Mr. A will oblige Mr. C, by paying to the order of’ P”.
- The order must be unconditional.

Classification of bills

Bills can be classified as:
Inland and foreign bills

Inland bill: A bill is, named as an inland bill if:
- it is drawn in India on a person residing in India, whether payable in or outside India, or
- it is drawn in India on a person residing outside India but payable in India.

The following are the inland bills
- A bill is drawn by a merchant in Delhi on a merchant in Madras. It is payable in Bombay. The bill is an inland bill.
- A bill is drawn by a Delhi merchant on a person in London, but is made payable in India. This is an inland bill.
- A bill is drawn by a merchant in Delhi on a merchant in Madras. It is accepted for payment in Japan. The bill is an inland bill.

Foreign Bill: A bill which is not an inland bill is a foreign bill. The following are the foreign bills:
- A bill drawn outside India and made payable in India.
- A bill drawn outside India on any person residing outside India.
- A bill drawn in India on a person residing outside India and made payable outside India.
- A bill drawn outside India on a person residing in India.
- A bill drawn outside India and made payable outside India.

Bills in sets (Sections 132 and 133):
The foreign bills are generally drawn in sets of three, and each sets is termed as a ‘via’. As soon as anyone of the set is paid, the others become inoperative. These bills are drawn in different parts. They are drawn in order to avoid their loss or miscarriage during transit. Each part is despatched separately. To avoid delay, all the parts are sent on the same day; by different mode of conveyance.

Rules: Sections 132 and 133 provide for the following rules:
- A bill of exchange may be drawn in parts, each part being numbered and containing a provision that it shall continue payable only so long as the others remain unpaid. All parts make one bill and the entire bill is extinguished, i.e. when payment is made on one part- the other parts will become inoperative (Section 132).
- The drawer should sign and deliver all the parts but the acceptance is to be conveyed only on one of the parts. In case a person accepts or endorses different parts of the bill in favour of different persons, he and the subsequent endorsers of each part are liable on such part as if it were a separate bill (Sec. 132).
- As between holders in due course of the different parts of the same bill, he who first acquired title to anyone part is entitled to the other parts and is also entitled to claim the money represented by bill (Sec. 133).

Time and demand bill
Time bill: A bill payable after a fixed time is termed as a time bill. In other words, bill payable “after date” is a time bill.

Demand bill: A bill payable at sight or on demand is termed as a demand bill.

Trade and accommodation bill
Trade bill: A bill drawn and accepted for a genuine trade transaction is termed as a “trade bill”.

Accommodation bill: A bill drawn and accepted not for a genuine trade transaction but only to provide financial help to some party is termed as an “accommodation bill”.

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Example: A, is need of money for three months. He induces his friend B to accept a bill of exchange drawn on him for Rs. 1,000 for three months. The bill is drawn and accepted. The bill is an “accommodation bill”. A may get the bill discounted from his bankers immediately, paying a small sum as discount. Thus, he can use the funds for three months and then just before maturity he may remit the money to B, who will meet the bill on maturity.

In the above example A is the “accommodated party” while B is the “accommodating party”.

It is to be noted that a recommendation bill may be for accommodation of both the drawer and acceptor. In such a case, they share the proceeds of the discounted bill.

Rules regarding accommodation bills are:

- In case the party accommodated continues to hold the bill till maturity, the accommodating party shall not be liable to him for payment of, the bill since the contract between them is not based on any consideration (Section 43).
- But the accommodating party shall be liable to any subsequent holder for value who may know the exact position that the bill is an accommodation bill and that the full consideration has not been received by the acceptor. The accommodating party can, in turn, claim compensation from the accommodated party for the amount it has been asked to pay the holder for value.
- An accommodation bill may be negotiated after maturity. The holder or such a bill after maturity is in the same position as a holder before maturity, provided he takes it in good faith and for value (Sec. 59).

In form and all other respects an accommodation bill is quite similar to an ordinary bill of exchange. There is nothing on the face of the accommodation bill to distinguish it from an ordinary trade bill.

Cheques
Section 6 of the Act defines “A cheque is a bill of exchange drawn on a specified banker, and not expressed to be payable otherwise than on demand”.

A cheque is bill of exchange with two more qualifications, namely,

- It is always drawn on a specified banker, and
- It is always payable on demand.

Consequently, all cheques are bill of exchange, but all bills are not cheque. A cheque must satisfy all the requirements of a bill of exchange; that is, it must be signed by the drawer, and must contain an unconditional order on a specified banker to pay a certain sum of money to or to the order of a certain person or to the bearer of the cheque. It does not require acceptance.
Fictitious bill
Where both drawer and payee of a bill are fictitious persons, the acceptor is liable on the bill to a holder in due course. If the latter can show that the signature of the supposed drawer and the first endorser are in the same hand, for the bill being payable to the drawer’s order the fictitious drawer must indorse the bill before he can negotiate it. (Sec. 42).

Documentary and clean bills
When Documents of title goods and other necessary documents like invoice, insurance policy, etc; are annexed to a bill of exchange, such bill is called a documentary bill. All such documents are delivered to the buyer on acceptance or payment of the bill. But when no documents relating the goods represented by the bill are annexed to it, such bill is called as clean bill.

Inchoate instrument
Section 20 of the Act states: “Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in 2[India], and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount Provided that no person other than a holder in due course shall recover from the person delivering the instrument any thing in excess of the amount intended by him to be paid thereunder.”

An inchoate instrument is an incomplete instrument in some respect. For example, a bill is drawn. “Payable to...... or order”. A holder may write his name as a payee in the blank space and sue upon the instrument. The principle behind an inchoate instrument is essentially one of estoppels. It enables persons to lend their credit to others by signing their names on blank instruments which can subsequently be filled in and thus they bind themselves as drawers, makers, acceptors or endorsers.

Ambiguous instrument
Where an instrument owing to its faulty drafting may be interpreted wither as a bill of exchange or a promissory note, it is called an ambiguous instrument. The holder of such instrument has to elect once for all whether to treat it a bill or promissory note. Once he does it, he has to abide by his election. The provisions pertaining to ambiguous instruments are made in Section 17 and 18 which are as follows:
Section 17: Ambiguous instrument
Where an instrument may be construed either as a promissory note or bill of exchange, the holder may at his election treat it as either, and the instrument shall be thenceforward treated accordingly.

Section 17 of the Act states that an instrument which may be construed either as a promissory note or as a bill of exchange (Section 17) is considered as an ambiguous instrument.

In the following cases the instrument is treated as ambiguous instrument:

- Where the drawer and drawee are the same person.
- Where the drawee is a fictitious person
- Where the drawee is a person incapable of entering into contract.

[Section 18]-Where amount is stated differently in figures and words
If the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid.

The holder of such a bill is at liberty to treat the instrument as a bill or a promissory note. The holder shall decide it once for all. After having made his choice he cannot afterwards fall back and say that it is the other kind of instrument.

Following illustrations make the above mentioned provisions more clear: If Mr. Jignesh addresses an instrument in the form of a promissory note to Mr. Munde who accepts it. In this case, the holder may treat the instrument as a promissory note or a bill of exchange at his option.

Escrow
A bill, endorsed or delivered to a person subject to the understanding that it will be paid only if certain conditions are fulfilled, is called an “Escrow”. Regarding these bills there is no liability of the drawer until the conditions agreed are fulfilled. However, the rights of a holder in due course will not be affected.

For example, Mr. ABC writes a promissory note in favour of his relative employee and hands it over to his custody till the death of Mr. ABC and thereafter hand it over to that relative if he continues to be an employee and remains in the service. If this condition is fulfilled and the solicitor hands over the promissory note to the relative, the relative gets the right to claim the amount mentioned in the promissory note. This illustration gives a brief idea about the nature of an escrow.

Bills in sets
Sometimes, a bill of exchange is drawn in several parts. All the parts so drawn are referred to as bill drawn in sets. OF course, all parts from one set and the whole set goes to constitute one bill and each of its parts is numbered and contains the reference to the other parts so that it continues to be payable so long as the other parts remain unpaid. The provisions relating to bills in sets have been made in Section 132 and 133 of the Acts in Chapter XV of the Act. From the provisions of these sections, we get an idea about the bills in sets. The provisions are as follows:

Set of bills: “Bills of exchange may be drawn in parts, each part being numbered and containing a provision that it shall continue payable only so long as the others remain unpaid. All the parts together make a set; but the whole set constitutes only one bill, and is extinguished when one of the parts if a separate bill, would be extinguished.” (Section 132)

Exception: - When a person accepts or indorses different parts of the bill in favour of different persons, he and the subsequent endorsers of each are liable on such part as if it were a separate bill.

Holder of first acquired part entitled to all:
As between holders in due course of different parts of the same set, he who first acquired title to his part is entitled to the other parts and the money represented by the bill. (Sec 133)
It is usually found that foreign bills are drawn in sets because of the following important advantages.

- As foreign bills are sent over long distances and hence, there exists a possibility of loss or delay. In order to reduce the risk of loss in course of transit foreign bills are drawn in sets.
- In order to facilitate prompt and easy presentment for acceptance as well as payment.

### Inland and foreign instruments

From the provisions of Section 11, 12, 104, 134, 135, 136, 137, we get an idea about the meaning, the inland and meaning, protest etc. of foreign instruments and hence, these sections are given below. Sections from 134 to 137 are included in chapter XVI of the Act under the heading, “Of International Law”.

| Section 11 - Inland Instrument | “A promissory note, bill of exchange or cheque drawn or made in [India] and made payable in, or drawn upon any person resident in, [Indian] shall be deemed to be an inland instrument.” |
| Section 12 - Foreign Instrument | “Any such instrument not so drawn, made or made payable shall be deemed to be a foreign instrument.” |
| Section 104: Protest of Foreign Bills | Foreign bills of exchange must be protested for dishonour when such protest is required by the law of the place where they are drawn. |
| Section 134 - Law governing liability of maker, acceptor or endorser of foreign instrument | In the absence of a contract to the contrary, the liability of the maker of drawer of a foreign promissory note, bill of exchange or cheque is regulated in all essential matters by the law of the place where he made the instrument, and the respective liabilities of the acceptor and endorser by the law of the place where the instrument is made payable. **Illustration**

A bill of exchange was drawn by A California where the rate of interest is 25 percent, and accepted by B, payable in Washington where the rate of interest is 6 per cent. The bill is endorsed in "[India], and is dishonoured. An action on the bill is brought against B in "[India]. He is liable to pay interest at the rate of 6 per cent, only; but if A is charged as drawer, A is liable to pay interest at the rate of 25 percent. |
| Section 135. Law of place of payment governs dishonours | Where a promissory note, bill of exchange or cheque is made payable in a different place from that in which it is made or endorsed, the law of the place, where it is made payable determines what constitutes dishonour and what notice of dishonour is sufficient. **Illustration**

A bill of exchange drawn and endorsed in "[India], but accepted payable in France, is dishonoured. The indorsee cause it to be protested for such dishonour, and gives notice thereof in accordance with the law of France through not in accordance with the rules herein contained in respect of bills which are no foreign. The notice is sufficient.
### Section 136. Instrument made, etc. out of India, but in accordance with the law of India

If a negotiable instrument is made, drawn accepted or endorsed [outside India], but in accordance with the [law of India] the circumstance that any agreement evidenced by such instrument is invalid according to the law of the country wherein it was entered into does not invalidate any subsequent acceptance or endorsement made thereon [within India].

### Section 137. Presumption as to foreign law

The law of any foreign country [* * *] regarding promissory note, bills of exchange and cheques shall be presumed to be the same as that of [India], unless and until the contrary is proved.”

### Table 4.2 Sections from 134 to 137 for inland and foreign instruments

#### Instruments payable on demand [Section 19]

There are certain instruments which are payable on demand. Section 19 makes it clear that, “A promissory note or bill of exchange, in which no time for payment is specified, and a cheque, are payable on demand.”

- Cheques are always payable on demand, i.e., when they are presented to the bank in due course of time.
- In a promissory note or bill of exchange the expressions “at sight” and “on presentment” means on demand. [Section 21]
- Promissory notes or bills of exchange in respect of which no time limit is specified are also payable on demand.

#### 4.2.4 Presumptions as to Negotiable Instrument

Sections 118 and 119 of the Negotiable Instrument Act lay down certain presumptions which the court presumes in regard to negotiable instruments. In other words these presumptions need not be proved as they are presumed to exist in every negotiable instrument. Until the contrary is proved the following presumptions shall be made in case of all negotiable instruments:

<table>
<thead>
<tr>
<th>Presumption</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consideration:</td>
<td>It shall be presumed that every negotiable instrument was made drawn, accepted or endorsed for consideration. It is presumed that, consideration is present in every negotiable instrument until the contrary is presumed. The presumption of consideration, however may be rebutted by proof that the instrument had been obtained from, its lawful owner by means of fraud or undue influence.</td>
</tr>
<tr>
<td>Date:</td>
<td>Where a negotiable instrument is dated, the presumption is that it has been made or drawn on such date, unless the contrary is proved.</td>
</tr>
<tr>
<td>Time of acceptance:</td>
<td>Unless the contrary is proved, every accepted bill of exchange is presumed to have been accepted within a reasonable time after its issue and before its maturity. This presumption only applies when the acceptance is not dated; if the acceptance bears a date, it will prima facie be taken as evidence of the date on which it was made.</td>
</tr>
<tr>
<td>Time of transfer:</td>
<td>Unless the contrary is presumed it shall be presumed that every transfer of a negotiable instrument was made before its maturity.</td>
</tr>
<tr>
<td>Order of endorsement:</td>
<td>Until the contrary is proved, it shall be presumed that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.</td>
</tr>
<tr>
<td>Stamp:</td>
<td>Unless the contrary is proved, it shall be presumed that a lost promissory note, bill of exchange or cheque was duly stamped.</td>
</tr>
</tbody>
</table>
Holder in due course:
Until the contrary is proved, it shall be presumed that the holder of a negotiable instrument is the holder in due course. Every holder of a negotiable instrument is presumed to have paid consideration for it and to have taken it in good faith. But if the instrument was obtained from its lawful owner by means of an offence or fraud, the holder has to prove that he is a holder in due course.

Proof of protest:
Section 119 lays down that in a suit upon an instrument which has been dishonoured, the court shall on proof of the protest, presume the fact of dishonour, unless and until such fact is disproved.

Table 4.3 Presumptions for negotiable instruments

4.2.5 Distinction between Bill of Exchange and Promissory Note
Difference between bill of exchange and promissory note is given below.

<table>
<thead>
<tr>
<th>Number of parties:</th>
<th>In a promissory note there are only two parties – the maker (debtor) and the payee (creditor). In a bill of exchange, there are three parties; drawer, drawee and payee; although any two out of the three may be filled by one and the same person,</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment to the maker:</td>
<td>A promissory note cannot be made payable the maker himself, while in a bill of exchange to the drawer and payee or drawee and payee may be same person.</td>
</tr>
<tr>
<td>Unconditional promise:</td>
<td>A promissory note contains an unconditional promise by the maker to pay to the payee or his order, whereas in a bill of exchange, there is an unconditional order to the drawee to pay according to the direction of the drawer.</td>
</tr>
<tr>
<td>Prior acceptance:</td>
<td>A note is presented for payment without any prior acceptance by the maker. A bill of exchange is payable after sight must be accepted by the drawee or someone else on his behalf, before it can be presented for payment.</td>
</tr>
<tr>
<td>Primary or absolute liability:</td>
<td>The liability of the maker of a promissory note is primary and absolute, but the liability of the drawer of a bill of exchange is secondary and conditional.</td>
</tr>
<tr>
<td>Relation:</td>
<td>The maker of the promissory note stands in immediate relation with the payee, while the maker or drawer of an accepted bill stands in immediate relations with the acceptor and not the payee.</td>
</tr>
<tr>
<td>Protest for dishonour:</td>
<td>Foreign bill of exchange must be protested for dishonour when such protest is required to be made by the law of the country where they are drawn, but no such protest is needed in the case of a promissory note.</td>
</tr>
<tr>
<td>Notice of dishonour:</td>
<td>When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate endorsers, but no such notice need be given in the case of a note.</td>
</tr>
</tbody>
</table>

Table 4.4 difference between bill of exchange and promissory note
4.2.6 Distinction between Bills of Exchange and Cheque

- A bill of exchange is usually drawn on some person or firm, while a cheque is always drawn on a bank.
- It is essential that a bill of exchange must be accepted before its payment can be claimed. A cheque does not require any such acceptance.
- A cheque can only be drawn payable on demand, a bill may be also drawn payable on demand, or on the expiry of a certain period after date or sight.
- A grace of three days is allowed in the case of time bills while no grace is given in the case of a cheque.
- The drawer of the bill is discharged from his liability, if it is not presented for payment, but the drawer of a cheque is discharged only if he suffers any damage by delay in presenting the cheque for payment.
- Notice of dishonour of a bill is necessary, but no such notice is necessary in the case of cheque.
- A cheque may be crossed, but not needed in the case of bill.
- A bill of exchange must be properly stamped, while a cheque does not require any stamp.
- A cheque drawn to bearer payable on demand shall be valid, but a bill payable on demand can never be drawn to bearer.
- Unlike cheques, the payment of a bill cannot be countermanded by the drawer.

4.3 Parties to a Negotiable Instrument

Necessary parties for different negotiable instruments are discussed below.

4.3.1 Parties to Bill of Exchange

Following are the parties involved in bill of exchange.

- Drawer: The maker of a bill of exchange is called the ‘drawer’.
- Drawee: The person directed to pay the money by the drawer is called the ‘drawee’.
- Acceptor: After a drawee of a bill has signed his assent upon the bill, or if there are more parts than one, upon one of such pares and delivered the same, or given notice of such signing to the holder or to some person on his behalf, he is called the ‘acceptor’.
- Payee: The person named in the instrument, to whom or to whose order the money is directed to be paid by the instrument is called the ‘payee’. He is the real beneficiary under the instrument. Where he signs his name and makes the instrument payable to another person, that person does not become the payee.
- Endorser: When the holder transfers or indorses the instrument to anyone else, the holder becomes the ‘endorser’.
- Indorsee: The person to whom the bill is indorsed is called an ‘indorsee’.
- Holder: A person who is legally entitled to the possession of the negotiable instrument in his own name and to receive the amount thereof, is called a ‘holder’. He is either the original payee, or the indorsee. In case the bill is payable to the bearer, the person in possession of the negotiable instrument is called the ‘holder’.
- Drawee in case of need: When in the bill or in any endorsement, the name of any person is given, in addition to the drawee, to be resorted to in case of need, such a person is called ‘drawee in case of need’. In such a case it is obligatory on the part of the holder to present the bill to such a drawee in case the original drawee refuses to accept the bill. The bill is taken to be dishonoured by non-acceptance or for non-payment, only when such a drawee refuses to accept or pay the bill.
- Acceptor for honour: In case the original drawee refuses to accept the bill or to furnish better security when demanded by the notary, any person who is not liable on the bill, may accept it with the consent of the holder, for the honour of any party liable on the bill. Such an acceptor is called ‘acceptor for honour’.
4.3.2 Parties to a Promissory Note
Following are the parties involved in a promissory note.
- Maker. He is the person who promises to pay the amount stated in the note. He is the debtor.
- Payee. He is the person to whom the amount is payable, i.e., the creditor.
- Holder. He is the payee or the person to whom the note might have been indorsed.
- The endorser and indorsee (the same as in the case of a bill).

4.3.3 Parties to a Cheque
- Drawer. He is the person who draws the cheque, i.e., the depositor of money in the bank.
- Drawee. It is the drawer’s banker on whom the cheque has been drawn.
- Payee. He is the person who is entitled to receive the payment of the cheque.
- The holder, endorser and indorsee (the same as in the case of a bill or note).

4.3.4 Capacities of Parties to the Negotiable Instruments
According to section 26 of the Act, every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Any person who is competent to enter into contract can become a party to a negotiable instrument. His capacity to incur liability as a party to a negotiable instrument is coextensive with his capacity to contract. If any party, who makes, accepts, draws, indorses, delivers or negotiate any negotiable instrument, is incompetent to do so, the agreement is void against the party.

The different cases of incapacity to incur liability as a party to a negotiable instrument are discussed below:

**Minor**
A minor may draw, indorse, deliver and negotiate such instruments to as to bind all parties except himself. An Agreement with a minor is void. He cannot bind himself by becoming a party to a negotiable instrument. However, he may draw, endorse, deliver and negotiate a negotiable instrument to bind other parties except himself. The negotiable instrument does not become void merely because a minor is a party to it.

**Lunatics or persons of unsound mind**
Agreements with lunatics, drunken persons and idiots are void. Negotiable instruments made or drawn by such persons are void as against these persons provided that they were not capable of forming any rational judgement at the time of execution of the instruments as to the effects of such negotiable instruments. But lunatics may bind themselves by the negotiable instruments if signed by them during lucid intervals.

**Insolvent**
A person, who has been adjudicated as a insolvent, cannot accept or endorse a bill. An insolvent cannot sue on an instrument as his property vests in an official receiver. Nothing herein contained shall be deemed to empower a corporation to make, indorse or accept such instruments except in cases in which, under the law for the time being in force, they are so empowered.

**Agent**
Duly Authorised agents can draw or accept the negotiable instruments on behalf of their principles. The authority of an agent to draw or to accept or to endorse negotiable instruments must be in clear terms
A secretary, a manager, a director, or any such person working as man agent must disclose the name of the firm, company as the case may be on whose behalf such agent signs, endorses or accepts the instruments. The provisions relating to the capacities of an agent are found in Sections 27 and 28 which are as follows:
• **Section 27**: Every person capable of binding himself or of being bound, as mentioned in section 26, may so bind himself or be bound by a duly authorised agent acting in his name. A general authority to transact business and to receive and discharge debts does not confer upon an agent the power of accepting or indorsing bills of exchange so as to bind his principal. An authority to draw bills of exchange does not of itself impart an authority to endorse.

• **Section 28**: Liability of agent signing. An agent who signs his name to a promissory note, bill of exchange or cheque without indicating thereon that he signs as agent, or that he does not intend thereby to incur personal responsibility, is liable personally on the instrument, except to those who induced him to sign upon the belief that the principal only would be held liable.”

**Partnership firm**

A partner of a trading firm has an implied authority to draw, accept, endorse or negotiate a negotiable instrument. A partner of a non-trading firm cannot draw, accept, endorse or negotiate a negotiable instrument unless he gets an express authority to that effect. Of course, in both the cases, liability must be incurred in the name of the firm so as to bind all the partners of the firm.

**Joint stock company**

A trading joint stock company has an implied power to draw, accept, endorse or negotiate the bill of exchange. But a non-trading joint stock company has no implied power to deal in promissory notes, bills of exchanges etc; A non-trading joint stock company has to obtain his power of draw, accepting etc; of negotiable instruments by the objects clause of the memorandum of association.

**Legal representatives**

A legal representative has all the rights to all the negotiable instruments after the death of the holder. He can sue for them and recover the amounts of the instruments. Section 29 of the Act states that a legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is liable personally thereon unless he expressly limits his liability to the extent of the assets received by him as such.

**Hindu joint family**

As karta or a manager of a Hindu Joint family represents the family in all dealings with the third parties, he has an implied authority to contract debts and pledge the credit of the family. He can draw, accept, endorse or negotiate instruments on behalf of his family members. Even the minor members of his family are equally liable to the extent of their share in the assets of the family, though they are not personally held liable.

**4.4 Liability of the Parties to Negotiable Instruments**

There are provisions in the Negotiable Instruments Act relating to the question of liability of the parties to negotiable instruments. The liabilities of parties to negotiable instruments have been laid down in Sections 30 to 32 and 35 to 43 of the Negotiable Instruments Act. The provisions of these sections are explained below.

**4.4.1 Liability of the Drawer (Section 30)**

The provisions relating to the liability of the drawer are given in Section 30. According to Section 30, “The drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been give to, or received by, the drawer as hereinafter provided.”

In the provisions of this Section 30, the positions of the drawer of a bill of exchange and that of the drawer of a cheque is not exactly identical from the view of liability in respect of a bill or a cheque as the case may be. This is made clear below:
Liability of the drawer of a bill of exchange:
The drawer of a bill is primarily responsible until the bill has been accepted by the concerned drawee. But when the bill has been accepted by the drawee thereafter the acceptor becomes liable to the holder of the bill thereof and the liability of the concerned drawer becomes secondary to that of the acceptor. Further, if the holder of a bill makes a default in presentment for acceptance where it is compulsory, or in presentment for payment, the drawer is discharged altogether.

In order to make the drawer liable on the dishonour by the drawee or the acceptor, it is essential that a notice of dishonour according to the provisions of this Act must have been given to him.

Liability of the drawer of a cheque:
When a drawer issues a cheque, it is his liability to pay to the holder the amount of the cheque through his banker when the cheque is duly presented for payment. If the cheque is dishonoured, the drawer is liable for payment. IF the cheque is dishonoured, the drawer is liable to compensate the holder of the cheque provided that the drawer has received a notice of dishonour. However, the drawer of a cheque will not be entitled to a notice of dishonour, if the dishonour is due to lack of funds in his account.

Thus, the drawer of a cheque always remains liable to the holder as there is no question of acceptance of a cheque. But the holder of a bill of exchange can sue the acceptor if other conditions are fulfilled. Moreover, the holder of a cheque has no remedy against the banker. His remedy is only against the drawer of a cheque.

4.4.2 Liability of Drawee Cheque
The provisions related to the liability of the drawee of a cheque are mentioned in Section 31 of the Negotiable Instruments Act. According to Section 31:

- “The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque when duly required to do so, and in default of such payment, must compensate the drawer for any loss or damage caused by such default”.
- The drawee of a cheque who is always a banker is liable to the drawer if he, having sufficient funds of his customer, wrongfully refuses or fails to honour his customer’s cheque.
- The liability of the drawee arises only when the cheque has been dishonoured by mistake. But where the cheque is dishonoured for any of the reasons explained earlier in this chapter, the banker does not incur any liability for rightful dishonour.

Liability of the Maker of a Promissory Note and the Acceptor of a Bill of Exchange
According to Section 32 of the Negotiable Instruments Act, “In the absence of contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity according to the apparent tenor of the note or acceptance respectively, and the acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand.

In default of such payment as aforesaid, such maker or acceptor is bound to compensate any party to the note or bill for any loss or damage sustained by him and caused by such default.”

From these provisions of Section 32, we come to know that the liability of the maker of a promissory note and of the acceptor of a bill of exchange is the same. They are primarily responsible for the payment due on the instrument. Their liability is absolute and unconditional.

4.4.3 Liability of Endorser [Section 35]
When the marker or holder of an negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, one the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to indorse the same, and is called the “endorser”.

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The literal meaning of the term endorsement is writing on an instrument. But in the negotiable Instruments Act, it means the writing of person’s name on the face or back of a negotiable instrument or on a slip of paper attached thereto which done for the purpose of negotiation. The person who signs on the back or on the face of the instrument or on the slip attached thereto is called endorser and the person to whom the instrument is endorsed is called the indorsee. An endorsement can be made by the holder of an instrument or by the maker who signs it otherwise than the maker.

Provision of Section 35 of the negotiable Instruments Act make clear the liability of the endorser. According to Section 35, “In the absence of a contract to the contrary, whoever indorses and delivers a negotiable instrument before maturity, without in such endorsement, expressly excluding or making conditional his own liability, is bound thereby to every subsequent holder, in case of dishonour by the drawee, acceptor or maker, to compensate such holder for any loss or damage caused to him by such dishonour, provided due notice of dishonour has been given to, or received by, such endorser as hereinafter provided.

Every endorser after dishonour is liable as upon an instrument payable on demand.”

The endorser of an instrument by endorsing and delivering the instrument, before maturity, undertakes the responsibility that –

• That on the due presentment it shall be accepted, (if a bill), and paid; and
• That if it is dishonoured by the drawee, acceptor or maker, he will indemnify the holder or subsequent endorsers who are compelled to pay, provided due notice of dishonour is received by him.

But he may or make his liability conditional. In this respect, his position is better than that of a drawer or an acceptor, neither of whom can exclude his liability.

Where the holder of a negotiable instrument, without the consent of the endorser, destroys or impairs the endorser’s remedy against a prior party, the endorser is discharged from liability to the holder to the extent as if the instrument had been paid at maturity.

4.4.4 Liability of Parties to Holder in Due Course

According to Section 36, “Every prior party (i.e., maker or drawer, acceptor and all intervening endorsers to an instrument is liable to a holder in due course until the instrument is satisfied (paid).” Therefore, the maker and endorsers of a note are jointly and severally liable for the payment and may be sued jointly.

4.4.5 Provisions of Section 37,38 and 39 Regarding Liability

Provisions of Section 37, 38 and 39 regarding liability are discussed under

Provisions of Section 37

According to Section 37, “The maker of a promissory note or cheque, the drawer of bill of exchange until acceptance, and the acceptor are, in the absence of a contract to the contrary, respectively liable thereon as principal debtors, and the other parties thereto are liable thereon as sureties for the maker, drawer or acceptor, as the case may be.”

Though Section 36 lays down that all prior parties are liable to a holder in due course, their liability. But the liability is not of the same kind. Section 37 provides that, in the absence of a contract to the contrary. i) the maker of a promissory note or cheque, the drawer of bill of exchange until acceptance, and the acceptor are respectively liable thereon on principal debtors, and ii) the other parties thereto are liable thereon as sureties for the maker, drawer or acceptor, as the case may be. But there must not be contract to the contrary.

Provisions of Section 38 and 39:

Section 38 provides that, “38. Prior party a principal in respect of each subsequent party. As between the parties so liable as sureties, each prior party is, in the absence of a contract to the contrary, also liable thereon as a principal debtor in respect of each subsequent party.
Illustration
A draws a bill payable to his own order on B, who accepts. A afterwards indorses the bill to C, C to D, and D to E. As between E and B, B is the principal debtor, and A, C and D are his sureties. As between E and A, A is the principal debtor, and C and D are his sureties. As between E and C, C is the principal debtor and D is his surety.

The above illustration clearly proves that all the successive endorsers are not in the positions of co-sureties under the Indian Contract Act. Section 39 pertains to surety ship. According to this Section 39 of the Negotiable Instruments Act, “When the holder of an accepted bill of exchange enters into any contract with the acceptor which, under section 134 or 135 of the Indian Contract Act, 1872 (9 of 1872), would discharge the other parties, the holder may expressly reserve his right to charge the other parties, and in such case they are not discharged.”

Thus, it can be noted that the relation of holder and acceptor is that of a principal debtor and principal creditor. All other parties in between them play the role of sureties, i.e., they, between them, are sureties.

4.4.6 Other Important Provisions of the Negotiable Instrument Act
Some important provisions of the Negotiable Instrument Act are given below.

Forged instrument and liability of acceptor (Sec 41)
“An acceptor of a bill of exchange already indorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe the endorsement to be forged when he accepted the bill”. This simply means if the acceptor of a bill, i.e., drawee is ignorant of forgery while accepting the bill, he is relieved of liability so far as that instrument is concerned. But if he knew or had reason to believe that the endorsement was forged and even then he accepted the bill, then he would not be allowed to plead the forgery of endorsement in respect of such bill.

Liability of acceptor for a bill of exchange drawn in a fictitious name[Section 42]
Acceptance of bill drawn in fictitious name. An acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer’s order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an endorsement by the same hand as the drawer’s signature, and purporting to be made by the drawer.

When both the drawer and the payee are fictitious, the acceptor of such bill is liable to a holder in due course, if it is proved that the signature of the concerned drawer and that of the first endorser, i.e., payee are in the same handwriting.

Liability on an instrument made drawn etc. without consideration
In Accordance with the provisions of Section 43, an instrument made, drawn accepted, endorsed or transferred without consideration creates no obligation of payment between the parties to the transaction. Further a bill drawn or accepted without consideration does not impose any liability either on the drawer or on the acceptor to pay the holder. Similarly, if an instrument is endorsed without consideration, the endorser is not liable.

Exception I.-No party for whose accommodation a negotiable instrument has been made, drawn, accepted or indorsed can, if he have paid the amount thereof, recover thereon such amount from any person who became a party to such instrument for his accommodation.

Exception II.-No party to the instrument who has induced any other party to make, draw, accept, indorse or transfer the same to him for a consideration, which he has failed to pay or perform in full shall recover thereon an amount exceeding the value of the consideration (if any) which he has actually paid or performed.

But if any party to such an instrument has transferred the instrument to a holder for a consideration such holder and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or from any party prior thereto.
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**Liability in respect of partial absence or failure of money – consideration (Sec 44)**
“When the consideration for which a person signed a promissory note, bill of exchange or cheque consisted of money, and was originally absent in part or has subsequently failed in part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced. “

**Explanation.** - The drawer of a bill of exchange stands in immediate relation with the acceptor. The maker of a promissory note, bill of exchange or cheque stands in immediate relation with the payee, and the indorser with his indorsee. Other signers may by agreement stand in immediate relation with a holder.

**Illustration**
A draws a bill on B for Rs. 500 payable to the order of A. B accepts the bill, but subsequently dishonours it by non-payment. A sues B on the bill; B proves that it was accepted for value as to Rs. 400, and as an accommodation to the plaintiff as to the residue. A can only recover Rs. 400.

**Liability relating to partial failure of consideration not consisting of money (Sec 45)**
“Where a part of the consideration for which a person signed a promissory note, bill of exchange or cheque, though not consisting of money, is ascertainable in money without collateral enquiry, and there has been a failure of that part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.”

**Provisions of Section 46[Para 3]**
Provisions of Section 46 imply that when an instrument is negotiated to a holder in due course, it may be shown that the instrument was delivered conditionally or for a special purposes only, and not for the purpose of transferring absolutely the property therein.

**Liability in Respect of an Instrument Obtained by Unlawful Means or For Unlawful Consideration**

**Provision of Section 58 are related to the an instrument obtained by unlawful means or for unlawful consideration:**
When a negotiable instrument has been lost, or has been obtained form any maker, acceptor or holder thereof by means of offence or fraud, or for an unlawful consideration, no possessor or indorsee who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder, unless such possessor or indorsee is, or some person through whom he claims was, a holder thereof in due course.

Thus, a person who obtains the instrument by unlawful means cannot claim any amount due to the instrument, except when such person is claiming the amount is holder in due course. He is held liable for such instruments.

**4.5 Holder and Holder in Due Course**

**Holder and holder in due course is explained below.**

**4.5.1 Holder**
According to section 8 of the Act, the ” holder” of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto.

Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.
Possession of instrument:
The person must be a de jure holder. He must be entitled to possess the instrument in his own name. His possession must be under some legal and valid title. A thief or any person who finds the instrument or an indorsee under a forged endorsement though in possession of the negotiable instrument, is not a holder in the absence of a legal title to it. Even an agent holding a negotiable instrument for his principal is also not a holder though he has a right to receive the payment.

Entitled to receive the amount:
The person must be entitled to receive the amount of the instrument and give a valid discharge to the buyer. A person may be bearer of an instrument or payee or indorsee of an instrument but he may not be called a holder of instrument if he is prohibited by law from receiving the amount due on the instrument.

It must be remembered that no person can sue an instrument unless his name appears thereon either as the payee or the indorsee unless the instrument is made payable to bearer. Moreover, a true owner unless he is a holder cannot maintain a suit in the court of law.

Following persons are considered the holders of the negotiable instruments:
- A principal whose name appears on an instrument as the holder though it is executed in the name of his agent for him.
- Where a negotiable instrument is a bearer one, any person who is in the possession of such instrument is the holder,
- Where a negotiable instrument is in the name of a partner of a firm, it naturally becomes a holder as it is not a separate entity from the partner.
- The indorsee of a cheque is called a holder.
- If a holder of a negotiable instrument is dead, the heirs of the deceased holder become the holders.
- A principal on whose behalf a promissory note is endorsed in blank and is delivered to his agent, he is the holder of the instrument though his name does not appear on the instrument.

However the following persons are not called holders
- A thief or any person who finds the instrument or an indorsee under a forged endorsement is not a holder though he is in possession of the negotiable instrument.
- The word ‘entitled’ used in the definition of a holder shows that the title of the person who claims to be the holder must be acquired in a lawful manner. A person obtaining the instrument under forgery is not a holder.
- When the endorsement of a bill is ‘for collection only’ the indorsee cannot be a holder.

The above mentioned lists are not complete.

4.5.2 Holder in Due Course
Section 9 of the Act defines ‘holder in due course’ as any person who
- for valuable consideration,
- becomes the possessor of a negotiable instrument payable to bearer or the indorsee payee thereof,
- before the amount mentioned in the document becomes payable, and
- without having sufficient cause to believe that any defect existed in the title of the person from whom he derives his title. (English law does not regard payee as a holder in due course).

The essential qualification of a holder in due course may, therefore, be summed up as follows:
He must be a holder for valuable consideration.
Consideration must not be void or illegal, example, a debt due on a wagering agreement. It may, however, be inadequate. A donee, who acquired title to the instrument by way of gift, is not a holder in due course, since there is no consideration to the contract. He cannot maintain any action against the debtor on the instrument. Similarly, money due on a promissory note executed in consideration of the balance of the security deposit for the lease of a house taken for immoral purposes cannot be recovered by a suit.

- He must have become a holder (passessor) before the date of maturity of the negotiable instrument. Therefore, a person who takes a bill or promissory note on the day on which it becomes payable cannot claim rights of a holder in due course because he takes it after it becomes payable, as the bill or note can be discharged at any time on that day.
- He must have become holder of the negotiable instrument in good faith. Good faith implies that he should not have accepted the negotiable instrument after knowing about any defect in the title to the instrument. But, notice of defect in the title received subsequent to the acquisition of the title will not affect the rights of a holder in due course.

Besides good faith, the Indian Law also requires reasonable care on the part of the holder before he acquires title of the negotiable instrument. He should take the instrument without any negligence on his part. Reasonable care and due caution will be the proper test of his bona fides.

It will not be enough to show that the holder acquired the instrument honestly, if in fact, he was negligent or careless. Under conditions of sufficient indications showing the existence of a defect in the title of the transferor, the holder will not become a holder in due course even though he might have taken the instrument without any suspicion or knowledge.

Example:
- A bill made out by pasting together pieces of a torn bill taken without enquiry will not make the holder, a holder in due course. It was sufficient to show the intention to cancel the bill. A bill should not be taken without enquiry if suspicion has been aroused.
- A post-dated cheque is not irregular. It will not preclude a bonafide purchase instrument from claiming the rights of a holder in due course.

It is to be noted that it is the notice of the defect in the title of his immediate transferor, which deprives a person from claiming the right of a holder in due course. Notice of defect in the title of any prior party does not affect the title of the holder.

- A holder in due course must take the negotiable instrument complete and regular on the face of it.

4.5.3 Rights and Privileges of a Holder in Due Course
A holder in due course gets certain rights and special privileges which an ordinary holder of a negotiable instrument cannot possess. Certain defences which can be set up against an ordinary holder claiming as a negotiable instrument cannot be set up against a holder in due course. Moreover, a holder in due course gets a title to a negotiable instrument free from equities. Various rights and privileges of a holder in due course are summarised below.

Instrument purged of all defects
A holder in due course who gets the instrument in good faith in the course of its currency is not only himself protected against all defects of title of the person from whom he has received it, but also serves, as a channel to protect all subsequent holders. A holder in due course can recover the amount of the instrument from all previous parties although, as a matter of fact, no consideration was paid by some of the previous parties to instrument or there was a defect of title in the party from whom he took it. Once an instrument passes through the hands of a holder in due course, it is purged of all defects. It is like a current coin. Who-so-ever takes it can recover the amount from all parties previous to such holder (Sec. 53).
It is to be noted that a holder in due course can purify a defective title but cannot create any title unless the instrument happens to be a bearer one.

Examples:

- A obtains B’s acceptance to a bill by fraud. A indorses it to C who takes it as a holder in due course. The instrument is purged of its defects and C gets a good title to it. In case C indorses it to some other person he will also get a good title to it except when he is also a party to the fraud played by A.

- A bill is payable to “A or order”. It is stolen from A and the thief forges A’s signatures and indorses it to B who takes it as a holder in due course. B cannot recover the money. It is not a case of defective title but a case where title is absolutely absent. The thief does not get any title therefore, cannot transfer any title to it.

- A bill of exchange payable to bearer is stolen. The thief delivers it to B, a holder in due course. B can recover the money of the bill.

Privilege in case of inchoate instrument not affected:
Right of a holder in due course to recover money is not at all affected even though the instrument was originally an inchoate stamped instrument and the transferor completed the instrument for a sum greater than what was intended by the maker. (Sec. 20)

- Liability of Prior Parties: All prior parties to the instrument (the maker or drawer, acceptor and intervening indorser) continue to remain liable to the holder in due course until the instrument is duty satisfied. The holder in due course can file a suit against the parties liable to pay, in his own name (Sec. 36).

- Privilege (Can enforce payment) in case of a fictitious bill: Where both drawer and payee of a bill are fictitious persons, the acceptor is liable on the bill to a holder in due course. If the latter can show that the signature of the supposed drawer and the first indorser are in the same hand, for the bill being payable to the drawer’s order the fictitious drawer must indorse the bill before he can negotiate it. (Sec. 42).

- No effect of conditional delivery or of special delivery: Where negotiable instrument is delivered conditionally or for a special purpose and is negotiated to a holder in due course, a valid delivery of it is conclusively presumed and he acquired good title to it. (Sec. 46).

Example: A, the holder of a bill indorses it “B or order” for the express purpose that B may get it discounted. B does not do so and negotiates it to C, a holder in due course. D acquires a good title to the bill and can sue all the parties on it.

- No effect of absence of consideration or presence of an unlawful consideration: The plea of absence of or unlawful consideration is not available against the holder in due course. The party responsible will have to make payment (Sec. 58).

- Estoppel against denying original validity of instrument: The plea of original invalidity of the instrument cannot be put forth, against the holder in due course by the drawer of a bill of exchange or cheque or by an acceptor for the honour of the drawer. But where the instrument is void on the face of it example, promissory note made payable to “bearer”, even the holder in due course cannot recover the money. Similarly, a minor cannot be prevented from taking the defence of minority. Also, there is no liability if the signatures are forged. (Sec. 120).

- Estoppel against denying capacity of the payee to indorse: No maker of promissory note and no acceptor of a bill of exchange payable to order shall, in a suit therein by a holder in due course, be permitted to resist the claim of the holder in due course on the plea that the payee had not the capacity to indorse the instrument on the date of the note as he was a minor or insane or that he had no legal existence (Sec 121).

- Estoppel against endorser to deny capacity of parties: An indorser of the bill by his endorsement guarantees that all previous endorsements are genuine and that all prior parties had capacity to enter into valid contracts. Therefore, he on a suit thereon by the subsequent holder, cannot deny the signature or capacity to contract of any prior party to the instrument.
4.5.4 Distinction between Holder and Holder in Due Course

<table>
<thead>
<tr>
<th>Basis of Distinction</th>
<th>Holder</th>
<th>Holder in Due Course</th>
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<tr>
<td><strong>Meaning</strong></td>
<td>Holder means any person entitled in his own name to the possession of the negotiable instrument and to recover or receive the amount due thereon from the parties thereto.</td>
<td>A holder in due course on the other hand, means a holder who takes the instrument in good faith for consideration before it is overdue and without any notice of defect in the title of the person who transferred it to him.</td>
</tr>
<tr>
<td><strong>Consideration</strong></td>
<td>Consideration may not pass from a holder of the instrument.</td>
<td>A person who claims to be a holder in due course must show that he acquired the instrument for consideration.</td>
</tr>
<tr>
<td><strong>Title</strong></td>
<td>Holder of negotiable instrument does not acquire a better title than that of the person from whom he acquired the instrument. Thus a holder does not acquire a good title if the title of any of the prior parties is defective.</td>
<td>A holder in due course gets a good title even though there was a defect in the title of any prior parties to the instrument.</td>
</tr>
<tr>
<td><strong>Liability</strong></td>
<td>A holder of the instrument can enforce it against the person who has signed it and also against the transfer-or from whom he obtained it.</td>
<td>A holder in due course can sue all prior parties to a negotiable instrument until the instrument is duly satisfied</td>
</tr>
<tr>
<td><strong>Maturity</strong></td>
<td>A holder may acquire the instrument even after it has become due for payment.</td>
<td>A person will be a holder in due course only if he acquires the instrument before the amount mentioned in it becomes payable</td>
</tr>
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Table 4.5 Distinction between holder and holder in due course

4.6 Negotiation and Types of Endorsement

Negotiation may be defined as the process by which a third party is constituted the holder of the instrument so as to entitle him to the possession of the same and to receive the amount due thereon in his own name. According to section 14 of the Act, ‘when a promissory note, bill of exchange or cheque is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated.’ The main purpose and essence of negotiation is to make the transferee of a promissory note, a bill of exchange or a cheque the holder thereof.

Negotiation thus requires two conditions to be fulfilled, namely:

- There must be a transfer of the instrument to another person; and
- The transfer must be made in such a manner as to constitute the transferee the holder of the instrument. Handing over a negotiable instrument to a servant for safe custody is not negotiation; there must be a transfer with an intention to pass title.
4.6.1 Procedure of Transfer or Modes of negotiation

Negotiation may be effected in the following two ways:

- **Negotiation by delivery (Sec. 47):** Where a promissory note or a bill of exchange or a cheque is payable to a bearer, it may be negotiated by delivery thereof.

  **Example:** A, the holder of a negotiable instrument payable to bearer, delivers it to B’s agent to keep it for B. The instrument has been negotiated.

- **Negotiation by endorsement and delivery (Sec. 48):** A promissory note, a cheque or a bill of exchange payable to order can be negotiated only by endorsement and delivery.

Unless the holder signs his endorsement on the instrument and delivers it, the transferee does not become a holder. If there are more payees than one, all must endorse it.

4.6.2 Types of Endorsement

The word ‘endorsement’ in its literal sense means, writing on the back of an instrument. But under the Negotiable Instruments Act it means, the writing of one’s name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein.

Thus, endorsement is signing a negotiable instrument for the purpose of negotiation. The person who effects an endorsement is called an ‘endorser’, and the person to whom negotiable instrument is transferred by endorsement is called the ‘indorsee’.

An endorsement may be:

- Blank or general
- Special or full
- Partial
- Restrictive
- Conditional

**Blank or general endorsement (Sections 16 and 54).**

It is an endorsement when the endorser merely signs on the instrument without mentioning the name of the person in whose favour the endorsement is made. Endorsement in blank specifies no indorsee. It simply consists of the signature of the endorser on the endorsement. A negotiable instrument even though payable to order becomes a bearer instrument if endorsed in blank. Then it is transferable by mere delivery.

An endorsement in blank may be followed by an endorsement in full.

**Example:** A bill is payable to X. X endorses the bill by simply affixing his signature. This is an endorsement in blank by X. In this case the bill becomes payable to bearer.

There is no difference between a bill or note indorsed in blank and one payable to bearer. They can both be negotiated by delivery.

**Special or full endorsement (Section 16)**

When the endorsement contains not only the signature of the endorser but also the name of the person in whose favour the endorsement is made, then it is an endorsement in full. Thus, when endorsement is made by writing the words “Pay to A or A’s order,” followed by the signature of the endorser, it is an endorsement in full. In such an endorsement, it is only the indorsee who can transfer the instrument.
Conversion of endorsement in blank into endorsement in full:
When a person receives a negotiable instrument in blank, he may without signing his own name, convert the blank endorsement into an endorsement in full by writing above the endorser’s signature a direction to pay to or to the order of himself or some other person. In such a case the person is not liable as the endorser on the bill. In other words, the person transferring such an instrument does not incur all the liabilities of an endorser. (Section 49).

Example: A is the holder of a bill endorsed by B in blank. A writes over B’s signature the words “Pay to C or order.” A is not liable as endorser but the writing operates as an endorsement in full from B to C.

Where a bill is endorsed in blank, or is payable to bearer and is afterwards endorsed by another in full, the bill remains transferable by delivery with regard to all parties prior to such endorser in full. But such endorser in full cannot be sued by any one except the person in whose favour the endorsement in full is made. (Section 55).

Example: C the payee of a bill endorses it in blank and delivers it to D, who specially endorses it to E or order. E without endorsement transfers the bill to F. F as the bearer is entitled to receive payment or to sue the drawer, the acceptor, or C who endorsed the bill in blank but he cannot sue D or E.

Partial endorsement (Section 56)
A partial endorsement is one which purports to transfer to the indorsee a part only of the amount payable on the instrument. Such an endorsement does not operate as a negotiation of the instrument.

Example: A is the holder of a bill for Rs.1000. He endorses it “pay to B or order Rs.500.” This is a partial endorsement and invalid for the purpose of negotiation.

Restrictive endorsement (Section 50)
The endorsement of an instrument may contain terms making it restrictive. Restrictive endorsement is one which either by express words restricts or prohibits the further negotiation of a bill or which expresses that it is not a complete and unconditional transfer of the instrument but is a mere authority to the indorsee to deal with bill as directed by such endorsement.

“Pay C,” “Pay C for my use,” “Pay C for the account of B” are instances of restrictive endorsement. The indorsee under a restrictive endorsement acquires all the rights of the endorser except the right of negotiation.

Conditional or qualified endorsement
It is open to the endorser to annex some condition to his owner liability on the endorsement. An endorsement where the indorsee limits or negatives his liability by putting some condition in the instrument is called a conditional endorsement. A condition imposed by the endorser may be a condition precedent or a condition subsequent. An endorsement which says that the amount will become payable if the indorsee attains majority embodies a condition precedent. A conditional endorsement unlike the restrictive endorsement does not affect the negotiability of the instrument. It is also some times called qualified endorsement. An endorsement may be made conditional or qualified in any of the following forms:

(i) ‘Sans recourse’ endorsement: An endorser may be express word exclude his own liability thereon to the endorser or any subsequent holder in case of dishonour of the instrument. Such an endorsement is called an endorsement sans recourse (without recourse). Thus ‘Pay to A or order sans recourse,’ ‘pay to A or order without recourse to me,’ are instances of this type of endorsement. Here if the instrument is dishonoured, the subsequent holder or the indorsee cannot look to the indorser for payment of the same. An agent signing a negotiable instrument may exclude his personal liability by using words to indicate that he is signing as agent only. The same rule applies to directors of a company signing instruments on behalf of a company. The intention to exclude personal liability must be clear. Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all intermediate endorsers are liable to him.
Example: A is the holder of a negotiable instrument. Excluding personal liability by an endorsement without recourse, he transfers the instrument to B, and B endorses it to C, who endorses it to A. A can recover the amount of the bill from B and C.

- **Facultative endorsement:** An endorsement where the endorser extends his liability or abandons some right under a negotiable instrument, is called a facultative endorsement. “Pay A or order, Notice of dishonour waived” is an example of facultative endorsement.
- **‘Sans frais’ endorsement:** Where the endorser does not want the indorsee or any subsequent holder, to incur any expense on his account on the instrument, the endorsement is ‘sans frais’.
- **Liability dependent upon a contingency:** Where an endorser makes his liability depend upon the happening of a contingent event, or makes the rights of the indorsee to receive the amount depend upon any contingent event, in such a case the liability of the endorser will arise only on the happening of that contingent event. Thus, an endorser may write ‘Pay A or order on his marriage with B’. In such a case, the endorser will not be liable until the marriage takes place and if the marriage becomes impossible, the liability of the endorser comes to an end.

### 4.6.3 The Duration of Negotiability

It should be remembered that payment of a negotiable instrument must be made at or after the maturity of such instrument to stop further negotiability of the instrument. If the instrument is paid before its maturity, it is not discharged and can be negotiated further. Section 60 of the Act states that, “A negotiable instrument may be negotiated (except by the maker, drawee or acceptor after maturity) until payment or satisfaction thereof by the maker, drawee or acceptor at or after maturity, but not after sect payment or satisfaction.” This implies that if the amount of an instrument has been paid before its maturity by its acceptor or maker, he can refuse the same before its due date.

### 4.7 Dishonour of Negotiable Instrument

When a negotiable instrument is dishonoured, the holder must give a notice of dishonour to all the previous parties in order to make them liable. A negotiable instrument can be dishonoured either by non-acceptance or by non-payment. A cheque and a promissory note can only be dishonoured by non-payment but a bill of exchange can be dishonoured either by non-acceptance or by non-payment.

#### 4.7.1 Dishonour by Non-acceptance (Section 91)

A bill of exchange can be dishonoured by non-acceptance in the following ways:

- If a bill is presented to the drawee for acceptance and he does not accept it within 48 hours from the time of presentment for acceptance. When there are several drawees even if one of them makes a default in acceptance, the bill is deemed to be dishonoured unless these several drawees are partners. Ordinarily when there are a number of drawees all of them must accept the same, but when the drawees are partner’s acceptance by one of them means acceptance by all.

- When the drawee is a fictitious person or if he cannot be traced after reasonable search.

- When the drawee is incompetent to contract, the bill is treated as dishonoured.

- When a bill is accepted with a qualified acceptance, the holder may treat the bill of exchange having been dishonoured.

- When the drawee has either become insolvent or is dead.

- When presentment for acceptance is excused and the bill is not accepted. Where a drawee in case of need is named in a bill or in any endorsement thereon, the bill is not dishonoured until it has been dishonoured by such drawee.
4.7.2 Dishonour by Non-Payment (Section 92)

A bill after being accepted has got to be presented for payment on the date of its maturity. If the acceptor fails to make payment when it is due, the bill is dishonoured by non-payment. In the case of a promissory note if the maker fails to make payment on the due date the note is dishonoured by non-payment. A cheque is dishonoured by non-payment as soon as a banker refuses to pay.

An instrument is also dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid (Sec 76).

- **Notice of dishonour:** Notice of dishonour means the actual notification of the dishonour of the instrument by non-acceptance or by non-payment. When a negotiable instrument is refused acceptance or payment notice of such refusal must immediately be given to parties to whom the holder wishes to make liable. Failure to give notice of the dishonour by the holder would discharge all parties other than the maker or the acceptor (Sec. 93).

- **To whom the notice of dishonour should be given:** Notice of dishonour must be given to all parties to whom the holder seeks to make liable. No notice need be given to a maker, acceptor or drawee, who are the principal debtors (Section 93). Notice of dishonour may be given to an endorser. Notice of dishonour may be given to a duly authorised agent of the person to whom it is required to be given. In case of the death of such a person, it may be given to his legal representative. Where he has been declared insolvent the notice may be given to him or to his official assignee (Section 94). Where a party entitled to a notice of dishonour is dead, and notice is given to him in ignorance of his death, it is sufficient (Section 97).

- **Form or Mode of notice:** The notice of dishonour may be oral or written or partly oral and partly written. It may be sent by post. It may be in any form but it must inform the party to whom it is given either in express terms or by reasonable intendment that the instrument has been dishonoured and in what way it has been dishonoured and that the person served with the notice will be held liable thereon.

**Rules for giving notice of dishonour**

**Reasonable Time of giving notice of dishonour**

If the holder and the party to whom notice of dishonour is give carry on business or live (as the case may be) in different places, such notice is given within a reasonable time if it is dispatched by the next post or on the day next after the day of dishonour. If the said parties carry on business or live in the same place, such notice is given within a reasonable time if it is dispatched in time to reach its destination on the day next after the day of dishonour. [Section 106]

**Reasonable time for transmitting such notice**

A party receiving notice of dishonour, who seeks to enforce his right against a prior party, transmits the notice within a reasonable time if he transmits it within the same time after its receipt as he would have had to give notice if he had been the holder.[Section 107]

**When notice of dishonoured**

Notice of dishonour is not necessary

- when it is dispensed with by the party entitled thereto
- in order to charge the drawer, when he has countermanded payment
- when the party charged could not suffer damage for want of notice
- when the party entitled to notice cannot after due search be found, or the party bound to give notice is, for any other reason, unable without any fault of his own to give it.
- to charge the drawers, when the acceptors is also a drawer.
- in the case of a promissory note which is not negotiable.
- when the party entitled to notice, knowing the facts, promise unconditionally to pay the amount due on the instrument.
4.8 Noting and Protesting

When a negotiable instrument is dishonoured the holder may sue his prior parties i.e the drawer and the indorser after he has given a notice of dishonour to them. The holder may need an authentic evidence of the fact that a negotiable instrument has been dishonoured. When a cheque is dishonoured generally the bank who refuses payment returns back the cheque giving reasons in writing for the dishonour of the cheque. Sections 99 and 100 provide convenient methods of authenticating the fact of dishonour of a bill of exchange and a promissory note by means of ‘noting’ and ‘protest’.

4.8.1 Noting

As soon as a bill of exchange or a promissory note is dishonoured, the holder can after giving the parties due notice of dishonour, sue the parties liable thereon. Section 99 provides a mode of authenticating the fact of the bill having been dishonoured. Such mode is by noting the instrument. Noting is a minute recorded by a notary public on the dishonoured instrument or on a paper attached to such instrument.

When a bill is to be noted, the bill is taken to a notary public who represents it for acceptance or payment as the case may be and if the drawee or acceptor still refuses to accept or pay the bill, the bill is noted as stated above.

Noting should specify in the instrument,

- the fact of dishonour
- the date of dishonour
- the reason for such dishonour, if any
- the notary’s charges,
- a reference to the notary’s register and
- the notary’s initials

Noting should be made by the notary within a reasonable time after dishonour. Noting and protesting is not compulsory but foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn. Cheques do not require noting and protesting. Noting by itself has no legal effect. Still it has some advantages. If noting is done within a reasonable time protest may be drawn later on. Noting without protest is sufficient to allow a bill to be accepted for honour.

4.8.2 Protest

Protest is a formal certificate of the notary public attesting the dishonour of the bill by non acceptance or by non-payment. After noting, the next step for notary is to draw a certificate of protest, which is a formal declaration on the bill or a copy thereof. The chief advantage of protest is that the court on proof of the protest shall presume the fact of dishonour.

Besides the protest for non-acceptance and for non-payment the holder may protest the bill for better security. When the acceptor of a bill becomes insolvent or suspends payment before the date of maturity, or when he absconds the holder may protest it in order to obtain better security for the amount due. For this purpose the holder may employ a notary public to make the demand on the acceptor and if refused, protest may be made. Notice of protest may be given to prior parties. When promissory notes and bills of exchange are required to be protested, notice of protest must be given instead of notice of dishonour. (Sec. 102)

Inland bills may or may not be protested. But foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn (Sec. 104).

Where a bill is required to be protested under the Act within a specified time, it is sufficient if it is ‘noted for protest’ within such time. The formal protest may be given at anytime after the noting (Sec. 104A)
### 4.8.3 Distinction between Noting and Protest

<table>
<thead>
<tr>
<th>Noting</th>
<th>Protest</th>
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<tbody>
<tr>
<td>When a promissory note or bill of exchange has been dishonoured</td>
<td>When a promissory note or bill of exchange has been dishonoured</td>
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<tr>
<td>has been dishonoured non-acceptance or non-payment, the holder may</td>
<td>by non-acceptance or non-payment, the holder may, within a reasonable</td>
</tr>
<tr>
<td>cause such dishonour to be noted by a notary public upon the instrument,</td>
<td>time, cause such dishonour to be noted and certified by a notary public.</td>
</tr>
<tr>
<td>or upon a paper attached thereto, or partly upon each. [Section 99]</td>
<td>Such dishonour to be noted and certified by a notary public. Such</td>
</tr>
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<td></td>
<td>certificate is called a protest. [Section 100]</td>
</tr>
</tbody>
</table>

Section-99 of the Negotiable Instruments Act of 1991 makes clear the meaning of ‘Noting’

‘Noting’ is done upon the instrument itself or upon a paper attached thereto, or partly upon the instrument and partly upon a paper attached thereto by the Notary Public

‘Protest’ is a certificate issued separately which makes clear the fact of the dishonour of the instrument by the Notary Public.

Noting simply means the recording of the fact of dishonour of the instrument by a notary public within a reasonable time after the dishonour of the instrument. Noting contains only the fact and date of dishonour, the reason or reasons, if any, of the dishonour, the notary charges incurred, and if the instrument has not been expressly dishonoured, the reason as to why the holder wants to treat the same as dishonoured. These details are given in Section 99 of the Act.

Protest contains more details regarding the dishonour other Instrument which are given in Section 100 of the Negotiable Acts of 1881. Such details are mentioned in the certificate by the notary public himself.

Noting is required to be done first. Only when the noting has been done, is the protest, i.e., the certificate issued thereafter by the notary public.

Protest is issued only after noting.

Noting is an apparent proof which makes clear that the instrument is dishonoured.

Protest is the documentary evidence or proof which is accepted by the court.

The important advantages of noting are different than the protest. They are as follows:

(a) Noting may provisionally serve the purpose of a protest which may be drawn later. Thus noting is equivalent to protest under 104A Act

(b) According to the provisions of Section 108, noting even without protest is sufficient to allow a bill of exchange to be accepted for an honour.

The advantages of protest are different than that of protesting. They are as follows:

(a) Protest affords the authentic and satisfactory evidence of dishonour of the instrument.

(b) In a suit upon an instrument which has been dishonoured, the Court shall, on proof of the protest, presume the fact of dishonour, unless and until such fact is disproved.

| Table 4.6 Difference between notice and protest |
4.8.4 Provision of the Act relating to “Reasonable Time”

It has already been made clear that noting and protest is recording of the fact of dishonour of the instrument by a notary public within a reasonable time after dishonour [Section 99 and Section 100]. But what is reasonable time? The answer of this question lies in the provisions of Section 105, 106, 107 of the Negotiable Instruments Act of 1881. They are:

- When a bill or promissory note is dishonoured the notice of dishonour is required to be given. Such notice may be oral or written. Written notice is sent by a post or even by a courier. If the notice is directed properly and sent by the post, it is considered a good notice even if it is miscarried. The notice may be in any form, but it must clearly state the fact of dishonour of the instrument. Such notice must be given within reasonable time at the place of business or at the residence of the party concerned. So far as reasonable time is concerned, it is stated in Section 105 that, “In determining what is a reasonable time for presentment for acceptance or payment, for giving notice of dishonour and for noting, regard shall be had to the nature of the instrument and the usual course of dealing with respect to similar instruments; and, in calculating such time, public holidays shall be excluded.” Such notice must inform the party to whom it is given (a) the fact that a specified instrument has been dishonoured and the party to whom the notice is given be held responsible for that and (b) whether the instrument is dishonoured by non-payment or non-acceptance.

**Reasonable time of giving notice of dishonour**

If the holder and the party to whom notice of dishonour is given to carry on business or live (as the case may be) in different places such notice is given within a reasonable time if it is dispatched by the next post or on the day next after the day of dishonour.

If the said parties carry on business or live in the same place, such notice is given within a reasonable time if it is dispatched in time to reach its destination on the day next after the day of dishonour.[Section 106]

**Reasonable time for transmitting such notice**

A party receiving notice of dishonour, who seeks to enforce his right against a prior party, transmits the notice within a reasonable time if he transmits it within the same time after its receipt as he would have had to give notice if he had been the holder.[Section 107]
Summary

- Negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer, whether the word “order” or “bearer” appear on the instrument or not. (Section 13)

- Section 4 of the Act defines, “A promissory note is an instrument in writing (note being a bank-note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money to or to the order of a certain person, or to the bearer of the instruments.”

- Section 5 of the Act defines, “A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument”.

- A bill drawn and accepted not for a genuine trade transaction but only to provide financial help to some party is termed as an “accommodation bill”.

- A cheque is a bill of exchange drawn on a specified banker, and not expressed to be payable otherwise than on demand. (Section 6)

- A bill, endorsed or delivered to a person subject to the understanding that it will be paid only if certain conditions are fulfilled, is called an “Escrow”.

- The ” holder” of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. (Section 8)

- When a promissory note, bill of exchange or cheque is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated (section 14)

- ‘Endorsement’ under the Negotiable Instruments Act means writing of one’s name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein.

- Notice of dishonour means the actual notification of the dishonour of the instrument by non-acceptance or by non-payment.

- Noting- When a promissory note or bill of exchange has been dishonoured non-acceptance or non-payment, the holder may cause such dishonour to be noted by a notary public upon the instrument, or upon a paper attached thereto, or partly upon each. (Section 99)

- When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may, within a reasonable time cause such dishonour to be noted and certified by a notary public. Such dishonour to be noted and certified by a notary public. Such certificate is called a protest. (Section 100)

References


Recommended Reading

### Self Assessment

1. Under the Negotiable Instruments Act, ______ means writing of one’s name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein.
   a. negotiation  
   b. cheque  
   c. noting  
   d. endorsement

2. A bill drawn and accepted not for a genuine trade transaction but only to provide financial help to some party is termed as a/an “________ bill”.
   a. Time  
   b. Demand  
   c. Inland  
   d. Accommodation

3. ______ is a written document which creates a right in favour of some person and which is freely transferable.
   a. Negotiable Instrument  
   b. Promissory Note  
   c. Bill Of Exchange  
   d. Cheque

4. A _____ is a bill of exchange drawn on a specified banker, and not expressed to be payable otherwise than on demand.
   a. promissory note  
   b. cheque  
   c. negotiable instrument  
   d. demand bill

5. A bill, endorsed or delivered to a person subject to the understanding that it will be paid only if certain conditions are fulfilled, is called an ________.
   a. bill of exchange  
   b. endorsement  
   c. escrow  
   d. trade bill

6. Which statement is false
   a. A bill which is not an inland bill is a foreign bill.  
   b. An endorsement may be blank or general  
   c. A bank-note or a currency note is an example of a promissory note.  
   d. Noting can be done only after issuing a protest.
7. ______ is any person entitled in his own name to the possession of the negotiable instrument and to recover or receive the amount due thereon from the parties thereto.
   a. Holder
   b. Holder in due course
   c. Drawee
   d. Endorser

8. A person who claims to be a __________ must show that he acquired the instrument for consideration
   a. drawer
   b. indorsee
   c. holder in due course
   d. holder

9. A __________ can be accepted as a documentary evidence or proof, by the court.
   a. noting
   b. protest
   c. negotiable instrument
   d. notice of dishonour

10. Notice of dishonour is not necessary in the case of a ________ which is not negotiable.
    a. cheque
    b. bill of exchange
    c. promissory note
    d. endorsement
Chapter V
The Companies Act, 1956

**Aim**

The aim of this chapter is to:

- introduce the concept of ‘company’ as a form of business organisation
- explain the Companies Act, 1956
- enlist various types of companies

**Objectives**

The objectives of this chapter are to:

- explain important stages involved in the process of formation of a Company
- elucidate the types of share capital
- classify companies on basic of jurisdiction, liability
- describe the characteristics of company

**Learning outcome**

At the end of this chapter, you will be able to:

- understand the procedure of registration of a Company
- distinguish between private and public companies
- differentiate between articles and memorandum
5.1 Introduction

The Companies Act, 1956 came into force on April 1, 1956. Despite its thoroughness, it has been revised from time to time in order to meet the growing needs of protecting the investors and ensuring efficient and honest management of the affairs of the companies. The latest in the series is the Companies (Amendment) Act 1988. This Act provides detailed rules regarding the formation and administration of companies in India. This chapter gives detailed information related to the definition of a company, the main feature a company form of business organisation, its distinction from partnership and the various types of companies that can be formed in India.

A company is a voluntary association of individuals formed to carry on business to earn profits or for non-profit purposes. These persons contribute towards the capital by buying its shares in which it is divided. A company is an association of individuals incorporated as a company possessing a common capital, i.e., share capital contributed by the members comprising it for the purpose of employing it in some business to earn profit.

Definition and Meaning of a Company

According to Section 3 (1) (i) of the Companies Act 1956, a Company means a company formed and registered under this Act or an existing company as defined in clause (ii) of Section 3. Clause (ii) states that “an existing company means a company formed and registered under any previous Companies laws.”

The Act provides elaborate provisions for the formation of a company including registration or incorporation, which is the primary part of formation (Section 1.12). Once the registration or incorporation is complete, the Registrar of Companies issues a certificate of incorporation and once the certificate is issued, the company becomes a body corporate (Section 34). Therefore, a company means a registered body and a body corporation. According to the Act, there are many other types of companies also (Section 1.7).

5.1.1 Characteristic Features of a Company

The various above noted definitions reveal the following essential characteristics of a Company.

Separate Legal Entity

Unlike partnership, Company is distinct from the persons who constitute it. (R.D. Singh v. Secretary, Bihar State Small Industries Corp\ Kathiawar Industries Ltd. V. E.G. of Evacuee Property). A Company can hold property, can sue and can be sued in its own name. In other words, it has an independent existence. Any of its members can enter into contracts with it in the same manner as any other individual can and he cannot be held liable for the acts of the company even if he holds virtually the entire share capital. The company’s money and property belong to the company and not to the Shareholders. Section 34(2) says that on registration, the association of persons becomes a body corporate by the name contained in the memorandum.

The importance of the separate entity of a company was very well brought out in the famous case of Salomon v Salomon and Co. Ltd.

Lord Macnanghtan in this famous case observed that: “The company is at law a different person altogether from the subscribers; and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are they subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or firm, except to the extent and in the manner provided by the Act.”

The facts of the famous Salomon’s case were as follows: One Salomon was boot and shoe manufacturer. His business was in sound condition and there was a substantial surplus of assets over liabilities. He incorporated a company named Salomon and Co. Ltd. for the purpose of taking over and carrying on his business. The seven subscribers to the memorandum were Salomon, his wife and daughter and four sons and they remained the only members of the company. Salomon, with his own sons, constituted board of directors of the company. The business was transferred to the company for £40,000. In payment Salomon took
£20,000 shares of £2 each and debentures worth £10,000. These debentures certified that the company owed Salomon £10,000 and created a charge on the company’s assets. One share was given to each remaining member of his family. The company went into liquidation within a year.

On winding up, the state of affairs was broadly something like this: Assets - £6,000, Liabilities - Salomon and debenture-holder: - £1 0,000 and unsecured creditors - £7,000. Thus after paying off the debenture holder, nothing would be left for the unsecured creditors.

The unsecured creditors, therefore, contended that, though incorporated under the Act, the company never had an independent existence, it was in fact Salomon under another name, he was the managing director, the other directors being his sons and under his control. His vast preponderance of shares made him absolute master. The business was solely his, conducted, solely for and by him and the company was a mere sham and fraud, in effect entirely contrary to the intent and meaning of the Companies Act. But it was held that Salomon and Co. Ltd. was a real company fulfilling all the legal requirements. It must be treated as a company as entirely consisting of certain corporators, but a distinct and independent corporation.

In Lee v. Lee Farming Limited a company was formed for the purpose of manufacturing aerial top-dressing. Lee, a qualified pilot, held all but one of the shares in the company, and by the articles was appointed governing director of the company and chief pilot, Lee was killed while piloting the company’s aircraft, and his widow claimed compensation for his death under the Workmen Compensation Act. The company opposed the claim on the ground that Lee was not a ‘worker’ as the same person could not be employer and the employee.

Held: There was a valid contract of service between Lee and the company, and Lee was, therefore, a worker. Mrs. Lee’s contention was upheld.

In Bacha F. Guzdar v. The Commissioner of Income Tax. Proma!” The plaintiff (Mrs. Guzdar) received certain amounts as dividend in respect of shares held by her in a tea company, under the Indian Income-Tax Act, agricultural income is exempted from payment of income-tax. As income of a tea company is partly agricultural, only 40% of the company’s income is treated as income from manufacture and sale and, therefore, liable to tax. The plaintiff claimed that the dividend income in her hands should be treated as agricultural income up to 60%, as in the case of a tea company, on the ground that dividends received by shareholders represented the income of the company. Held by the Supreme Court, that though in income in the hands of the company was partly agricultural yet the same income when received by Mrs. Guzdar as dividend could not be regarded as agricultural income.

**Limited liability**

The Company, being a separate person is the owner of its assets and bound by its liabilities. Members, even as a whole, are neither the owner’s of the company’s undertaking, nor liable for its debts. In other words, the liability of the members is limited. No member is bound to contribute anything more than the nominal values of the share held by him.

A Company may be a company limited by shares or a company limited by guarantee. In a company limited by shares, the liability of members is limited to the unpaid value of the shares.

For example, if the face value of a share in a company is Rs. 10 and a member has already paid Rs.7 per share, he can be called upon to pay not more than Rs.3 per share during the lifetime of the company. In a company limited by guarantee, the liability of members, is limited to such amounts as the members may undertake to contribute to the assets of the company, in the event of its being wound up.

**Separate property**

A Company is a legal person distinct from its members. It is, therefore, capable of owing enjoying and disposing of property in its own name. Although its capital and assets are contributed by its shareholders, they are not the private and joint owner’s of its property. The company is the real person in which all its property is vested and by which it is controlled, managed and disposed of.
An artificial person
A Company is purely a creation of law. It is invisible, intangible, immoral (Law alone can dissolve it) and exists only in the eyes of Law. It has no soul, no body, no conscience and still it is in a position to exist to enter into a contract, to appoint people as its employees and in short, it can do everything just like natural persons except, of course, it cannot take oath, cannot appear on its own person in a court (i.e., it must be represented by counsel), cannot be sent to jail, cannot practise a learned profession like Law or Medicine, nor can it marry or divorce. But a company cannot be treated as a ‘fictitious’ entity because it really exists.

Incorporated association
A Company to be distinct from other associations like a partnership or Joint Hindu Family, must be incorporated or registered under the Companies Act Unlike a natural person, a company seeks its existence from the law. The registration or incorporation of a body corporate as a company marks the birth of a company. Thus, registration is compulsory. It will probably be not out of place to mention that an association of more than 10 persons in the case of the banking industry and 20 persons in other trading activities, if not registered as a company, becomes an illegal association.

Perpetual succession and common seal
A Company being an artificial person cannot be incapacitated by illness and it does not have an allotted span of life. The death, insolvency or retirement of its members leaves the company unaffected.

In the case of a company, it may be said that “members may come and members may go but the company goes on forever: During the war, all the members of one private company while, in a general meeting, were killed by a bomb. But the company survived, not even a hydrogen bomb could have destroyed it.

A Company’s life is determined by the terms of its memorandum of association. It may be perpetual or it may continue for a specified time to carry on a task or object as laid down in the memorandum of association. Again since the company has no physical existence, it must act through its agents (called directors) and all such contracts entered into by the agent must be under the common seal of the company.

The common seal is the official signature of a company. The name of the company is engraved on it, as a substitute for its signature. Any document not bearing the common seal of the company will not be binding on the company.

A company registered under the Act should have only one common seal for use within India.

The Department of Company Affairs clarifies that a metallic (and not a rubber stamp) seal should be used in the day-to-day working of the company.

Not a citizen
Although a company is a legal person having nationality and domicile, it is not a citizen (State Trading Corporation of India Ltd. v. Commercial Tax officer). A company cannot, therefore, claim the protection of those fundamental rights which are expressly guaranteed to citizens only, example, the right of franchise. But still they are sufficiently protected under the constitution. For instance, their freedom of trade or commerce cannot be curtailed, and no unjust discrimination in any matter whatsoever can be shown against them. The company has the right to challenge a law if the law happens to violate fundamental rights of citizens (Prithivi Cotton Mills v. Broack Borough Municipality). According to the constitution of India, citizen means men and women and so a body corporate cannot be a citizen (Jupiter General Insurance Co. v. A. Rajagopalan). All citizens are persons but all persons are not citizens.
Transferability of shares
Since business is separate from its members in a company form of organisation, it facilitates the transfer of members interests. When joint stock companies were established, the great object was that the shares should be capable of being easily transferred. Accordingly, the Companies Act in Section 82 declares; The shares or other interests of any members in a company shall be movable property, transferable in the manner provided by the articles of the company. Thus incorporation enables a member to sell his shares in the open market and to get back his investment without having to withdrawn the money from the company. This right may be restricted by articles of a private company. This provides liquidity to the investor and stability to the company.

5.2 Important Types of Companies
In most of the cases, companies are primarily classified on the basis of
• Liability
• Mode of Incorporation
• Of Ownership
• The Jurisdiction of Functioning

5.2.1 Classification of Companies on The Basis of Liability
On the basis of liability, an incorporated company may either be (i) a company limited by shares, or (ii) a company limited by guarantee, or (iii) an unlimited company.

• Company limited by shares: A company in which the liability of its members is determined on the basis of the amount, if any, remaining unpaid on the shares held by them, is termed as a company limited by shares. Such companies are popularly known as limited liability companies. The liability of the members is limited to the extent of nominal value of shares held by them. If a member has paid the full amount of shares, then his liability shall be nil.

For example.-Suppose you buy 100 shares of a company of the face value of Rs. 101 each. In this company your liability is fixed to the tune of Rs. 1000 only. If you pay (when called by the company) Rs. 600 to the company, you are now liable to pay the company only Rs. 400, this being the amount unpaid on your shares. When you have paid the entire amount of Rs. 1,000 (which means when your share have been fully paid up) your liability shall be nil. The liability can be enforced against the members of the company during the existence of the company’ or during the winding up of the company.

• Company limited by guarantee: Section 12(12) (b) of the Act provides that a company having the liability of its members limited by its memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up is termed as a ‘company limited by guarantee’. Such companies are generally formed for the promotion of art, science, culture, sports, etc. It is interesting to note that in a company limited by guarantee, a member is required to pay the amount guaranteed by him only if the company is wound up while he is a member or within one year after he ceases to be a member. Thus, the members cannot be asked to pay the guaranteed amount during the life time of the company. The memorandum of association of a company limited by guarantee, should state that each member of the company undertakes to contribute to the assets of the company in the event of its being wound up. You should, however, remember that a member cannot be asked to pay an amount in excess of the amount for which he has given the guarantee.

Such a company may or may not have share capital. If a company limited by a guarantee is formed without any share capital, then the members would be liable to pay only the guaranteed amount and that too when the company goes into, liquidation. But if the company limited by guarantee is formed with share capital, then the members are also liable to pay the unpaid amount on their shares. But the guaranteed amount can be called up only at the time of winding up of the company.
• **Unlimited company**: A company where the liability of members is unlimited i.e., there is no limit on the liability of members is termed as an unlimited company. The members of such companies may be required to pay company’s losses from their personal property. Because such companies have separate legal entity, its creditors cannot file a suit against the members directly. The creditors will have to apply to the court for the winding up of the company and then the liquidator will direct the members to contribute to the assets of the company to pay off its liabilities.

As in the case of a company limited by guarantee, here also an unlimited company may or may not have a share capital. If the company has share capital, the articles of association of the company must specify the amount of share capital with which the company is to be registered. Such a company must have its memorandum and articles of association. The articles of association must specify the number of members with which the company is to be registered.

### 5.2.2 Classification of Companies on The Basis of Mode of Incorporation

Companies may be classified into various categories on the following basis.

**A classification on the basis of incorporation.**

Companies can be generally classified according to incorporation into the following broad groups:

- Royal or Chartered Companies
- Statutory Companies
- Registered Companies under the Act

**Royal or chartered companies**

This is the oldest form of companies in its true sense used to be formed in Great Britain by the Royal Charter, i.e., the special order of the King or Queen for the time being occupying the throne. In India, we do not find such type of companies. The East India Company is the most significant example of a chartered company formed in 1600. It may be noted that such type of East India company was also formed in other European countries following the example of Great Britain. A chartered company is governed by its charter which defines the nature of the company and at the same time incorporates it. These companies find no place in India after the country attained independence in 1947.

**Statutory companies**

Such companies have now-a-days become very popular all over the world including India. These are nothing but corporations formed by specific Acts of Parliament or the state legislative but these are practically national corporations formed to render specific services to the nation with more or less monopoly in a particular industry or commerce. These are public enterprises and very often public utilities. The British Broadcasting Corporation formed in 1926 is the first example. In India, numerous statutory corporations have been formed and are being formed in the country. For example, the Reserve Bank of India, the State Bank of India, the Life Insurance Corporation, the Industrial Finance Corporation, the Unit Trust of India, the Food Corporation of India, the Industrial Development Bank of India, the State Trading Corporation, etc. These companies are mostly public undertakings and are formed with the main object of public utilities and not for profit. Any change in the working of these companies is regulated by parliament’s or legislature’s amendments only. The Companies Act, 1956 applies to these companies if its provisions are not inconsistent with the provisions of the special Acts under which they are formed.

**Registered companies under the Act**

A registered company is one which is formed and registered under the Indian Companies Act, 1956 or under any earlier Companies Act in force in India. Companies registered under the Companies Act are either:

- Government Companies
- Ordinary Companies
5.2.3 Classification of Companies Based on The Basis of Ownership

Classification of companies based on the basis of ownership are explained below.

Private Company:
Under Section 3(1) (iii) of the Companies Act of 1956, a private limited company has been defined as a company which, by its Articles of Association (a) restricts the right to transfer its share if any, (b) limits the number of its members to fifty, and (c) prohibits any invitations to the public to subscribe for any shares in, or debentures of, the company.

Let us now discuss the implications of each of these restrictions.

• **Restriction on the right of members to transfer their shares.** The articles of association of a private company must specifically have a provision restricting the right of the members to transfer their shares, if any. It means that the shares of a private company are not as freely transferable as those of the public companies.

But it does not mean that the shares of a private company cannot be transferred at all. The articles generally provide that whenever a member of a private company desires to transfer his shares, he must offer them to the existing members at a price to be determined by the directors. This restriction is placed so as to preserve the family nature of the company’s members. That is why a private company is sometimes called a ‘closed corporation. The Act, however, does not specify the manner in which this restriction is to be imposed. You should note that a private company having no share capital need not contain this restriction in its articles.

• **Restriction on maximum number of members:** A private limited company is also required to limit the maximum number of its members to fifty. It means that the number of members in a private company can be between two and fifty, two being the statutory minimum required for the formation of a private company. While counting the members the following are not to be included:
  - persons who are in the employment of the company and by virtue of their employment happen to be members of the company, and
  - persons, who, having been in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased. It is also provided that where two or more persons hold one or more shares of the company jointly; they shall be treated as a single member for the purpose of counting the number

• **Prohibition on invitation to public:** This restriction implies that a private limited company must not issue a prospectus or any other public invitation, directly or indirectly to the general public so as to invite them to invest in its shares or debentures. The question arises as to how one would ascertain whether an invitation made by the company is in the nature of public invitation or not. The public may include any section of the public whether selected as members or the debenture holders of the company or as customers of the person issuing the prospectus, or in any other manner. The invitation cannot be treated as one made to the public when it can, under all circumstances, be properly regarded as a domestic or private concern of the persons making the invitation and those receiving it.

In simple words, it means that a private company cannot issue any invitation to the public. It has to make its own private arrangement to raise its capital or loan.

You should note that since the above mentioned three restrictions must be contained in the articles of a private limited company, it is necessary for a private company to frame its own articles. In case a private company is a limited company, then it must add the words ‘Private Limited’ at the end of its name. A private company may be (a) a company limited by shares or (b) a company limited by guarantee, or (c) an unlimited company. If a private company does not comply with any of the restrictions contained in the articles, it ceases to enjoy some of the privileges granted to a private company.
**Public Company:**
According to Section 3(1) (iv) of the Companies Act, a public limited company means a company which is not a private company. In Section 2.2 of this unit you learnt about the restrictions imposed on a private company. Thus, it can be said that a public company is one, the articles of which do not contain these restrictions. In other words, a public company is one which does not impose any restrictions on the right of the members to transfer their shares, does not restrict the maximum number of members, and which can invite general public to subscribe for its shares. Thus, any member of the public can acquire shares or debentures of a public company. The shares of a public company can be traded on a stock exchange. It should be noted that the minimum number of members in a public company must be seven.

A public company, like a private company, can also be (a) a company limited by shares, or (b) a company limited by guarantee, or (c) an unlimited company.

**Distinction between Private and Public Limited Company**
The following are the main points of difference between a private company and a public company:

- Minimum number: For the formation of a public company you require at least seven members, while the minimum number of members required for forming a private company is only two.

- Maximum numbers: In the case of a public company there is no restriction on the maximum number of members, but in the case of a private company the maximum number must not exceed fifty.

- Name: The name of a public company limited by shares os guarantee must end with the word ‘Limited’ whereas the name of a private company limited by shares or guarantee must end with the words ‘Private limited’.

- Transferability of shares: The shares of a public company are freely transferable, whereas in a private company the right to transfer the shares is restricted by the articles of association.

- Invitation to the public: A public company, after issuing a prospectus or a statement in lieu of prospectus, invites the general public to subscribe for its shares or debentures. But a private company cannot invite public to subscribe for its shares or debentures, as its articles prohibit any such invitation to the public.

- Commencement of business: A private company can commence its business soon after obtaining the certificate of incorporation, but a public company can commence business only after obtaining the certificate of incorporation as well as the certificate to commence business.

- Documents: The memorandum of association and articles of association of a public company should be signed by seven members, while in case of a private company; they are required to be signed by two members. If a public company chooses not to prepare its own articles of association and instead chooses to adopt ‘Table A’ of the Companies Act as its articles of association, it can do so, but, a private company has to compulsorily frame its own articles of association because it is by this document alone that the company places some statutory restrictions,

- Allotment of Shares: No public company can allot shares until the amount of minimum subscription has been received by the company. No such restriction is applicable in case of a private company. A private company can allot shares immediately after incorporation.

- Share Warrant: A public company can issue bearer share warrants but a private company cannot issue share warrants.

- Statutory meeting: A public company must hold a statutory meeting and file a statutory report with the Registrar of companies. A private company is neither required to hold the statutory meeting nor file a statutory report with the Registrar.

- Directors: A public company must have at least three directors whereas a private company must have at least two directors. The director of a public company must file with the Registrar a written consent to act as a director. He is also required to sign the memorandum and enter into a contract for their qualification shares, while the directors of a private company need not do any such thing. Two third of the total number of directors of a public company must retire by rotation, while the directors of a private company are not liable to retire by rotation, they may be appointed as permanent life directors. In case of a public company, no loan can be given to its directors without the approval of the Central Government, but directors of a private company can borrow from their company.
Legal Aspects of Business

without the approval of the Central Government. Any director of a public company, if he has any interest in the subject matter, which is being discussed in a meeting, cannot participate in the Board’s proceedings nor can be vote on that issue. But in case of a private company, the interested director can participate in the meeting. He is also entitled to cast his vote.

• Special privileges: A private company enjoys some special privileges, but a public company enjoys no such privileges.

5.2.4 Classification of Companies Based on The Jurisdiction of Functioning

A National Company:
When the operations of a company are confined only within the boundaries of the country in which the company is registered, such a Company is called as a national Company.

Multinational Company:
When the operations of a company are extended beyond the boundaries of the country wherein it is registered, such a company is called a multinational or transnational company.

Foreign Company:
In simple words, it can be said that a foreign company is one which is incorporated outside India but has a place of business in India. Part XI of the Companies Act of 1956 deals with the Companies incorporated outside India. Section 591(1) makes clear the meaning of a foreign company and accordingly, “all foreign companies, that is to say, companies falling under the following two classes, namely:-

Companies incorporated outside India which, after the commencement of this Act, establish a place of business within India; and (b) Companies incorporated outside India which have, before the commencement of this Act, established a place of business within India and continue to have an established place of business within India at the commencement of this Act.

Section 591(2) lays down, “Notwithstanding anything contained in sub-section (1), where not less than fifty per cent of the paid up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, or by one or more citizens of India and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this Act as may be prescribed with regard to the business carried on by it in India, as if it were a company incorporated in India”.

5.2.5 Classification of Companies on the basis of Control and/or Share Holding

On the basis of control, the companies may be classified into:
• Holding companies [Section 4 (4)], and
• Subsidiary companies [Section 4 (1)].

When a company has control over another company, it is known as the holding company and the company over which control is exercised is called the subsidiary company. The Act defines these terms as under:

Holding Company
“A company shall be deemed to be the holding company of another, if that other is its subsidiary [Section 4 (4)].”
**Subsidiary Company**
A company is deemed to be under the control of another (i.e., a subsidiary company), if and only if
- that other controls the composition of board of directors;
- that other company holds more than half of nominal value of its equity share capital, or
- it is a subsidiary of any other company which is the other company’s subsidiary.
- that other company controls more than half of the total voting power of the other company. [Section 4 (1)]

**Illustration**
Company Y is a subsidiary of Company X and Company Z is a subsidiary of Company Y. Company Z is therefore, a subsidiary of Company X. Similarly if Company P is a subsidiary of Company Z, Company P will be a subsidiary of Company Y and consequently also of Company X [Free Wheel (India) Ud v. Dr. Veda Mitra2B).

**Shares hold or powers exercisable to be excluded**
In coming to conclusion, whether one company is subsidiary of another, shares hold or powers exercisable, in the following cases shall be excluded:
- Where the shares are held or power is exercised by the company over the other in a fiduciary capacity;
- Where shares are held and power is so exercised because of the provisions of any debentures or of a trust deed;
- Where shares are held or powers are so exercised by way of security by a lending company.

Every holding company has to attach to its annual accounts, copies of the balance sheet, profit and loss account, director’s report and the auditor’s report, etc. in respect if each subsidiary company as per requirements of Sections 212 to 214, so that a true and fair view of the state of affairs of the group as whole may be presented to a shareholder, a creator and a potential investor in that company. Under Section 77, a subsidiary company is restricted from buying shares of its holding company.

**5.2.6 Other Types of Companies**
Other types of companies are explained below.

**One-Man Company**
A company in which a single individual holds the whole, or virtually the whole, of the ‘share capital is termed as ‘one-man company’. Though there may be other members also, but these members are usually his relatives, friends or nominees. This dominating person is usually the managing director of the company and has full control over the company. This is a means to enjoy the benefits of the corporate status and limited liability of the company. Although only ones person runs the entire show in such a company, yet such type of companies are legal. The formation of one-man companies has certainly been to the disadvantage of creditors because they cannot proceed against the actual proprietor.

For Example- A private company is registered with a share capital of Rs. 5,00,000 divided into 5,000 shares of Rs. 100 each. Of these shares 4,999 are held by A and one share is held by A’s wife B, This is a one man company.

Such a company in fact is a true company in the eyes of law and is regarded as a separate entity distinct from its shareholders, unless otherwise proved. It is obvious from the observations made in the following case:
(T. R. Pratt (Bombay) Ltd. v. E.D. Sassoon and Co. Ltd.)

“Under the law an incorporated company is a distinct entity, and although all the shares may be practically controlled by one person, in law a company is distinct entity and it not permissible or relevant to inquire whether directors belonged to the same family or whether it is compendiously described as “one-man company”.
Associations not for profits or licenced companies

According to Section 13(1)(a), the name of a limited company must end with the word “limited” in the case of a public company, and with the words, ‘private Limited’ in the case of private company. Section 25 of the Act, however, permits the registration, under a licence granted by the Central Government, of associations not for profit with limited liability without using word ‘Limited’ or the words ‘Private Limited’ to their names.

The peculiarities of such companies are:

- On registration, it enjoys certain exemptions and privileges as compared to an ordinary limited company.
- Such companies are allowed to exclude the words ‘Limited’ or ‘Private Limited’ from their names. They are registered without paying any stamp duty in connection with their memorandum and articles of association.
- These companies also need not comply with the provisions of Sections 147, 160(I)(aa), 166(2), 177(1), 209(4)(a), 257, 264(1), 285, 287, 299,301 and 302(2), of the Companies Act either wholly or in part as per the Government of India, Notification No S.O. 1578 dated July 8, 1961.
- Such companies may be public or private companies and may not have a share capital.

Existing company

According to Section 3(I)(ii) “existing company” means a company formed and registered under any of the previous companies laws specified below:

- any Act or Acts relating to companies in force before the Indian Companies Act, 1866 (10 of 1866) and repealed by the Act;
- the Indian Companies Act, 1866 (10 of 1866);
- the Indian Companies Act, 1882 (6 of 1882);
- the Indian Companies Act, 1913 (7 of 1933);
- the Registration of Transferred Companies Ordinance 1942 (54 of 1942); and
- any law corresponding to any of the Acts or the Ordinance aforesaid and in force-
  - in the merged territories or in a Part B State (other than the State of Jammu and Kashmir), or any part thereof, before the extension thereto of the Indian Companies Act, 1913 (7 of 1913); or
  - in the State of Jammu and Kashmir, or any part thereof, before the commencement of the Jammu and Kashmir (Extension of Laws) Act, 1956 (62 of 1956), [in so far as banking, insurance and financial corporations are concerned, and before the commencement of the Central Laws (Extension to Jammu and Kashmir) Act, 1968 (25 of 1968) insofar as other corporations are concerned];] and
  - the Portugese Commercial Code [***], in so far as it relates to “sociedades anonimas”;

5.3 Prohibition of Associations and Partnerships Exceeding Certain Number

No company, association or partnership consisting of more than ten persons shall be formed for the purpose of carrying on the business of banking, unless it is registered as a company under this Act, or is formed in pursuance of some other Indian Law.[Section 11(1)] and (2) No company, association or partnership consisting of more than twenty persons shall be formed for the purpose of carrying on any other business that has for its object the acquisition of gain by the company, association or partnership or by the individual members thereof, unless it is registered as a company under this Act, or is formed in pursuance of some other Indian law.[Section 11(2)]. Thus, if the number of members in a partnership or an association exceeds the statutory limit as mentioned in Section 11 (1) and (2) and if such partnership or an association is not registered under the Companies Act, it becomes an illegal association and does not possess any legal existence. These provisions have been made in order to prevent the mischief from large trading undertakings carried on by large fluctuating bodies. Of course, to the associations registered according to the provisions of Section 25 provisions of Section 11 are not applicable. Provisions of Section 11 do not apply to a joint family as such carrying on a business; and where a business is carried on by two or more joint families, in computing the number of persons for the purposes of sub-sections (1) and (2), minor members of such families shall be excluded [Section 11(3)].
Consequences of an illegal association

“Every member of a company, association or partnership carrying on business in contravention of this section shall be personally liable for all liabilities incurred in such business[Section 11(4)] and every person who is a member of a company, association or partnership formed in contravention of this section shall be punishable with fine which may extend to ten thousand rupees [Section 11(5)].

Such illegal Associations are penalised for improper use of words “Limited” and “Private Limited, according to the provisions of Section 631. Section631 lays down that, “If any person or persons trade or carry on business under any name or title of which the word “Limited” or the words “Private Limited”, or any contraction or imitation thereof is or are the last word or words, that person or each of those persons shall, unless duly incorporated with limited liability, or unless duly incorporated as a private company with limited liability, as the case may be, be punishable with fine which may extend to five hundred rupees for every day upon which that name or title has been used.”

5.4 Incorporation of a Company

For a public company, the minimum number of members is seven, while it is two in the case of a private company. The promoter has to gather the required number for subscribing to the Memorandum of Association.

The following are the steps for the incorporation of a company:

- **Application for Availability of Name:** A company cannot be registered in the name of an existing company. It also cannot be registered in a name, which is undesirable in the opinion of the Central Government. Therefore, it is necessary for the promoters to find out the availability of the name of the company from the Registrar of Companies. The first step in the formation of a company is the approval of the name by the Registrar of Companies (ROC) in the State/Union Territory in which the company is to be registered. This approval is provided subject to certain conditions. For instance, there should not be an existing company by the same name. Further, the last words in the name are required to be “Private Ltd.” in the case of a private company and “Limited” in the case of a Public Company. Finalisation of name: The application for approval of name should mention at least four suitable names of the proposed company, in order of preference. The ROC, generally, informs the applicant within seven days from the date of submission of the application, whether or not any of the names applied for is available. Once a name is approved, it is valid for a period of six months, within which time Memorandum of Association and Articles of Association together with miscellaneous documents should be filed. If one is unable to do so, an application may be made for renewal of name, by paying additional fees. After obtaining the name approval, it normally takes approximately two to three weeks to incorporate a company, depending on where the company is registered.

- **Filing of Documents:** The following three documents are required to be filed with the Registrar of Companies of the State in which the registered office of the company is to be situated: (i) Memorandum of Association, (ii) Articles of Association, and (iii) Agreement with the company for the proposed appointment of the managing director, whole-time director or manager. The above documents (i) and (ii) are required to be signed by the seven persons in the case of the public company and two persons in the case of private company.

- **Payment of Stamp Duty and Filing Fee:** The company has to pay the necessary stamp duty and filing fee, according to the authorized share capital of the company.

- **Declaration of Compliance of Act and Rules:** A declaration that the requirements of the Act and the rules framed there under have been complied. This declaration is to be signed by an advocate of the Supreme Court or High Court or attorney or a pleader having the right to appear before High Court. Alternatively, this declaration can be signed by a Company Secretary or Chartered Accountant in whole time-practice, who is engaged in the formation of a company or a person named in the articles as a director. This declaration is also to be filed with the Registrar of Companies, where the registered office of the company would be located. - Section 33(2).

- **Additional Requirement, in Case requirements are to be complied with:** The additional requirement of a Public Company, in case requirements that are to be compiled with are as follows.
  - A list of persons who have consented to act as directors.
  - Written consent of the directors to act in that capacity.
  - An undertaking by the directors to take up and pay for the qualification shares.
Certificate of Incorporation or Registration: If the Registrar is satisfied that the requirements under the Act for the purpose of registration of a company have been complied with, he shall register the company and issue a certification of incorporation, under his hand and seal.

5.4.1 Important Stages involved in the Process of Formation of a Company

Stages involved in the process of formation of a company are explained below.

- Promotion
- Registration
- Floatation and Raising of Capital
- Commencement of Business are the four very Important Stages involved in the Process of Formation of a Company.

Promotion

Promotion is in fact the first stage in the formation of a company. Promotion means “the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits therefrom”.

Palmer defined a ‘Promoter’ as “a person who originates a scheme for the formation of the company, has the Memorandum and Articles prepared, executed and registered and finds the first directors and settles the terms of the Preliminary contracts and prospectus (if any) and makes arrangements for advertising and circulating the prospectus and placing the capital, is a promoter.”

A promoter is a person who does the necessary preliminary work incidental to the formation of a company.

In Whatey Bridge Calico Printing Co. v. Green and Smith:1, Bowen L.J. stated that the term ‘promoter’ is a term not of law, but of business, usefully summing up in a single word a number of business operations familiar to the commercial world, by which a company is generally brought into existence. It is a short and convenient way of designating those who set in motion the machinery by which the Act enables them to create on incorporated company.

A person who acts in a professional capacity is not a promoter, like an advocate, solicitor or auditor.

- The term promoter has not been defined under the Companies Act, although the term is used expressly in Sections 62, 69, 76, 478 and 519. Even in English law, no general statutory definition of a promoter is available. In Section 38(1) of the English Companies Act, a promoter is indirectly described as a person engaged or interested in the formation of a company and Section 43(5) gives a definition for the purpose of that Section only, stating, the expression ‘Promoter’ means a promoter who was a party to the preparation of the prospectus, but does not include any person by reason of his acting in a professional capacity or persons engaged in procuring the formation -of the company. Thus, the persons assisting the promoters by acting in a professional capacity do not thereby become promoters themselves.

Perhaps, the true test of whether a person is a promoter is whether he has a desire that the company be formed, and is prepared to take some steps, which mayor may not involve other persons, to implement it.

Who can be a promoter?

Definition of promoter is not given in the Act. However, Section 62(6) (a) makes clear the meaning of a promoter for the purpose of Section 62 only and accordingly,” the expression “promoter” means a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company;
The role of the promoter:
The role of the promoter is vital in the formation of a company. His functions in this regard may be summarised under: He conceives the idea of the formation of the company after a thorough study of the business world that a particular business field is still unexplored or may be explored further.

- He draws up the scheme and determines the object of a future company.
- He prepares the Memorandum of Association, the Articles of Association and the Prospectus. He gets together the able directors to act as such for the company.
- He takes the necessary leave of the appropriate Government authorities for that purpose.
- He finds out suitable financiers to backup the company.
- He makes arrangement with vendors, legal advisers and other persons required for floating a company.
- He takes pain for filing the necessary documents with the Registrar of Companies for the certificate of incorporation.
- He bears all the preliminary expenses.

Registration:
For the purposes of the registration of a company, an application is required to be done to the Registrar of the companies as per the provisions of Section 12 which is given later on in 6.4.2 under the heading “Procedure of Registration of a Company.”

Floatation and Raising a Capital:
After completing the legal formalities required for registration, a company goes in the third stage for raising the sufficient capital to commence and carry on its business.

Commencement of Business:
In respect of private companies, or companies having no share capital can start their business immediately after they are incorporated. But public companies have share capital are required to obtain the necessary certificate from the Registrar of Companies to commence the business. [Section 149].

5.4.2 Procedure of Registration of a Company
The procedure of registration of a company is as follows:

Mode of forming Incorporated Company
- Any seven or more persons, or where the company to be formed will be a private company, any two or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability.
- Such a company may be either
  - a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them (in this Act termed “a company limited by shares”);
  - a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up (in this Act termed “a company limited by guarantee”); or
  - a company not having any limit on the liability of its members in this Act termed “an unlimited company”). [Section 12]. Thus, any seven persons for forming a public company or any two persons for forming a private company may come together and apply to the Registrar by giving necessary information in the prescribed form, accompanied by required documents. They can form either a company with limited or unlimited liability, limited by shares or guarantee.
Registration of Memorandum and Articles
Section 33(1) lays down There shall be presented for registration, to the Registrar of the State in which the registered office of the company is stated by the memorandum to be situate.

- the memorandum of the company;
- its articles, if any; and
- the agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or whole-time director or manager.

A declaration by an advocate of the Supreme Court or of a High Court, an attorney or a pleader entitled to appear before a High Court, or [a Secretary or a chartered accountant in whole-time practice in India] who is engaged in the formation of a company, or by a person named in the articles as a director manager or secretary of the company, that all the requirements of this Act and the rules there under have been complied with in respect of registration and matters precedent and incidental thereto, shall be filed with the Registrar; and the Registrar may accept such a declaration as sufficient evidence of such compliance. [Section 33(2)]

If the Registrar is satisfied that all the requirements aforesaid have been complied with by the company and that it is authorised to be registered under this Act, he shall retain and register the memorandum, the articles, if any, and the agreement referred to in clause (c) of sub-section (1), if any. [Section 33(3)].

Thus, from the above mentioned provisions, it becomes clear that the procedure of registering a company begins with an application in the prescribed form which has to be filed with the Registrar of Companies of the State in which the registered office of the company is to be situate.

Certificate of Incorporation
An application to be made to the Registrar of Companies of the State where the proposed company is going to be registered, suggesting intended name of the proposed company and wanting to know whether the suggested name is available. Generally three names, in order of priority are suggested. The suggestions shall be made carefully so that the provisions of Emblems and names (Prevention of Improper use) Act, 1950 are not violated. The application shall be made in a form vide Rule 44 of the Companies (Central Government’s) General Rules and Forms, supplied by the office of the Registrar. The application shall be accompanied with prescribed fee.

The Registrar will send a reply, ordinarily within 14 days, stating whether the name is available or not. If not, a fresh application has to be made with fresh suggestion.

Effects of Registration
Section 34 (I and II) states that,” On the registration of the memorandum of a company, the Registrar shall certify under his hand that the company is incorporated and, in the case of a limited company that the company is limited.

Moreover, from the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in this Act.

Meanwhile Section 35 states that,” A certificate of incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of this Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under this Act.”

Thus, on the basis of Section 34 and 35, it can be concluded that the certification of incorporation is conclusive evidence about registration and compliance of all the legal requirements. Date of certificate of incorporation is date of birth of a company.
Once a company is registered, the certificate of incorporation cannot be challenged, though there may be irregularities prior to registration.

A company obtains separate legal existence only after it is registered under the Companies Act. By virtue of this legal existence, the company comes into being as a separate person, distinct from the persons who form it. The company becomes a body corporate, with perpetual succession.

Once company is registered, the only method to end it is through the process of winding up. The certificate of incorporation cannot be cancelled by the Registrar of Companies, even if irregular.

5.5 Memorandum of Association And Article of Association

Memorandum of Association and article of association are explained below.

5.5.1 Definition of Memorandum of Association

Under Section 2(28) of the Companies Act, Memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. But this definition is not an exhaustive one. Lord Cairns in the famous case of Ashbury Railway Carriage Co. V. Riche defined memorandum as following: The memorandum of association of a company is its charter and defines the limitations of the powers of the company. The Memorandum of Association of a company is its charter. It contains the fundamental conditions upon which alone the company can be brought into existence. It tells us what the company can do as specified in its objects clause. The objects clause is an important clause in the Memorandum, as it tells us the scope of activities of the company. The company’s actions cannot go beyond this clause. Thus, it defines as well as confines the sphere of activities of the company. If the company does something beyond the objects as given in the Memorandum, that will be ultra vires (beyond powers) of the company and is declared by law to be void.

The Memorandum of Association is a public document open for inspection by any member of the public, therefore, every person who deals with the company is presumed to have the knowledge of its contents. The main purpose of the Memorandum of Association is to enable its shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities. Thus the intending shareholder can find out the field in, or the purpose for which his money is going to be used by the company and what risk he is taking in making the investment. Also anyone dealing with the company, say, a supplier of goods or a lender of money, will know whether the transaction he intends to make with the company is within the objects of the company or not. In case, he finds that the contract, which he intends to enter into with the company, does not fall within the purview of objects as stated in the Memorandum, he would, for his own interest, refrain from entering into the intended contract.

5.5.2 Definition of Article of Association

Section 2(2) of the Companies Act defines Articles as “the Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies’ law or of this Act”. This definition is not sufficient to explain its meaning.

The Articles of Association of a company are the rules and regulations relating to the management of its internal affairs. They are similar to the ‘partnership deed’ in a partnership. The Memorandum defines the area beyond which the company cannot act while the articles contain the rules and regulations for carrying out the business of the company. Thus ‘Articles’ is subordinate to, and controlled by the ‘Memorandum’.

The Articles embody the powers of directors, officers and of the shareholders as to voting etc., the mode and the form in which the business of the company is to be carried out and the mode and the form in which changes in the internal regulations can be made. The rights, duties and powers of the company vis-a-vis the members are included in the Articles of Associations. The Articles bind not only the existing members, but the future members of the company also. Even the successors, legal representatives or heirs of members are bound by whatever is contained in the Articles. In fact, the Articles bind the company and the members as if they had been signed by each one of them.
An article of Association is the basis of contract between the company and the members. Members have certain rights against the company. Also members have certain duties towards the company. These rights and duties of members are given in the Articles.

For example, a member is under an obligation to pay or call money on his shares as and when the directors of the company decide to make the calls in accordance with the procedure laid down in the Articles of Association. If the member fails to make the payment, his shares may be forfeited by the company in accordance with the procedure prescribed. On the other hand, a member has a number of rights. For example, he has a right to attend the meeting of the Company and vote.

Further, Articles of Association of a company constitute a contract not only between members and the company; but members inter se also.

**5.5.3 Distinction Between Memorandum And Articles**

The following are the main points of distinction between the Memorandum and Articles:

- Memorandum of Association is the charter of the company. It lays down the scope and powers of the company. In fact, Memorandum defines the area beyond which the actions of the company cannot go. Inside that area the shareholders may make such regulations for the governance of the company as they think fit.

- Memorandum of Association is a fundamental document. Articles of Association are subordinate, to and are controlled by the Memorandum of Association.

- The purpose of Memorandum is two fold:
  - to tell the intending purchaser of shares the scope of the activities of the company and the objects on which his money will be invested.
  - to tell those who deal with the company as to what the objects of the company are so as to enable them to enter into only those contracts with the company which are not ultra vires. The purpose of the Articles of Association is to provide rules and regulations for the internal management of the company. Thus, a company is not bound to an outsider, but it is bound to a member by whatever is contained in its Articles of Association.

- Articles of Association is the basis of a contract between the company and its members, Memorandum of Association generally defines the relation between the company and outsiders.

- A public company limited by shares need not frame its own Articles of Association. It may adopt Table A as its Articles. But every company, without exception, must prepare its own Memorandum of Association.

- The clauses of the Memorandum cannot be easily altered. The company has to follow the strict procedure for the alteration of its clauses. In some cases, an alteration requires the approval of the Company Law Board or the Court whereas; articles can be altered easily by passing a special resolution.

- Any act which is beyond the powers given in the Memorandum is ultra vires and void and it cannot be ratified even by the whole body of share holders. But any act which is ultra vires the Articles may be ratified by shareholders by passing a special resolution.

**5.6 Prospectus**

After the grant of the certificate of registration, the next problem of the company is to raise funds for its working. A private company is not allowed to invite the public for subscribing to any shares in or debentures of the company, [Section 3(iii)(c)]. On the other hand, a public company, which cannot arrange its capital privately, may resort to several devices. These may be:

- By issue of a prospectus,
- By an offer for sale, or
- By a “placing” Definition of Prospectus
When a public company or the promoters of a public company decides that the money should be raised from the public by way of invitation to offer to the shares and debentures of the company, a document is drawn up which is known as a ‘Prospectus’.

Section 2(36) defines a prospectus as “any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public for the subscription or purchase of any shares in, or debentures of a body Corporate”. In simple words, any document inviting deposits from the public or inviting offers from the public for purchasing shares or debentures of a company is a prospectus.

The main characteristic of a prospectus is that it invites the public for making investment. From the definition it is very clear that the prospectus is not an offer in itself from the company to the public. It is rather an invitation to offer to the public. The company is at liberty to accept the offers made by the public for the purchase of shares in and debentures of the company.

But if the document satisfies the condition of invitation to the public, it is an prospectus even though it is issued to a defined class of the public (Nash v. Lynde l18 ). Thus, an advertisement which stated that some shares are still available for sale according to the terms of the company which may be obtained on application” was held to be a prospectus as it invited the public to purchase shares (Pramtha Nath Sanyal v. Kali Kumar Dut(1 19 ).

5.6.1 Statement in Lieu of Prospectus

If a Public company makes a Private arrangement for raising its capital then it must file a statement in lieu of prospectus with the Registrar at least three days before any allotment of shares or debentures can be made. The statement is required to contain the particulars set out in Part I of Schedule III of this Act and the reports set out in Part II of the Schedule. The information and the reports required to be disclosed in the statement are almost the same as are required to be disclosed in a prospectus. The statement must be signed by every person who is named therein as a director or proposed director of the company or by his agent authorised in writing.

If allotment of shares or debentures is made without filing the statement in lieu of prospectus, the allottee may avoid it within two months after the statutory meeting, or where no such meeting is to be held, within two months of the allotment. Contravention also renders the company and every director liable to a fine upto Rs. 1000/–.

The Statement in Lie of Prospectus should contain the particulars as per the provisions of Section 70. The provisions of Section 70 are given below:-

• A company having a share capital, which does not issue a prospectus on or with reference to its formation, or which has issued such a prospectus but has not proceeded to allot any of the shares offered to the public for subscription, shall not allot any of its shares or debentures unless at least three days before the first allotment of either shares or debentures, there has been delivered to the Registrar for registration a statement in lieu of prospectus signed by every person who is named therein as a director or proposed director of the company or by his agent authorised in writing in the form and containing the particulars set out in Part I of Schedule III and, in the cases mentioned in Part II of that Schedule setting out the reports specified therein, and the said Parts I and II shall have effect subject to the provisions contained in Part III of that Schedule. [Section 70 (1)]

• Every statement in lieu of prospectus delivered under sub-section (1), shall, where the persons making any such report as aforesaid have made therein, or have without giving the reasons indicated therein, any such adjustments as are mentioned in clause 5 of Schedule III, have endorsed thereon or attached thereto a written statement signed by those persons, setting out the adjustments and giving the reasons thereof. [Section 70 (2)]

• This section shall not apply to a private company. [Section 70 (3)]

• If a company acts in contravention of sub-section (1) or (2), the company, and every director of the company who wilfully authorises or permits the contravention, shall be punishable with fine which may extend to [ten thousand rupees]. [Section 70 (4)]

• Where a statement in lieu of prospectus delivered to the Registrar under sub-section (1) includes any untrue statement, any person who authorised the delivery of the statement in lieu of prospectus for registration shall be punishable with imprisonment for a term which may extend to two years or with fine which may extend to
[fifty thousand rupees] or with both, unless he proves either that the statement was immaterial or that he had reasonable ground to believe, and did up to the time of the delivery for registration of the statement in lieu of prospectus believe, that the statement was true. [Section 70 (5)]

• For the purposes of this section
  • a statement included in a statement in lieu of prospectus shall be deemed to be untrue if it is misleading in the form and context in which it is included; and
  • where the omission from a statement in lieu of prospectus of any matter is calculated to mislead, the statement in lieu of prospectus shall be deemed, in respect of such omission, to be a statement in lieu of prospectus in which an untrue statement is included. [Section 70 (6)]

• For the purposes of sub-section (5) and clause (a) of sub-section (6), the expression “included” when used with reference to a statement in lieu of prospectus, means included in the statement in lieu of prospectus itself or contained in any report or memorandum appearing on the face thereof, or by reference incorporated therein, or issued therewith. [Section 70 (7)]

5.6.2 Distinction between a Prospectus and a Statement in Lieu of Prospectus

<table>
<thead>
<tr>
<th>Point of Distinction</th>
<th>Prospectus</th>
<th>Statement in Lieu of Prospectus</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Purpose</td>
<td>It is prepared for filing with the Registrar of companies and publicity</td>
<td>It is prepared only for filing purpose</td>
</tr>
<tr>
<td>2. Approach</td>
<td>It does publicity and has a selling approach</td>
<td>It is prepared for fulfilling the legal formality of filing with the Registrar of the companies and has an informative approach</td>
</tr>
<tr>
<td>3. Suitability</td>
<td>Publication of prospectus is necessary for the companies for raising the capital from public</td>
<td>It is suitable for companies which raise the capital from known sources where shares are not offered to the public for subscription.</td>
</tr>
<tr>
<td>4. Prospectus</td>
<td>Prospectus is necessary when the company wants to raise the capital from the general public.</td>
<td>It is not meant for general public. It is to be filed with the Registrar of the Companies.</td>
</tr>
</tbody>
</table>

Table 5.1 Distinction between a prospectus and a statement in lieu of prospectus

5.7 Share Capital

Capital in ordinary sense denotes the value of some accumulated goods. In the business world, capital means finance or that part of money which is invested for earnings. Such money comes out of savings. A body corporate needs such finance or capital to carry out its activities. This is contributed by the members who join the body corporate whether at the time of incorporation or afterwards.

The Act does not define capital from Section 12. We may deduce that capital of a company comes either in the form of share capital or guarantee capital. There are companies where both types of capital simultaneously exist.

The common form of capital of a company is the ‘Share Capital’. Share capital means the capital raised by a company, by the issue of shares. The Act has not defined the term ‘Share Capital’. Section 13 (4) (a) states that “unless the company is an unlimited company; the memorandum shall also state the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount.”

5.7.1 Classification of Share Capital

According to Section 82, the shares or debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company, and According to Section 83. “Each share in a company having a share capital shall be distinguished by its appropriate number.”
Share Capital refers to the capital raised by the company by issuing its shares to the people. Share capital of a company can be classified as given below. The classification is primarily based on time sequence.

They are:

**Nominal Authorised or Registered Capital**
The Registered Capital is the capital with which a company is registered. In fact, authorised capital is no capital in real sense. It is the limit upto which the company can raise capital. This is the maximum capital which the company will have during its lifetime. When the original amount of the authorised capital is exhausted by issue of shares, it can be increased by passing an ordinary resolution.

**Issued Capital**
Issued capital is the nominal value of the shares which are offered to the public for subscription. A company does not normally issue all its capital at once, so that issued capital in such a case is less than the nominal capital. The issued capital an never exceed the nominal capital; it can at the most be equal to the nominal capital.

**Subscribed Capital**
This is that part of issued capital which is taken up by subscribers for consideration of cash. The amount of subscribed capital is either equal to or less than the issued capital. The subscribed capital can never be more than the issued capital.

**Called up Capital**
The company may not call up full amount of the face value of the shares. Thus, the called-up capital represents the total amount called-up on the shares subscribed. The amount of called-up capital can be either equal to or less than the subscribed capital.

Thus uncalled capital represents the total amount not called up on shares subscribed, and the shareholders continue to be liable to pay the amounts as and when called. However, the company may reserve all or part of the uncalled capital, which can then be called in the event of the company being wound up. For this purpose, a special resolution is required to be passed, and then it known as Reserve Capital or Reserve Liability (Section 99).

**Paid-up Capital**
It is the total amount of capital paid up or credited as paid-up on shares issued, including premium on shares.

**5.7.2 Share and Types of Share Capital**
A company raises capital by issuing either preference shares or equity shares. When it raises capital by issuing shares, it is known as owned capital. But besides by issuing shares, a company debentures and bonds and raises the capital, that is known as borrowed capital. Provisions of Section 85 make clear two types or kinds of share capital i.e., Preference Share Capital and Equity share capital.

“Preference share capital” means, with reference to any company limited by shares, whether formed before or after the commencement of this Act, that part of the share capital of the company which fulfils both the following requirements, namely:

- that as respects dividends, it carries or will carry a preferential right to be paid a fixed amount or an amount calculated at a fixed rate, which may be either free of or subject to income-tax; and
- that as respects capital, it carries or will carry, on a winding up or repayment of capital, a preferential right to be repaid the amount of the capital paid up or deemed to have been paid up, whether or not there is a preferential right to the payment of either or both of the following amounts, namely:
  - any money remaining unpaid, in respect of the amounts specified in clause (a), up to the date of the winding up or repayment of capital; and
  - any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company. [Section 85(1)]
Capital shall be deemed to be preference capital, notwithstanding that it is entitled to either of both of the following rights, namely:

- that, as respects dividends, in addition to the preferential right to the amount specified in clause (a), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;
- that, as respects capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in clause (b); it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid. [Section 85(1)]

“Equity share capital” means, with reference to any such company, all share capital which is not preference share capital [Section 85(2)].

The expressions “preference share” and “equity share” shall be construed accordingly. [Section 85(3)]

The Companies (Amendment) Act, 2000 has substituted Section 86 with new provisions which are as follows:

The share capital of a company limited by shares shall be of two kinds only, namely:

- Equity share capital
- Preference share capital.

5.7.3 Provisions Relating to “Certificate of Shares”

A share shall be movable property, transferable in the manner provided by the articles of the company [Section 82] while a certificate of shares is a certificate, under the common seal of the company, specifying any shares held by any member, shall be prima facie evidence of the title of the member to such shares [Section 84]. According to Section 84 of the Act,

- A certificate, under the common seal of the company, specifying any shares held by any member, shall be prima facie evidence of the title of the member to such shares. [Section 84(1)].
- A certificate may be renewed or a duplicate of a certificate may be issued if such certificate is proved to have been lost or destroyed, or having been defected or mutilated or torn is surrendered to the company. [Section 84(2)].
- If a company with intent to defraud renews a certificate or issues a duplicate thereof, the company shall be punishable with fine which may extend to ten thousand rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to [one lakh rupees], or with both. [Section 84(3)].
- Notwithstanding anything contained in the articles of association of a company, the manner of issue or renewal of a certificate or issue of a duplicate thereof, the form of a certificate (original or renewed) or of a duplicate thereof, the particulars to be entered in the register of members or in the register of renewed or duplicate certificates, the form of such registers, the fee on payment of which, the terms and conditions if any (including terms and conditions as to evidence and indemnity and the payment of out-of-pocket expenses incurred by a company in investigating evidence) on which a certificate may be renewed or a duplicate thereof may be issued, shall be such as may be prescribed. [Section 84(4)].
5.7.4 Alteration of Share Capital

Section 94 provides that, if the articles authorise, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital so as:

- to increase its authorised share capital by such amount as it thinks expedient by issuing fresh shares;
- to consolidate and divide all or any of its share capital into shares of large amount than its existing shares,
- to convert all or any of its fully paid-up shares into stock, and reconvert the stock into fully paid-up shares of any denomination,
- to sub-divide its shares, or any of them, into shares of smaller amount than fixed by the memorandum, but the proportion paid and unpaid on each share must remain the same,
- to cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person.

A cancellation of shares is not deemed to be a reduction of share capital within the meaning of the companies Act, 1956. The company must give notice of the above alteration to the registrar within 30 days after doing so (Section 95 and 97)

5.7.5 Increase in Share Capital

A limited company having a share capital can further issue its share capital according to the provisions of Section 81. The Central Government may, if in its opinion it is necessary in the public interest so to do, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to that Government to be reasonable in the circumstances of the case, even if the terms of issue of such debentures or the terms of such loans do not include a term providing for an option for such conversion.

Notwithstanding anything contained in this Act, where the Central Government has, by an order made under sub-section (4) of section 81, directed that any debenture or loan or any part thereof shall be converted into shares in a company, the conditions contained in the memorandum of such company shall, where such order has the effect of increasing the nominal share capital of the company, stand altered and the nominal share capital of such company shall stand increased by an amount equal to the amount of the value of the shares into which such debentures or loans or part thereof has been converted.

Thus, the above mentioned provisions have been made in the Companies Act, of 1956 to increase the share capital of the company.

5.7.6 Reduction of Share Capital

The provisions relating to reduction of share capital have been made in Sections 100 to 105.

Section 100 lays down that, “Subject to confirmation by the Court, a company limited by shares or a company limited by guarantee and having a share capital, may, if so authorised by its articles, by especial resolution, reduce its share capital in any way; and in particular and without prejudice to the generality of the foregoing power, may—

- extinguish or reduce the liability on any of its shares in respect of share capital not paid up;
- either with or without extinguishing or reducing liability on any of its shares cancel any paid-up share capital which is lost, or unrepresented by available assets; or
- either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company, and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly.”
As a matter of fact, no action resulting in reduction of share capital of a company is allowed. But the reduction in the share capital can only be affected under statutory authority or by forfeiture and strictly according to the procedure, if any, laid down in the Articles of Association of the company. A reduction in the share capital contrary to the provisions is not legal. Section 100, which is reproduced above, implies that subject to confirmation by the Court, a company limited by shares or by guarantee and having a share capital may, if so authorised by its articles, by a special resolution, reduce its share capital. It can be done in one of the following ways:

- By extinguishing or reducing the liability as any of its shares, in respect of that share capital which is not paid up. Suppose X is a company limited by guarantee and has a share capital of Rs. 5,00,000, each share of Rs. 10. Of it, Rs. 7 per share is called up and paid-up. The company does not require the remaining uncalled capital of Rs. 3 per share. After complying with necessary legal formalities, the company can extinguish the remaining liability, i.e., Rs. 3 per share of the uncalled share capital.

- A company can either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of its requirements. X is a company limited by shares having an equity share capital of Rs. 5,00,000, a share of Rs. 10 each fully paid-up. The directors feel that the capital paid-up is excess and after completing the legal formalities, they must return Rs. 3 per share. Thus, each paid-up equity becomes of Rs. 7 only.
Summary

- The company is an association of persons for carrying on a commercial or industrial enterprise.
- The Companies Act, 1956 came into force on April 1, 1956.
- The Act provides elaborate provisions for the formation of a company including registration or incorporation, which is the primary part of formation.
- On the basis of liability, an incorporated company may either be (i) a company limited by shares, or (ii) a company limited by guarantee, or (iii) an unlimited company.
- On the basis of Mode of Incorporation, an incorporated company may either be (i) Royal or Chartered Companies, (ii) Statutory Companies or (iii) Registered Companies under the Act.
- Companies can be classified on the basis of Ownership, i.e., Private Company and Public Company.
- A company in which a single individual holds the whole, or virtually the whole, of the ‘share capital is termed as ‘one-man company’
- Promotion, Registration, Floatation and Raising of Capital and Commencement of Business are the four very Important Stages involved in the Process of Formation of a Company.
- Under Section 2(28) of the Companies Act, Memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act.
- The certification of incorporation is conclusive evidence about registration and compliance of all the legal requirements. Date of certificate of incorporation is date of birth of a company.
- Promotion means “the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits therefrom”
- Section 2(2) of the Companies Act defines Articles as the Articles of Association of a company as originally framed or as altered from time to time in pursuance of any previous companies law or of this Act.
- Section 2(36) defines a prospectus as “any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public for the subscription or purchase of any shares in, or debentures of a body Corporate.
- The common form of capital of a company is the ‘Share Capital’. It is the capital raised by a company, by the issue of shares.
- The common form of capital of a company is the ‘Share Capital’. It is the capital raised by a company, by the issue of shares.

References

Recommended Reading

Self Assessment

1. A company can be classified into a public or private company on the basis of___________.
   a. liability
   b. mode of incorporation
   c. ownership
   d. jurisdiction of functioning

2. The corporate veil can be lifted when the number of company’s members fails below__________ in the case of a private limited company
   a. seven
   b. three
   c. six
   d. two

3. Which statement is false?
   a. A company in which a single individual holds the whole, or virtually the whole, of the ‘share capital is termed as ‘one-man company’
   b. A company is an artificial person
   c. The corporate veil can be lifted when the number of company’s members fails below six in case of a public limited company
   d. A company comes into existence when the company is registered

4. An incorporated company can come into existence as a chartered company, as a statutory company and as ____________ Company.
   a. unlimited
   b. one-man
   c. national
   d. registered

5. The capital with which a company is registered is called a__________
   a. nominal authorised capital
   b. called up capital
   c. paid-up capital
   d. subscribed capital

6. The ____________ is conclusive evidence about registration and compliance of all the legal requirements
   a. certificate of incorporation
   b. prospectus
   c. share capital
   d. memorandum of association

7. __________, Registration, Floatation and Raising of Capital and Commencement of Business are the four very Important Stages involved in the Process of Formation of a Company.
   a. Incorporation
   b. Article of association
   c. Promotion
   d. Memorandum of association
8. _______ capital is the nominal value of the shares which are offered to the public for subscription.
   a. subscription
   b. authorised
   c. paid-up
   d. issued

9. The ____________ of a company is its charter and defines the limitations of the powers of the company.
   a. memorandum of association
   b. article of association
   c. prospectus
   d. registration

10. According to Section 82, a________ shall be movable property, transferable in the manner provided by the
    articles of the company.
    a. share
    b. share capital
    c. certificate of shares
    d. capital
Chapter VI
The Consumer Protection Act, 1986

Aim

The aim of this chapter is to:

- define the meaning and concept of a “consumer”
- introduce the provisions of laws aimed at protecting consumers;
- highlight the parties involved in consumer protection

Objectives

The objectives of this chapter are:

- elucidate the rights and responsibilities of the “Consumer”
- explain the various problems faced by consumers
- explicate the jurisdiction of consumer courts established for redressal of consumer disputes

Learning outcome

At the end of this chapter, you will be able to:

- understand the meaning of consumer protection
- comprehend the need for consumer protection
- discuss the role of non–government organisations in promoting consumer awareness
6.1 Introduction

We buy a variety of goods and services in our day-to-day life. However, sometimes we do not feel satisfied with the product we buy. This may be on account of poor quality of the product, overcharging by the shopkeeper, lower quantity of contents, misleading advertisement, and so on. Should we allow these practices to continue? Obviously not; then is there any remedy for such malpractices? The answer lies in the concept and practice of consumer protection, the rights and responsibilities of consumers, legal provisions and mechanism for settlement of consumer grievances.

Consumer is a person who consumes or uses any goods or services. Under the Consumer Protection Act 1986, the word Consumer has been defined separately for the purpose of goods and services.

- For the purpose of goods, a consumer means (i) one who buys any goods for consideration; and (ii) any user of such goods other than the person who actually buys it, provided such use is made with the approval of the buyer.

(The expression ‘consumer’ does not include a person who obtains such goods for resale or for any commercial purpose.)

- For the purpose of services, a consumer means (i) one who hires any service or services for consideration; and (ii) any beneficiary of such service(s) provided the service is availed with the approval of such person.

Consumer Protection

Consumer protection means safeguarding the interest and rights of consumers. In other words, it refers to the measures adopted for the protection of consumers from unscrupulous and unethical malpractices by the business and to provide them speedy redressal of their grievances. The most common business malpractices leading to consumer exploitation are given below.

- Sale of adulterated goods, i.e., adding something inferior to the product being sold.
- Sale of spurious goods, i.e., selling something of little value instead of the real product.
- Sale of sub-standard goods, i.e., sale of goods which do not confirm to prescribed quality standards.
- Sale of duplicate goods.
- Use of false weights and measures leading to underweight.
- Hoarding and black-marketing leading to scarcity and rise in price.
- Charging more than the Maximum Retail Price (MRP) fixed for the product.
- Supply of defective goods.
- Misleading advertisements, i.e., advertisements falsely claiming a product or service to be of superior quality, grade or standard.
- Supply of inferior services, i.e., quality of service lower than the quality agreed upon. The above instances show the exploitation of consumers in the context of goods and services. In a democratic nation like India, should we allow this to happen? So the measures adopted by the government or non-government organisations (NGOs) for safeguarding the interests of the consumers constitute consumer protection.

Examples of consumer exploitation in India

- The after sales service provider of the television set charged Rs 200 as service charge though he repaired the set within the warranty period.
- The tickets issued to different passengers on the same day for the same journey showed the same seat number.
- Penalty of Rs. 50 was charged by SBI after issuing the cheque book to the customer showing that the balance available in the account was less than the minimum required balance for issue of cheque book.
- The supply of cooking gas cylinder to the consumers is found to be underweight.
6.2 Need and objectives for Consumer Protection

The necessity of adopting measures to protect the interest of consumers arises mainly due to the helpless position of the consumers. There is no denying fact that the consumers have the basic right to be protected from the loss or injury caused on account of defective goods and deficiency of services. But they hardly use their rights due to lack of awareness, ignorance or lethargic attitude. However in view of the prevailing malpractices and their vulnerability there to, it is necessary to provide them physical safety, protection of economic interests, access to information, satisfactory product standard, and statutory measures for redressal of their grievances. The other main arguments in favour of consumer protection are as follows:

Social responsibility
The business must be guided by certain social and ethical norms. It is the moral responsibility of the business to serve the interest of consumers. Keeping in line with this principle, it is the duty of producers and traders to provide right quality and quantity of goods at fair prices to the consumers.

Increasing awareness
The consumers are becoming more mature and conscious of their rights against the malpractices by the business. There are many consumer organisations and associations who are making efforts to build consumer awareness, taking up their cases at various levels and helping them to enforce their rights.

Consumer satisfaction
Father of the Nation Mahatma Gandhi had once given a call to manufactures and traders to “treat your consumers as god”. Consumers’ satisfaction is the key to success of business. Hence, the businessmen should take every step to serve the interests of consumers by providing them quality goods and services at reasonable price.

Principle of social justice
Exploitation of consumers is against the directive principles of state policy as laid down in the Constitution of India. Keeping in line with this principle, it is expected from the manufacturers, traders and service providers to refrain from malpractices and take care of consumers’ interest.

Principle of trusteeship
According to Gandhian philosophy, manufactures and producers are not the real owners of the business. Resources are supplied by the society. They are merely the trustees of the resources and, therefore, they should use such resources effectively for the benefit of the society, which includes the consumers.

Survival and growth of business
The business has to serve consumer interests for their own survival and growth. On account of globalisation and increased competition, any business organisation which indulges in malpractices or fails to provide improved services to their ultimate consumer shall find it difficult to continue. Hence, they must in their own long run interest, become consumer oriented.

Objectives of Consumer Protection Act
The trading community is well organised while the consumers are scattered and unorganised. The rampant problems of illiteracy, ignorance, poverty and backwardness continue to exist and, in consequence, the consumers are always exploited. Some voluntary organisations have come forward to help the consumer movement, but their efforts are limited due to paucity of funds and lack of whole-hearted support of Government officials to the helping hand of the voluntary organisations. The Consumer Protection Act, 1986 seeks to provide protection to the interests of consumers, in general. Basic Objectives of Consumer Protection Act:
The basic objectives of Consumer Protection Act are

- To provide for better protection of consumers’ interests.
- To establish consumer councils and authorities for protection of the interests of consumers.
- To empower consumer councils and authorities to settle consumers’ disputes and matters connected therewith.

![Objectives of Consumer Protection Act Act, 1986](image)

**Fig. 6.1 Objectives of Consumer Protection Act**

**Salient features of the Act**

In this unit you will study the basic provisions of the Consumer Protection Act, 1986. The detailed rights of the consumers and how can those rights be enforced (i.e., the various reliefs available to consumers) shall be studied in the next unit.

Salient features of the Act are:

- The Act aims to provide better and all-round protection to consumers.
- In terms of geographical application, it applies to the whole of India except the state of Jammu and Kashmir.
- It applies to all goods and services unless otherwise expressly notified by the Central Government.
- It is indeed a very unique and highly progressive piece of social welfare legislation and is acclaimed as the magna carta of Indian consumers. The Act has made the consumer movement really going and more powerful, broad-based and effective and people oriented. In fact, the Act and its Amendment in 1993 have brought fresh hopes to the beleaguered Indian consumer. This is the only law which directly pertains to market place and seeks to redress complaints arising from it. Even prior to 1986, there were in force a number of laws which could be interpreted in favour of the consumers. But, this Act is r most powerful piece of legislation the consumer has had before 1986. Its provisions are F very comprehensive and highly efficacious. In fact, it provides more effective protection to consumers than any corresponding legislation in force even in countries which are considered to be much more advanced.
- It provides effective safeguards to the consumers against different types of exploitation such as defective goods, unsatisfactory (or deficient) services and unfair trade practices.
6.3 Extent, Commencement and Application of the Act

Basically, the Consumer Protection Act, 1986 was enacted as a result of widespread Consumer Protection Movement and was passed on 24th December, 1986 to provide for better protection of the interests of consumers and for the purpose to make necessary provisions for the establishment of Consumer Councils and other authorities for the settlement of consumer disputes and for other matters connected therewith. The said Act came into force on 15th April, 1987. Thereafter, the Act has been amended three times so far.

6.3.1 Amendments made in the Act in 1991

In order to make certain changes in the Act, the Consumer Protection (Amendment) Ordinance of 1991 was promulgated to provide inter alia,-

- For amendment of sub-section (2) of section 14 to provide that every proceeding of the District Forum shall be conducted by the President and at one member thereof sitting together.
- That every order made by the district Forum shall be signed by its President and member or members who conducted the proceeding.
- That where the proceeding is conducted by the president and a member of the District Forum and they differ on any point or points, the same shall be referred to the other member on such point or points and the opinion of the majority shall be the order of the District Forum.
- To validate the orders which have been signed by the President and one member of the District Forum or the State Commission before amendment and
- That in the case of vacancy in the office of the President, the person who is qualified to be appointed as President of the District Forum or the State Commission may be temporarily appointed to hold such office.

6.3.2 Amendments Made in the Act in 1993

It was observed that the working of the redressal agencies set up under this Act helped to arouse the expectations of the people at large and also brought to focus certain inadequacies in the coverage of this Act. Hence, the Consumer Protection (Amendment) Bill of 1993 was passed to plug the loopholes and enlarge the scope of areas covered and also to entrust some more powers to the redressal agencies under the Act. Accordingly, the Bill was passed to provide inter alia,-

- To enlarge the scope of the Act so as to enable the consumers to file class action complaints where such consumers have a common interest and to file complaints relating to restrictive trade practices adopted by a trader;
- To enable the consumers who are self-employed to file complaints before the redressal agencies where goods bought by them exclusively for earning their livelihood, suffer from any defect;
- To add ‘services’ relating to housing constructions
- To enable filing of class action complaints on behalf of groups of consumers having the same interest;
- To provide for constitution of selection committees for the selection of non-judicial members of various redressal agencies.
- To increase the monetary jurisdiction of District Fora/State Commissions/National Commission;
- To confer additional powers on the redressal agencies by way of awarding costs to the parties, for ordering removal of defects or deficiency from the services and for empowering to recall of goods likely to endanger the safety of the public; etc;
- To impose punishment on the complainant in cases of frivolous or vexatious complaints, and
- To provide for a limitation period of one year for filing complaints.
6.3.3 Amendments of 2002

No doubt, the Consumer Protection Act of 1986 was enacted as a result of widespread Consumer Protection movement and was an important milestone in the history of the consumer movement in our India. In order to provide for the better protection and promotion of consumer rights and also to provide simple, inexpensive and speedy justice to the consumers with the complaints against defective goods, deficient services and unfair and restrictive trade practices, along with other provisions, consumer disputes redressal agencies have been set up throughout India with the District Forum at the district level, the State Commission at the State level and the National Commission at the national level. To make this Act more effective and purposeful, it was also amended in 1991 and 1993.

It was observed that inspite of the consumer disputes, redressal agencies, to a considerable extent, served the purpose for which they were created, but the disposal of cases was not found to be fast enough. Several bottlenecks and shortcomings also came to light in the implementation of various provisions of the Act. Hence, the amendments have been made in 2002 in the Act in order to achieve quicker disposal of consumer complaints by the consumer disputes redressal agencies securing effective implementation of their orders, to widen the scope of some of the provisions of the Act to make it more effective and also to remove various lacunae, loopholes in the Act and streamlining the procedures. The Consumer Protection (Amendment) Act 62 of 2002 was passed by both the houses of the Parliament on 22nd Nov.2002 and assented by the President of India on 17th December, 2002 and thereafter, it has been made applicable. The highlights of amendments, inter alia, thus made in 2002 are given below:

Facilitating Quicker Disposal of Complaint

- Creation of Benches and appointment of additional members in the National Commission and State Commission.
- Provision for senior most Members to preside the Consumer Forums in the absence of President for any reason.
- Time frame prescribed for admission of complaints, issue of notices and disposal of complaints.
- Time frame prescribed for disposal of appeals.
- Where the complaint/ appeal could not be disposed within the time period, reasons for the same should be recorded.
- Ordinarily no adjournment to be given. Adjournments only when it is justified.
- Once complaint admitted shall not be transferred to any other Court/Tribunal.
- Provision for service of notices by courier, fax, speed post etc.
- Pecuniary jurisdiction for District Forum substantially revised from Rs.5 lakhs to Rs.20 lakhs, for State Commission above Rs.20 lakhs to Rs.1 crore and for National Commission from above Rs.20 lakhs to above Rs.1 crore.
- Services utilised for commercial purposes excluded from the purview of - Consumer Courts. (Goods already excluded).
- Provision for issue of interim orders during the pendency of the case.
- Provision to continue the proceeding from the stage where the previous Member instead of starting a de novo proceeding last heard the case.
- Resignation of the President/Member to become effective only on acceptance, thereby continuity of the function of the court is not affected.
- Sitting Judge of the High Court to preside the Selection Committee for selection of Members of State Commission and President and Members of District Forums, when State Commission President is absent for any reason.
Making Consumer Courts more capable

- Minimum Qualification prescribed for members (graduate, minimum 35 years of age, minimum 10 years in relevant field).
- Disqualification also prescribed (conviction for offence involving moral turpitude, insolvency, etc.)
- Provision for reappointment of Presidents & Members of forums / Commissions.

Widening the Scope of Act

- Sale of spurious goods/services included in unfair trade practice.
- Concept of unsafe goods widened. Also extended to services.
- Complaint can also be made against service provider indulging in unfair/ restrictive trade practice.

Strengthening Consumer Courts

- Consumer Courts to have cowers of First Class Judicial Magistrate to punish those not obeying order of court. This will remove any scope for challenging the constitutional validity of power of consumer courts to impose penalty of imprisonment.
- Compensation amount ordered by court can be recovered through certificate case as arrears of land revenue.
- Consumer courts can issue interim orders (complainant can get immediate relief in deserving cases).

Streamlining procedure

- Legal heir can be substituted if complainant/Opposite Party dies.
- Minimum amount to be deposited before appeal.

Strengthening consumer movement

- To establish a consumer protection council at district level and also make it as necessary requirement for the Government to establish District, State, Central level Councils.
- Besides, to enable nomination of upto 10 official or non-official members to the State Councils by the Central Government.
- The amendments expected to strengthen consumer movement at grass root level.

6.4 Definitions

The Consumer Protection Act, 1986 is explained below:

- It extends to the whole of India except the State of Jammu and Kashmir.
- It shall come into force on such date as the Central Government may, by notification, appoint and different dates may be appointed for different States and for different provisions of this Act.
- Save as otherwise expressly provided by the Central Government by notification, this Act shall apply to all goods and services.

6.4.1 Appropriate Laboratory [Sec2 (1) (a)]

In the Consumer Protection Act, 1986, unless the context otherwise requires, “appropriate laboratory” means a laboratory or organisation.

- recognised by the Central Government;
- recognised by a State Government, subject to such guidelines as may be prescribed by the Central Government in this behalf; or
- any such laboratory or organisation established by or under any law for the time being in force, which is maintained, financed or aided by the Central Government or a State Government for carrying out analysis or test of any goods with a view to determining whether such goods suffer from any defect;
6.4.2 Branch Office [Sec2 (1) (aa)]

“Branch office” means

• any establishment described as a branch by the opposite party; or
• any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the establishment;

6.4.3 Consumer [Sec2 (1) (d)]

“Consumer” means any person who

• buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose; or
• hires or avails of any services for a consideration, which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person but does not include a person who avails of such services for any commercial purposes;

Explanation

For the purposes of this clause, “commercial purpose” does not include use by a person of goods bought and used by him and services availed by him exclusively for the purposes of earning his livelihood by means of self-employment;

Therefore, to be a ‘consumer’ under the Act,

• the goods or services must have been purchased or hired or availed of for consideration which has been paid in full or in part or under a system of deferred payment, i.e., in respect of hire-purchase transactions;
• goods purchased should not be meant for re-sale or for a commercial purpose. Thus, where a vehicle has been purchased for the purpose of running it as a taxi, the purpose being commercial the buyer shall not be a ‘consumer’ under the Act [Western India State Motors v. Subhag Mal Meena and Others (1989)]. However, if the taxi is used by the buyer to earn his livelihood, the buyer will be considered as a consumer.

Any economic activity or transaction carried on with the motive of making profit would fall under the term commercial purpose, irrespective of the scale of operations In S. Pattahhiraman v. SP. ST. Palaniappan (Order dt. 3.5.1994), the National Commission ruled that a chartered accountant who is in practice and who purchased a computer for being installed in his office, cannot be regarded as a consumer under the Consumer Protection Act.

6.4.4 A Person [Sec2 (1) (m)]

A “person” includes:

• a firm whether registered or not;
• a Hindu undivided family;
• a co-operative society;
• every other association of persons whether registered under the Societies Registration Act, 1860 (21 of 1860) or not;
6.4.5 Goods [Sec2 (1) (i)]
Goods under this Act shall have the same meaning as assigned to them under the sale of goods Act, 1930 (Sec. 2(7) (i)).

Accordingly, Goods means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be served before sale or under the contract of sale (Sec. 2 (7) of the Sale of Goods Act, 1930).

Are shares before allotment goods?
The supreme court in Morgan Stanley Mutual Fund v. Kartick Das (1994) 4 (Supreme Court Cases 225), observed that till the allotment of shares takes place, ‘the shares do not exist’. Therefore, they can never be called goods. It is after allotment, rights may arise as for the contract (Articles of Association of Company), but certainly not before allotment.

6.4.6 Service [Sec2 (1) (O)]
Section 2 (1) (0) provides that ‘service’ means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service.

Are the services rendered by Government hospitals free of charge?
A controversy has been raised with regard to treatment at Government hospitals as to whether it constitutes a service within the meaning of service under the Act. There are some who believe that the treatment in Government hospitals is actually not free inasmuch as it is the taxpayer’s money which goes to fund these hospitals and, if therefore a taxpayer seeks the treatment, he is paying for the same though indirectly. However, National Commission in the Consumer Unity and Trust Society (CUTS) v. State of Rajasthan, (1989) held that complaints against government hospitals cannot be entertained under the Act on the ground that person receiving treatment in such hospitals is not a consumer as the patient does not hire the services. It further observed that this was their interpretation within the scope of the Act and if the Legislature intended otherwise, the Act ought to be amended suitably. However, service rendered by doctors in private hospitals for consideration would come under the purview of service (Cosmopolitan Hospitals v. Smt. Vasantha P. Nair 1992).

6.4.7 Spurious Goods and Services [Sec2 (1) (OO)]
“Spurious goods and services” mean such goods and services which are claimed to be genuine but they are actually not so;

6.4.8 Trader [Sec2 (1) (q)]
A trader in relation to any goods means a person who sells or distributes any goods for sale and includes the manufacturer thereof. Where such goods are sold or distributed in package form, the expression trader shall include the packer of those goods [Sec. 2(1) (q)].
6.4.9 Manufacturer [Sec2 (1) (j)]

Sec. 2 (1) (j) of the Act defines the expression ‘manufacturer’ to mean any of the following persons:

- A person who makes or manufactures any goods or part thereof.
- A person who does not make or manufacture any goods but assembles parts thereof made, or manufactured by others and claims the end-product to be goods manufactured by himself. But, where a manufacturer despatches any goods or part thereof to any branch office maintained by him, such branch office shall not be deemed to be manufacturer even though the parts so despatched to it are assembled at such branch office and are sold or distributed from such branch office.
- A person who puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer and claims such goods to be goods made or manufactured by himself.

6.4.10 Consumer Dispute [Sec2(1) (e)]

According to Section 2(1) (c), Consumer dispute means a dispute where person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

6.4.11 Complaint [Sec2 (1) (c) and Complainant [Sec2 (1) (b)]

A “complainant” means:

- a consumer; or
- any voluntary consumer association registered under the Companies Act, 1956 (1of 1956)or under any other law for the time being in force; or
- the Central Government or any State Government,
- one or more consumers, where there are numerous consumers having the same interest;
- in case of death of a consumer, his legal heir or representative; who or which makes a complaint;
- A “complaint” means any allegation in writing made by a complainant that—
  - an unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider;
  - the goods bought by him or agreed to be bought by him; suffer from one or more defects;
  - the services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;

6.4.12 Restrictive Trade Practice [Sec2 (1) (nn)]

‘Restrictive trade practice’, as per Sec. 2(1) (nn) means any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as a condition precedent for buying, hiring or availing of other goods or services.

Thus, compelling a consumer to buy insurance cover while purchasing a vehicle, or insisting on purchase of gas-stove as a pre-condition to release gas connection shall be a restrictive trade practice.

6.4.13 Unfair Trade Practice [Sec2 (1) (r)]

An “Unfair trade practice” means a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice including any of the following practices, namely:

- the practice of making any statement, whether orally or in writing or by visible representation which,—
  - falsely represents that the goods are of a particular standard, quality, quantity, grade, composition, style or model;
  - falsely represents that the services are of a particular standard, quality or grade;
  - falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods;
  - represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have;
• represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;

• makes a false or misleading representation concerning the need for, or the usefulness of, any goods or services;

• (vii) gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that is not based on an adequate or proper test thereof; Provided that where a defence is raised to the effect that such warranty or guarantee is based on adequate or proper test, the burden of proof of such defence shall lie on the person raising such defence;

• makes to the public a representation in a form that purports to be
  • a warranty or guarantee of a product or of any goods or services; or
  • a promise to replace, maintain or repair an article or any part thereof or to repeat or continue a service until it has achieved a specified result, if such purported warranty or guarantee or promise is materially misleading or if there is no reasonable prospect that such warranty, guarantee or promise will be carried out;

• materially misleads the public concerning the price at which a product or like products or goods or services, have been or are, ordinarily sold or provided, and, for this purpose, a representation as to price shall be deemed to refer to the price at which the product or goods or services has or have been sold by sellers or provided by suppliers generally in the relevant market unless it is clearly specified to be the price at which the product has been sold or services have been provided by the person by whom or on whose behalf the representation is made;

• gives false or misleading facts disparaging the goods, services or trade of another person.

**Explanation**

For the purposes of the above clause, a statement that is

• expressed on an article offered or displayed for sale, or on its wrapper or container; or

• expressed on anything attached to, inserted in, or accompanying, an article offered or displayed for sale, or on anything on which the article is mounted for display or sale; or

• contained in or on anything that is sold, sent, delivered, transmitted or in any other manner whatsoever made available to a member of the public, shall be deemed to be a statement made to the public by, and only by, the person who had caused the statement to be so expressed, made or contained;

• permits the publication of any advertisement whether in any newspaper or otherwise, for the sale or supply at a bargain price, of goods or services that are not intended to be offered for sale or supply at the bargain price, or for a period that is, and in quantities that are, reasonable, having regard to the nature of the market in which the business is carried on, the nature and size of business, and the nature of the advertisement.

**Explanation**

For the purpose of the above clause, “bargaining price” means

• a price that is stated in any advertisement to be a bargain price, by reference to an ordinary price or otherwise, or

• a price that a person who reads, hears or sees the advertisement, would reasonably understand to be a bargain price having regard to the prices at which the product advertised or like products are ordinarily sold;

• Permits—
  • the offering of gifts, prizes or other items with the intention of not providing them as offered or creating impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole;
  • the conduct of any contest, lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest;
6.4.14 Defect [Sec2(1) (f)]
According to Section 2(1) (c), Consumer Protection Act, 1986, as amended by the Amendment Act, 1993, a ‘defect’ means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or under any contract, express or implied, or claimed by the trader in any manner whatsoever in relation to any goods.

A ration shop supplied a ration-card holder with oil adulterated with known toxic adulterants. The complainant, and his family, as result of that rapeseed oil consumption suffered severely. He was attacked with paralysis of lower limbs and inspite of prolonged treatment he did not recover fully. His wife, inspite of medical treatment, was not able to carry on her ordinary avocation as housewife because of ailment. His two daughters and a son, all growing children were also affected and medical report was that they had severe attack. Their educational carrier was doomed. Considering all these facts, the Commission awarded a sum of Rs. 1,50,000/- to the complainant and Rs. 50,000/- for his wife and Rs. 25,000/- to each of the children resulting in awarding of total of Rs. 2,75,000/- (Barsad Ali vs. Managing Director, West Bengal Essential Commodities Supplies Corp. 1993, CCJ 476).

6.4.15 Deficiency [Sec2 (1) (g)]
“Deficiency” means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service;

6.4.16 Members [Sec2(1) (jj)]
“Member” includes the President and a member of the National Commission or a State Commission or a District Forum, as the case may be.

6.5 Six Rights in Consumer Protection Act
The Consumer Protection Act enshrines six rights of the consumers. These are the Right to Safety, Information, Choice, Be Heard, Redressal and Consumer Education.

6.5.1 Right to Safety
The Right to Safety means the right to be protected against the marketing of goods and services which are hazardous to life and property. What is required here is that the purchased goods (or services) should meet the needs of safety. Can you recollect some cases where this right of consumers was violated?

You hire a taxi or an auto rickshaw or decide to travel by a bus. The operator of that vehicle has not bothered about the mechanical fitness and worse, enroute the vehicle meets with an accident due to faulty breaks.

Here, the injury caused to you or any passenger is a case of violation of consumer right to safety. You or any other injured passenger is, therefore, entitled to compensation.

Similarly, an electric iron causing electric shock, negligence by a doctor while performing an operation, a driver of a bus driving the bus dangerously are the other examples of violation of this right.

It should be remembered that Right to Safety is not limited to the quality of product just at the time of purchase. The products should fulfils long term interests of consumers in terms of safety needs. Therefore before purchasing, consumers should insist on the quality of the products as well as on the guarantee of the products and services. But this does not mean that without a guarantee a consumer does not have right to safety. This Right, you will agree, is very important because it protects us against the dangers and harm to our body, life, health and property due to acts of omission or commission of manufacturers, traders or providers of services.

Think of situations where this right is of significant importance and try to look the ways in which it is violated.
6.5.2 Right to be Informed
Many a time you purchase a medicine. The medicine may be apparently to cure a disease. But there is a possibility of it proving to be harmful to certain persons in certain cases. Or a medicine having same contents might have been manufactured by different companies under different brand names and priced differently. In the first case if you do not know the harmful side effects of the medicine and consume it, what will be the result? In the second case you do not know the availability of different brands of medicine and are made to buy one which you cannot afford.

Don’t you think that in both these cases if you had the prior information it would have saved you in terms of loss to your health or money? Traders, simply to make profit by selling whatever is available with them or the product which gives them higher margin of profit generally do not inform the customers of availability of choices or qualities of product. It is because of this that the Consumer Protection Act has provided the Right to be informed. This Right means right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be, so as to protect the Consumer against unfair trade practices. In other the words the consumer can insist on getting all the information about the product or service before making a choice or a decision. The manufacturer or trader is duty bound to give this information. This right encourages the consumer to act wisely and responsibly and warns him/her from falling prey to high pressure selling techniques. You may think of many examples where right to information is very important.

6.5.3 Right to Choose
This Right means the right to be assured, wherever possible, of access to a variety of goods at competitive prices. In other words, a buyer has a right to buy a product of his/ her choice and get satisfaction out of a number of products available in terms of quality and price of goods. A shopkeeper cannot force or impress upon a customer to buy a particular brand or a type of product. In case a particular product is manufactured by only one producer, that is a monopoly product, then this Right means assurance of a satisfactory quality and service at a fair price. This also includes Right to basic goods and services. This is because unrestrained Right of the minority to choose can mean a denial for the majority of its fair share. It is true that in reality this Right can be better exercised in a competitive market where a variety of goods are available at competitive prices. In India such market does not exist as yet in many sectors and in many regions. However even in those cases where variety exists shopkeepers keeping in mind the profits they would secure, don’t offer the entire range of products to the consumer. This makes the consumer feel that variety either do not exist or is not available. Then consumer, therefore, has to be vigilant and make his/ her own enquiries in the market to be better aware of the choices available.

6.5.4 Right to be Heard
The Right to be heard means that consumer’s interests will receive due consideration at appropriate forums. It also includes Right to be represented in various forums formed to consider the consumer’s welfare. For the exercise of this right both the State and the voluntary agencies are supposed to provide necessary forums. The social accountability of producers also demands to provide such forums in the shape of grievance redressal or customer service departments or wings.

By enacting the Consumer Protection Act, the Government of India has created Consumer Forums at district, state and national levels to hear the complaints of consumers. The consumers themselves have started forming non-political and non-commercial consumer organisations which can be given representation in various committees formed by the Government and other bodies in matters relating to consumers. In your own town or state headquarters, you will notice such organisations.

6.5.5 Right to seek Redressal
This Right provides for the Right to seek redressal against unfair trade practices or unscrupulous exploitation of consumers. It also includes Right to fair settlement of the genuine grievances of the consumer.

It also involves the right to receive compensation for faulty goods or services. Redressal is the natural follow-up of hearing of complaints and making a settlement in a manner that is acceptable to the consumer as well as the seller.
For the effective exercise of this Right, laws and mechanisms for filling complaints are required. In subsequent blocks you will read about various laws like Consumer Protection Act under which complaints can be filed in different courts.

Consumers must make complaint for their genuine grievances. Many a time their complaint may be for a small value but its impact on the society as a whole may be very large. They can also take the help of consumer organisations in seeking redressal of their grievances.

6.5.6 Right to Consumer Protection
This Right encourages you to acquire the knowledge and skill to be an informed consumer throughout life. As we have already seen ignorance of consumers particularly the rural consumers of their Rights is mainly responsible for their exploitation. So, consumers should know of their rights and must exercise them willingly. To ensure this, availability of information at various levels and through various means is essential.

Consumer Protection Act itself provides the Right to consumer education. Therefore it becomes the duty of the government to keep consumers informed of their rights. Creating awareness among consumers is also part of their education. This will help a consumer in protecting himself/herself against fraudulent, deceitful and grossly misleading information, advertising labelling or other practices. By educating ourselves on consumer issues and Rights we can assert ourselves. By so doing, we can hope to get a fair deal. Consumer education also brings alertness and ability to question about price and quality of goods. In a way, Right to consumer education is an important means to make use of other consumer Rights. It is, therefore, important that we lay due emphasis on consumer education.

6.6 Responsibilities of Consumers
You have learnt about the various rights of the consumers. Let us now have an idea about their duties and responsibilities. These include the following:

6.6.1 Be Quality Conscious
To put a stop to adulteration and corrupt practices of the manufacturers and traders, it is the duty of every consumer to be conscious of the quality of product they buy.

They should look for the standard quality certification marks like ISI, Agmark, FPO, Woolmark, Eco-mark, Hallmark etc. while making the purchases.

6.6.2 Beware of Misleading Advertisements
The advertisement often exaggerates the quality of products. Hence, the consumers should not rely on the advertisement and carefully check the product or ask the users before making a purchase. In case there are discrepancies, the same should be brought to the notice of the sponsors and the appropriate authority, if need be.

6.6.3 Responsibility to Inspect a Variety of Goods before Making Selection
The consumer should inspect a variety of goods before buying the goods and service.

For this purpose he/she should compare their quality, price, durability, after sales service etc. This would enable the consumers to make the best choice within the limit of their own resource.

6.6.4 Collect Proof of Transaction
The consumer should insist on a valid documentary evidence (cash memo/invoice) relating to purchase of goods or availing of any services and preserve it carefully. Such proof of purchase is required for filing a complaint. In case of durable goods the manufactures generally provide the warrantee/guarantee card along with the product. It is the duty of consumers to obtain these documents and ensure that these are duly signed, stamped and dated. The consumer must preserve them till the warrantee/guarantee period is over.
6.6.5 Consumers Must be Aware of Their Rights
The consumers must be aware of their rights as stated above and exercise them while buying goods and services. For example, it is the responsibility of a consumer to insist on getting all information about the quality of the product and ensure himself/herself that it is free from any kind of defects.

6.6.6 Complaint for Genuine Grievances
As a consumer if you are dissatisfied with the product/services, you can ask for redressal of your grievances. In this regard, you must file a proper claim with the company first. If the manufacturer/company does not respond, then you can approach the forums. But your claim must state actual loss and the compensation claim must be reasonable. At no cost fictitious complaints should be filed otherwise the forum may penalise you.

6.6.7 Proper use of Product/Services
It is expected from the consumers that they use and handle the product/services properly. It has been noticed that during guarantee period, people tend to reckless use of the product, thinking that it will be replaced during the guarantee period. This practice should be avoided.

Apart from the responsibility enumerated above, the consumers should be conscious of their duty towards other consumers, society and ecology and make responsible choice. In other words, their purchases and consumption should not lead to waste of natural resources and energy and environmental pollution.

6.7 Consumer Protection Council
In order to promote and protect the consumer’s right, at two levels, the consumer protection councils have been established, i.e., at the centre, the Centre Consumer Protection Councils and at the state level, the various state consumer protection councils. The provisions relating to the establishment, procedure for meetings, objects, etc. of the Central Consumer Protection Council have been made in Sections from 4 to 8. Let us consider these provisions in brief.

6.7.1 The Central Consumer Protection Council [Section 4,5,6]
Establishment of the Central Consumer Protection Council
Section 4(1) states that the Central Government shall, by notification, establish with effect from such date as it may specify in such notification, a Council to be known as the Central Consumer Protection Council (hereinafter referred to as the Central Council).

[A] Constitution of the Central Council [Section 4]
Section 4 lays down that, the Central Council shall consist of the following members, namely:—

- the Minister in charge of the consumer affairs in the Central Government, who shall be its Chairman, and
- such number of other official or non-official members representing such interests as may be prescribed.

The Central Government, in order to carry out the provisions of Section 4, has established the Central Council and this Central Council has been constituted consisting of 150 members, as mentioned below according to the Rule 3 of the Consumer Protection Rules,1987.
(a) the Minister in-charge of Consumer Affairs in the Central Government who shall be the Chairman of the Central Council;

(b) the Minister of State (where he is not holding independent charge) or Deputy Minister in charge of Consumer Affairs in the Central Government who shall be the Vice-Chairman of the Central Council;

(c) the Minister in-charge of Consumer Affairs of two of the States from each region as mentioned in Schedule I to be changed by rotation on expiration of the term of the Council on each occasion;

(ca) an administrator (whether designated as administrator or Lieutenant Governor), of a Union Territory, to represent a Union Territory, as mentioned in Schedule II, to be changed by rotation on expiration of the term of the Council on each occasion;

(d) two Members of Parliament — one from the Lok Sabha and one from the Rajya Sabha;

(f) representatives of the Central Government Departments and autonomous organisations concerned with consumer interests—not exceeding five;

(fa) The Registrar, National Consumer Disputes Redressal Commission, New Delhi.

(g) representatives of the Consumer Organisations from amongst the Indian members of the International Organisation, namely, Consumer International – not exceeding six, to be nominated by the Central Government;

(ga) representatives with proven expertise and experience who are capable of representing consumer interests, drawn from amongst consumer organisations, consumer activists, women, farmers trade and industry – not exceeding five, one from each of the regions specified in Schedule annexed to these rules;

(j) the Secretary in-charge of Consumer Affairs in the State to be nominated by the Central Government – not exceeding three;

(k) the Secretary in-charge of Consumer Affairs in the Central Government shall be the member secretary of the Central Council.

Table 6.1 Section 4 of the Central Consumer Protection Council

The term of the Council shall be three years.

Any member may, by writing under his hand to the Chairman of the Central Council, resign from the Council. The vacancies so caused or otherwise, shall be filled from the same category by the Central Government and such person shall hold office so long as the member whose place he fills would have been entitled to hold office, if the vacancy had not occurred.

[B] Procedure for Meetings of the Central Council [Section 5]

It is provided in Section 5 that the Central Council shall meet as and when necessary, but at least one meeting of the Council shall be held every year.

Also, Section 5(2) makes it clear that the Central Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed.

Rule 4: Procedure of the Central Council:

Under sub-section (2) of section 5, the Central Council shall observe the following procedure in regard to the transaction of its business,—

- The meeting of the Central Council shall be presided over by the Chairman. In the absence of the Chairman, the Vice-Chairman shall preside over the meeting of the Central Council. In the absence of the Chairman and the Vice-Chairman, the Central Council shall elect a member to preside over that meeting of the Council.
Each meeting of the Central Council shall be called by giving, not less than ten days from the date of issue, notice in writing to every member.

Every notice of a meeting of the Central Council shall specify the place and the day and hour of the meeting and shall contain statement of business to be transacted thereat.

No proceedings of the Central Council shall be invalid merely by reasons of existence of any vacancy in or any defect in the constitution of the Council.

For the purpose of performing its functions under the Act, the Central Council may constitute from amongst its members, such working groups as it may deem necessary and every working group so constituted shall perform such functions as are assigned to it by the Central Council. The findings of such working groups shall be placed before the Central Council for its consideration.

In connection with the journey undertaken to and fro by the non-official members for attending the meeting of the Central Consumer Protection Council or its working group, they shall be entitled to avail first class or two-tier air-conditioned class of railway accommodation by all trains (including Rajdhani Express) and claim such fare or cost of actual mode of travel, whichever is less. The non-official members from Island territories shall be entitled to, to and fro air journey (economy class) in domestic airlines from the Islands to the nearest mainland airport and thereafter rail fare by entitled class. The non-official members who are senior citizens shall be entitled to, to and fro air-journey (economy class) in domestic airlines on availing senior citizen concessional air fare for their journeys provided the distance being travelled is 1000kms or above. The non-official members shall be entitled to a sum of Rs.1000 per day as incidental charges to cover the expenditure towards their daily allowance, lodging, local conveyance from residence to the station/airport and from station/airport to the venue of meeting and vice-versa. Every claim made under this sub-rule shall be subject to certifying that the member will not claim any benefit from any other Central Government Ministry, Department or Organisation during his visit for attending the meeting of the Central Consumer Protection Councillor any of its Working Group. Local non-official members residing at the place of the venue of the meeting, shall be paid consolidated conveyance, hire charges and incidental charges to cover the daily allowances, to the tune of Rs.200 per diem irrespective of the classification of the city’. Members of Parliament attending meetings of the Councillor its Working Group shall be entitled to travelling and daily allowances at such rates as are admissible to such members”.

The resolution passed by the Central Council shall be recommendatory in nature.

[C] Objects of the Central Council and the Statutory Rights of the Consumers to promote and protect their interests. [Section 6]
The objects of the Central Council shall be to promote and protect the rights of the consumers such as,—

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<tr>
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<th>the right to be protected against the marketing of goods and services which are hazardous to life and property;</th>
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<td>(a)</td>
<td>the right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be so as to protect the consumer against unfair trade practices;</td>
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<td>(b)</td>
<td>the right to be assured, wherever possible, access to a variety of goods and services at competitive prices;</td>
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<td>(c)</td>
<td>the right to be heard and to be assured that consumer’s interests will receive due consideration at appropriate forums;</td>
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<td>(d)</td>
<td>the right to seek redressal against unfair trade practices or restrictive trade practices or unscrupulous exploitation of consumers; and</td>
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<td>(e)</td>
<td>the right to consumer education;</td>
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Table 6.2 Objectives of the Central Council
6.7.2 The State Consumer Protection Councils

Under Section 7(1) of the Act, “The State Government shall, by notification, establish with effect from such date as it may specify in such notification, a Council to be known as the Consumer Protection Council for which is hereinafter referred to as the State Council”.

The State Council shall meet and when necessary but not less than two meetings shall be held every year. [Section 7(3)].

The State Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government. [Section 7(4)]

- Members of The State Consumer Protection Council

The State Consumer Protection Council shall consist of the following members, namely:

- the Minister in charge of consumer affairs in the State Government who shall be its Chairman;
- such number of other official or non-official members representing such interests as may be prescribed by the State Government.
- such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.

Objects of the State Council

The objects of every State Council shall be to promote and protect within the State the rights of the consumers laid down in clauses (a) to (f) of section 6.

6.7.3 The District Consumer Protection Councils [Section 8-A]

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<td>(1)</td>
<td>The State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection Council with effect from such date as it may specify in such notification [Section 8(1)]</td>
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| (2) | The District Consumer Protection Council (hereinafter referred to as the District Council) shall consist of the following members, namely:
|     | (a) the Collector of the district (by whatever name called), who shall be its Chairman; and
|     | (b) such number of other official and non-official members representing such interests as may be prescribed by the State Government. [Section 8(2)] |
| (3) | The District Council shall meet as and when necessary but not less than two meetings shall be held every year. [Section 8(3)] |
| (4) | The District Council shall meet at such time and place within the district as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government. [Section 8(4)] |

Table 6.3 The District Consumer Protection Council

The objects of District Council. [Section 8B]

The objects of every District Council shall be to promote and protect within the district the rights of the consumers laid down in clauses (a) to (f) of section 6.
6.8 Jurisdiction of Consumer Courts

The judicial system set up under the Consumer Protection Act, 1986, consists of consumer courts at the district level, state level and national level. These are known as District Forum, State Consumer Disputes Redressal Commission (State commission) and National Consumer Disputes Redressal Commission (National Commission). Any individual consumer or association of consumers can lodge a complaint in writing with the district, state or National level forum, depending on the value goods and claim for compensation, if any.

The district forum has the jurisdiction to deal with all complaints where the value of the goods or services or the compensation claimed does not exceed Rs 20 lakhs. The state commissions are empowered to deal with cases where the value or amount involved exceed Rs 20 lakh but does not exceed Rs One Crore. The State commissions also deal with appeals against orders of the district forum.

The National commission has the jurisdiction to take up all claims and grievances exceeding the value of Rs. 1 crore. It has also appellate jurisdiction, that is, power to deal with appeals against orders passed by state commissions. An aggrieved party can appeal to the Supreme Court against the orders of the National Commission.

6.9 Consumer Disputes Redressal Agencies

The consumer disputes redressal agencies are detailed below.

Establishment of consumer disputes redressal Agencies [Section 9]

There shall be established for the purposes of this Act, the following agencies, namely:

- a Consumer Disputes Redressal Forum to be known as the “District Forum” established by the State Government in each district of the State by notification:
  - Provided that the State Government may, if it deems fit, establish more than one District Forum in a district.
  - a Consumer Disputes Redressal Commission to be known as the “State Commission” established by the State Government in the State by notification; and
  - a National Consumer Disputes Redressal Commission established by the Central Government by notification.

6.9.1 District Forums

A Consumer Redressal Forum known as the ‘District Forum’ is established by the State Government in each district of the State. If the State Government feels necessary then it may establish more than one District forum in a district.

Composition of the District Forum

Provisions relating to composition (Section 10), jurisdiction (Section 110, manner of making complaints [Section 12], procedure to be followed on admission of complaints [Section 130], finding [Section 14]), of District Forum (Section 14) have been made in the Act. Let us consider these provisions in brief.

Each District Forum shall consist of

- a person who is, or has been, or is qualified to be a District Judge, who shall be its President,[Section 10(1) (a)]
- two other members, one of whom shall be a woman, who shall have the following qualifications, namely:
  - be not less than thirty-five years of age,
  - possess a bachelor’s degree from a recognised university,
  - be persons of ability, integrity and standing, and have adequate knowledge and experience of at least ten years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration:

Provided that a person shall be disqualified for appointment as a member if he

- has been convicted and sentenced to imprisonment for an offence which, in the opinion of the state Government involves moral turpitude; or
- is an undischarged insolvent; or
is of unsound mind and stands so declared by a competent court; or

- has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government; or

- has, in the opinion of the state Government, such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member; or

- has such other disqualifications as may be prescribed by the State Government;[Section 10(1)(b)]

**Jurisdiction of the District Forum**

- Subject to the other provisions of this Act, the District Forum shall have jurisdiction to entertain complaints where the value of the goods or services and the compensation, if any, claimed does not exceed rupees twenty lakhs.

- A complaint shall be instituted in a District Forum within the local limits of whose jurisdiction:
  - the opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain, or
  - any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office, or personally works for gain, provided that in such case either the permission of the District Forum is given, or the opposite parties who do not reside, or carry on business or have a branch office, or personally work for gain, as the case may be, acquiesce in such institution; or
  - the cause of action, wholly or in part, arises.

**Finding of the District Forum. [Section 14]**

If, after the proceeding conducted under section 13, the District Forum is satisfied that the goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in the complaint about the services are proved, it shall issue an order to the opposite party directing him to do one or more of the following things, namely:

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<td>(a)</td>
<td>to remove the defect pointed out by the appropriate laboratory from the goods in question;</td>
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<td>(b)</td>
<td>to replace the goods with new goods of similar description which shall be free from any defect;</td>
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<td>(c)</td>
<td>to return to the complainant the price, or, as the case may be, the charges paid by the complainant;</td>
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<td>(d)</td>
<td>to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party. Provided that the District Forum shall have the power to grant punitive damages in such circumstances as it deems fit;</td>
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<td>(e)</td>
<td>to remove the defects in goods or deficiencies in the services in question;</td>
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<td>(f)</td>
<td>to discontinue the unfair trade practice or the restrictive trade practice or not to repeat it;</td>
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<td>(g)</td>
<td>not to offer the hazardous goods for sale;</td>
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<td>(h)</td>
<td>to withdraw the hazardous goods from being offered for sale;</td>
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<td>(ha)</td>
<td>to cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature;</td>
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to pay such sum as may be determined by it if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently:

Provided that the minimum amount of sum so payable shall not be less than five per cent. of the value of such defective goods sold or service provided, as the case may be, to such consumers:

Provided further that the amount so obtained shall be credited in favour of such person and utilised in such manner as may be prescribed;

to issue corrective advertisement to neutralise the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement;

to provide for adequate costs to parties. [Section 14(1)]

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<td>to pay such sum as may be determined by it if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently: Provided that the minimum amount of sum so payable shall not be less than five per cent. of the value of such defective goods sold or service provided, as the case may be, to such consumers: Provided further that the amount so obtained shall be credited in favour of such person and utilised in such manner as may be prescribed;</td>
<td>to issue corrective advertisement to neutralise the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement;</td>
<td>to provide for adequate costs to parties. [Section 14(1)]</td>
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Table 6.4 Finding the District Forum

6.9.2 State Commission
This is established by the state governments in their respective states.

- **Composition:** The State Commission consists of a President and not less then two and not more than such number of members as may be prescribed, one of whom shall be a women. The Commission is headed by a person of the level of High Court judge.

- **Jurisdiction:** A written complaint can be filed before the State Commission where the value of goods or services and the compensation claimed exceeds Rs. 20 lakh but does not exceed Rs. One crore.

- **Appeal:** In case the aggrieved party is not satisfied with the order of the State Commission he can appeal to the National Commission within 30 days of passing of the order.

6.9.3 National Commission
The National commission was constituted in 1988 by the central government. It is the apex body in the three tier judicial machinery set up by the government for redressal of consumer grievances. Its office is situated at Janpath Bhawan (Old Indian Oil Bhawan),

- **Composition:** It consists of a President and not less than four and not more than such members as may be prescribed, one of whom shall be a woman. The National Commission is headed by a sitting or retired judge of the Supreme Court.

- **Jurisdiction:** All complaints pertaining to those goods or services and compensation whose value is more than Rs. one crore can be filed directly before the National Commission.

- **Appeal:** An appeal can be filed against the order of the National Commission to the Supreme Court within 30 days from the date of order passed.

It may be noted that in order to attain the objects of the Consumers Protection Act, the National Commission has also been conferred with the powers of administrative control over all the State Commissions by calling for periodical returns regarding the institution, disposal and pending of cases and issuing instructions for adoption of uniform procedures, etc.

6.10 Role of Non-Governmental Organisations
Non- Governmental Organisations (NGOs) are those associations of people which aim at promoting the welfare of the public without any profit motive. They are voluntary bodies having a constitution and rules of their own, and are free from government interference. They depend on donations and partly on government assistance. NGOs dealing with consumer problems are known as consumer associations or consumer organisations.
The role of NGOs has become increasingly more significant over the last two decades. There are now more than 800 such organisations in India. These organisations are registered under the Societies Registration Act or the Companies Act or as Charitable Trusts.

NGOs have undertaken various activities as part of the consumer movement. They perform several functions, like:

- Create awareness about consumer rights and educate the general public about consumer problems and remedies through seminars, workshops and training programmes.
- Provide legal aid to consumers by way, of assistance in seeking legal remedy.
- Undertake advocacy of consumers’ point of view as representative members of consumer protection councils and others official boards.
- Arrange comparative testing of consumer products through their own testing apparatus or accredited laboratories so as to evaluate the relative qualities of competing brands and publish the test results for the benefit of consumers to become informed buyers.
- Publish periodicals and journals to disseminate information among readers about consumer problems, legal reporting and other emerging matters of interest. Most of these periodicals do not accept advertisements from business firms.
- Make suggestions and recommend steps which government authorities should consider in policy making and administrative measures adopted in the interest of consumers.
- Some NGOs have successful used Public Interest Litigation (PIL) to enforce consumer rights in several cases. In other words, NGOs have filed cases in law courts in the interest of the general public, not for any individual.

### 6.11 Limitations of Consumer Protection Act, 1986

The Consumer Protection Act, 1986, is now in operation for more than a decade. The Act was amended in 1993 for enlarging its scope. However, there are certain shortcomings in the Act. They are:

- Presently, the position is that only those services come within this Act for which specific payment is made, such as electricity, telephones, banking, etc. Thus the doctors as well as hospitals including those where treatment is given free such as government hospitals do not come within the ambit of the Act. Also, the mandatory civil services, such as sanitation, water supply, etc. provided by the State or local authorities are not covered by the Act. The Government cannot remain a silent spectator to the sorry state of affairs in the government hospitals. The government hospitals doctors have failed to improve themselves in extending satisfactory services to the public.
- The Consumer Protection (Amendment) Act, 1993 incorporated two clauses regarding supply of hazardous goods, but it does not impose a strict liability on those who supply such goods.
- Further, the consumer Protection Act, 1986, does not give any definition of safety requirements and permitted hazard levels. Whatever safety regulations are already prescribed under some law or the other would have to he gone into as to whether they have been violated or not. In fact, the Act itself should incorporate certain product safety requirements.
- Under the Act, a consumer can seek redressal only he has suffered a loss on damage as a result of the unfair trade practice or deficiency in service or the unfair trade practices resorted to by a trader. However, the per se rule is not invoked. The per se rule ensures that any act or practice which prima facie appears to be unfair shall be regarded as unfair and against consumer interest a s such, pending its justifications by the opposite party.
- The Act does not empower the Consumer Redressal Forum to issue either interim injunction, or “case and desist orders”. These powers are vested in the Monopolies and Restrictive Trade Practices Commission under the Monopolies and Restrictive Trade Practices Act, 1969.
- The Act docs not empower the Consumer Redressal Forums to take up cases suo moto. The Monopolies and Restrictive Trade Practices Act, 1969 empowers and M.R.T.P. Commissions to inquire into any unfair practices upon its own knowledge or information.
• The Act does not empower consumer forum to publish the names of manufacturers, traders, and dealers whose goods are found to be hazardous to public safety. This empowerment, if made, will work as a deterrent to the erring business community and make the consumers informed.

• The Act does not permit a consumer to lodge a complaint with the Consumer Fora if a alternative remedy is available under some other law. The Consumer Protection Act, 1986 clearly lays down that its provisions are in addition to and not in derogation of any other law for the time being in force. In many cases of complaints brought before the consumer forums, the complainants were directed to seek relief in a Civil Court, on the ground that the complaints were of such a nature that they involved recording of voluminous evidence and expert opinion. The mere fact that witnesses may have to be examined and their cross-examination may also be necessary cannot by itself be considered a valid ground for refusing adjudication of a dispute before the Consumer Courts. Thus Consumer grievances redressal agencies are evading cases of complex nature on the specious plea that the matter could into be disposed within the time frame.

• The Act does not impose liability on the chief executive, manager or director where an offense is shown to have been committed by an organisation.

• The Act specifies a time frame within which the dispute is to be disposed of. The period specified is 90 days, but the actual time taken is much longer. In some cases, the complainants waited for about two years, attended the Consumer Courts several times before they were formed that the Courts would not be able to handle their cases. One of the reasons for not adhering to this time frame is piling up cases. Secondly the court is under obligation to straight away send the complaint to the other party for reply. The court does into find out whether the complaint falls within the scope of the Act and, therefore, should it be pursued or not. The reason for not adhering to the time frame is because of a rider to the effect, included in the Consumer Protection Rules: “As far as possible”. The quick relief, as is expected under the Consumer Protection Act, 1986, should be ensured. Under the Act, it is expected that there will not only be an effective and meaningful remedy made available to the consumer, but also, there will be a speedy remedy. Delay defeats justice. As the consumer movement is catching up momentum and strength, it is becoming difficult of the Redressal Fora to dispose of the cases coming before them. If the Forums take a long time, they will also become just ordinary civil courts. Cases are piling up before the Forums also. In such a situation, one of the main objectives of the enactment will be defeated.

• It has been observed that there is a rift between judicial and non-judicial member of the consumer courts. This is growing day by day and threatening of affect the functioning of these quasi-judicial bodies. The non-judicial members feel that they are accorded second class statuses by the Presidents or judicial member. They want that the Presidents of Consumer courts should treat them as their equals. There is a vast gap between the emoluments of judicial and non-judicial members. The non judicial members want that the government should follow a policy of equal pay for equal work.

• The non judicial members feel frustrated as their role as adjudicators was being ignored. In any case the Presidents and the members are expected to play an equal role in the redress process. The non judicial members selected to work on the benches of these courts are not competent. They do not get adequate compensation. Also they complain that they are completely ignored by the Presidents, who do not even extend the courtesy of consulting them before writing the orders.

The presence of non judicial members was expected to give an air of informality to the consumer courts and keep the entire procedure before them simple and short. However, this has not happened. The non judicial members of Consumer FORA hold the Presidents and lawyers jointly responsible for this state of affairs.

The misunderstanding between judicial and non-judicial members stem from the fact that judicial members are former judges who have vast experience in the field. In sharp contrast, many of the non-judicial members would have had no exposure to these kind 01 Redressal Forums and find it difficult, at least initially, to cope with the work. But over a period of time, they find that they have no role to play to express a contrary view or write a dissenting judgement.

• Another problem is that quite a few members are appointed not purely on the basis of merit, but on other - mostly political consideration. Therefore, many non-judicial members are ‘useless’, ‘good for nothing’. Therefore, the judicial members are mentally not prepared to accept such type of members as equal partners in the process of dispensing consumer justice.
The Act concedes six rights of consumers viz. right to choice; right to safety; right to be informed; right to be heard; right to redress; and right to consumer education. But these rights have not been made justiciable.

The Act completely ignores the right of consumers to a healthy environment. It acknowledges only six rights of the consumers as are recognised by the international organisation of consumer unions.

The Act is silent on the question of storage of commodities. Many a time this becomes the more important issue than even the manufacturing of the goods themselves.

The Consumer redressal agencies do not have requisite infrastructure; as a result they are hamstrung functioning effectively.

A major problem arising practically everywhere is that of execution of the orders passed by the Consumer Courts. In a large number of cases there are defaults in compliance with the orders. There are cases where consumer courts have resorted to issue of warrants to the defaulting parties. Cases have been taken to High Courts through writ petitions challenging the validity of issue of warrants (including non-bailable warrants). An important issue relating to the execution of the orders is that the consumer courts have to depend on the Civil Courts for the execution of the orders or on the Criminal Courts when cases are referred for service of warrants. These procedures involve frustrating delays.

Experience of functioning of consumer courts by and large has been that the organisations against which decision is given by the Court, including organisations such as electric supply company or banks, there is almost invariably a tendency on its part to file an appeal. This adds to the problems of the consumer and inevitably delays the application of sought remedy and payment of adjudicated compensation. In a large number of cases, when the remedy of appeal is exhausted, the organisation very often resorts to the strategy of filing a ‘revision’ petition before the Nation; Commission. This further delays the award of remedy and compensation. In some cases the organisations go even further and file appeals before the Supreme Court against decision of the National Commission. Not only that. The existing procedure provides opportunity to ask for condonation of delay in submission of appeals. Whenever a complaint is lodged by a consumer and thereafter the Courts sends the Complaint to the organisation or the trader for defect in the product, or deficiency in service or for unfair trade practice, the respondent engages a lawyer. The spirit of the Act all along has been that it will not be lost in the wrangling of the lawyers as in Civil and Criminal Courts. Another serious problems faced by intermediary or lawyers is that of adjournments. Quite often the cases are adjourned on the demand of lawyers, to suit their convenience.
Summary

For the purpose of goods, a consumer means (i) one who buys any goods for consideration; and (ii) any user of such goods other than the person who actually buys it, provided such use is made with the approval of the buyer.

The expression ‘consumer’ does not include a person who obtains such goods for resale or for any commercial purpose.

For the purpose of services, a consumer means (i) one who hires any service or services for consideration; and (ii) any beneficiary of such service(s) provided the service is availed with the approval of such person.

The basic objectives of Consumer Protection Act are: (i) To provide for better protection of consumers’ interests, (ii) To establish consumer councils and authorities for protection of the interests of consumers and (iii) To empower consumer councils and authorities to settle consumers’ disputes and matters connected therewith.

The Act aims to provide better and all-round protection to consumers.

The Consumer Protection Act, 1986 was enacted as a result of widespread Consumer Protection Movement and was passed on 24th December, 1986. The said Act came into force on 15th April, 1987.

The Act has been amended three times so far-i.) 1991, (ii.) 1993, and (iii.) 2002.

The Consumer Protection Act enshrines six rights of the consumers, namely- the Right to Safety, Information, Choice, Be Heard, Redressal and Consumer Education.

In order to promote and protect the consumer’s right, at two levels, the consumer protection councils have been established, i.e., at the centre, the Centre Consumer Protection Councils and at the state level, the various state consumer protection councils.

Section 4(1) states that the Central Government shall, by notification, establish with effect from such date as it may specify in such notification, a Council to be known as the Central Consumer Protection Council (hereinafter referred to as the Central Council).

Under Section 7(1) of the Act, “The State Government shall, by notification, establish with effect from such date as it may specify in such notification, a Council to be known as the Consumer Protection Council for which is hereinafter referred to as the State Council”.

The State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection Council with effect from such date as it may specify in such notification. [Section 8(1)]

The judicial system set up under the Consumer Protection Act, 1986, consists of consumer courts at the district level, state level and national level known as District Forum, State Consumer Disputes Redressal Commission (State commission) and National Consumer Disputes Redressal Commission (National Commission).

Non-Governmental Organisations (NGOs) are those associations of people which aim at promoting the welfare of the public without any profit motive.

References


Recommended Reading

- Singla, R.K., Business Studies. FK Publications.
Self Assessment

1. Which statement is false?
   a. For the purpose of goods, a consumer includes one who buys any goods for consideration;
   b. The expression ‘consumer’ (Under the Consumer Protection Act, 1886) includes a person who obtains goods for resale or for any commercial purpose.
   c. For the purpose of services, a consumer includes one who hires any service or services for consideration.
   d. The Act aims to provide better and all-round protection to consumers.

2. Subject to the provisions of the Consumer Protection Act, the District Forum shall have jurisdiction to entertain complaints where the value of the goods or services and the compensation, if any, claimed ‘does not exceed rupees_____________.
   a. ten lakhs
   b. forty lakhs
   c. twenty lakhs
   d. fifty lakhs

3. Which statement is true?
   a. The mandatory civil services provided by the municipal authorities are covered by the Consumer Protection Act, 1986.
   b. The Act empowers the Consumer Courts to issue interim injunction.
   c. The Act does not empower the Consumer Courts to issue ‘cease and desist’ order.
   d. The Consumer Courts can take up the Consumer cases suo motu.

4. Which statement is true?
   a. The provisions of the Act are in addition to and not in derogation of any other law for the time being in force.
   b. The Act specifies a time frame within which the consumer dispute is to be disposed off.
   c. The six rights of consumers have been made justiciable.
   d. The Consumer Courts have to depend on the Civil Courts for the execution of their orders. i) The Consumer Courts can get the services of warrants affected without the help of the Criminal Courts. ii) Engagement of lawyer is mandatory for the complainant.

5. The Consumer Protection Act has been amended ________ times so far.
   a. Two
   b. Four
   c. Six
   d. Three

6. ________ are voluntary bodies having a constitution and rules of their own, and are free from government interference.
   a. NGO’s
   b. Consumer Courts
   c. District Forums
   d. National Commission
7. __________ is the apex body in the three tier judicial machinery set up by the government for redressal of consumer grievances.
   a. State Commission
   b. National Commission
   c. Consumer Courts
   d. District Forum

8. The State Commission is headed by a person of the level of __________.
   a. High Court judge
   b. Retired Supreme Court Judge
   c. District Judge
   d. President

9. The provisions for all the definitions are included under __________ of the Consumer Protection Act, 1986.
   a. Section 11
   b. Section 4
   c. Section 6
   d. Section 2

    a. six
    b. four
    c. five
    d. two
Chapter VII
The Information Technology Act, 2000

Aim
The aim of this chapter is to:

• define the scope of Information Technology Act, 2000
• introduce the application of Information Technology Act, 2000
• explain the aims and objectives of the Information Technology Act, 2000

Objectives
The objectives of this chapter are to:

• elucidate rationale and need of Information Technology Act, 2000
• explicate the concept of digital signatures
• explain the problems and challenges faced while implementing Information Technology Act, 2000

Learning outcome
At the end of this chapter, you will be able to:

• discuss electronic governance
• comprehend the authentication of verification of digital signature
• understand the cyber law
7.1 Introduction

The Information Technology Act has introduced certain new concepts such as “digital signature” “e-governance” etc. The Act gives legal recognition to the electronic records and treats it at par with the paper based system if all the safeguards are followed.

The Information Technology Act comprises of 94 sections and these sections are divided into 13 chapters. Other than these sections, there are four schedules appended to the Act that lay down the relative amendments made to the Indian Evidence Penal Code of 1860, [the First Schedule to the Act], the Indian Evidence Act of 1872 [the Second Schedule to the Act], the Banker’s Books Evidence Act of 1891[the Third Schedule to the Act] and the Reserve Bank of India Act of 1934 [the Fourth Schedule to the Act].

Creation of the contract serves as the basic foundation for business. Due to introduction of information technology, new challenges as well as opportunities have been created. E-commerce has an important role in information technology and has revolutionalised trade.

Electronic commerce has eliminated the need to have the paper based transactions. Internet has become a new mode of communication because of its characteristics such as ease and speed. This has led to many new challenges cropping up. When the transactions are made through the written documents, the documents contain signatures of all the parties participating in the transaction. These signed transactions are verified and produced in the court of law whenever there is any dispute for settlement.

The following problems have occurred through the usage of electronic commerce.

- the need to identify the authenticity of the parties that are involved in transaction
- the method to verify the signatures
- legal recognition and support for the transaction
- the need to produce the evidence in the court of law in case of any disputes

Due to above factors, the need to make suitable amendments in the present laws were felt. It helps in providing legal recognition to the digital signatures as well as electronic records, which facilitates e-commerce.

7.2 Objectives of I.T. Act of 2000

The act has helped in the electronic filing of documents at the Government agencies. This is an alternative to the conventional paper based methods of communication and storage of information.

- discuss the aims and objectives of the Act i.e. what does the Act try to achieve
- analyse the concept of digital signature and discuss the powers and functions of the issuing authorities a authority to exercise control over the issuance of digital signatures
- discuss the provisions relating to e-governance and legal recognition of electronic records
- provide legal recognition for e-commerce and e-transactions
- helps in electronic storage of data
- helps in giving legal recognition to electronic fund transfers between financial institutions and banks
- eradicate computer based crimes
- security practices and procedures get ensured
- provide legal recognition to digital signatures meant for authentication of any information under any law
- facilitate the growth of electronic based transactions
- provides legal recognition to the book keeping of the banks in the electronic format
7.3 Application of the Act

The application of the Act and its extra-territorial effect can be explained by making a conjoint reading of sections 1, 75 and 81. The Act is applicable throughout India. It is also applicable to any offence or contravention committed outside India by any person. However, an exception to this rule has been mentioned in section 75 of the Act.

- Sub-section (1) of section 75 though, in wider terms, has made the Act applicable also to any offence or contravention committed outside India by any person irrespective of his nationality, this sub-section has been made subject to the provisions of sub-section (2), which states that for the purposes of sub-section (1), this Act shall apply to an offence or contravention committed outside India by any person, if the act or conduct constituting the offence or contravention involves a computer, computer system or computer network in India.

- In effect, if an act (amounting to an offence under the Act) has been committed and where any computer, computer system or computers which are interconnected to each other in a computer network and which is in India is also involved (which might be either as a tool for committing the crime or as a target to the crime), then the provisions of the Act would apply to such an act.

- Section 81 provides effect to the provisions of the Act notwithstanding anything inconsistent contained in any other law for the time being in force. Therefore, effectively even if an offence (falling under the Act) is committed outside India by a foreigner, yet the courts in India would have the jurisdiction.

- It is noticeable that with the IT Act, there has been a conceptual change with regard to the applicability of a statute.

- Due to the borderless connectivity of the computers through the Internet, and the ease with which one can commit a cyber crime in India while physically located beyond the boundaries of the country, the Parliament has made the provisions of the Act applicable irrespective of where the accused might be physically located.

- In contrast, if we see the extent of operation of the Indian Penal Code (IPC) under section 1, it extends only ‘to the whole of India except the State of Jammu and Kashmir’. No further applicability clause has been provided for.

- Section 2 of the IPC makes every person including a foreigner liable to punishment for every act or omission contrary to the provisions of IPC, of which he/she shall be guilty in India.

- Sections 3 and 4 of the IPC relate to the extra-territorial operation of the Code. But these sections too are restrictive in nature and not as broad as the combined effect of section 1(2) read with section 75 of the IT Act.

7.4 Short Title, Extent, Commencement and Application of the Act [Sec 1]

Provisions made available for Section 1 of the Act explains the applicability of the I.T. Act. The Act is applicable to whole of India. The Act is also applicable to any offence that is committed outside India by any person. However, it is not applicable in the following circumstances

- a negotiable instrument as defined in Section 13 of the Negotiable Instruments Act, 1881
- a power of attorney as defined in Section 1-A of the Powers of Attorney Act, 1882
- a trust as defined in Section 3 of the Indian Trusts Act, 1882
- a will as defined in Section 2(h) of the Indian Succession Act, 1925 including any other testamentary disposition by whatever name called
- any contract meant for sale or conveyance of immovable property or any interest in such property
- any such class of documents or transactions as may be notified by the Central Government in the Official Gazette [Section 1(4)]

Provisions mentioned in Section 1 relating to short title, extent and commencement are as given below

- This Act can also be called the Information Technology Act, 2000 [Section 1(1)]
- It shall extend to whole of India and save as otherwise provided in this Act, it applies also to any offence or contravention thereunder committed outside India by any person [Section 1(2)]
It shall come into force on such date as Central Government may, by notification, appoint and different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the commencement of that provision [Section 1(3)]. This Act received the assent of the President of India on 9th June, 2000 and came into force on 17th October 2000.

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Table 7.1 Different sections of the Information Technology Act

7.5 Definitions of Certain Words, Terms, Concept Used in the Act

Certain definitions of words, terms and concepts used in the act are given below.

- **Appropriate Government** [Section 2(e)]: “Appropriate Government” means as respects any matter enumerated in List II of the Seventh Schedule to the Constitution
- relating to any State law enacted under List III of the Seventh Schedule to the Constitution, the State Government and in any other case, the Central Government

- **Asymmetric Crypto System** [Section 2(f)]: “Asymmetric crypto system” means a system of a secure key pair consisting of a private key for creating a digital signature and a public key to verify the digital signature.

- **Certifying Authority** [Section 2(g)]: “Certifying Authority” means a person who has been granted a licence to issue a Digital Signature Certificate under section 24.

- **Certification Practice Statement** [Section 2(h)]: “Certification practice statement” means a statement issued by a Certifying Authority to specify the practices that the Certifying Authority employs in issuing Digital Signature Certificates.

- **Cyber Appellate Tribunal** [Section 2(n)]: “Cyber Appellate Tribunal” means the Cyber Regulations Appellate Tribunal established under sub-section (1) of section 48.
Electronic Form [Section 2(r)]: “Electronic form” with reference to information means any information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film, computer generated micro fiche or similar device.

Electronic Gazette [Section 2(s)]: “Electronic Gazette” means the Official Gazette published in the electronic form.

Electronic Record [Section 2(t)]: “Electronic record” means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche.

Intermediary [Section 2(w)]: “Intermediary” with respect to any particular electronic message means any person who on behalf of another person receives, stores or transmits that message or provides any service with respect to that message.

Key Pair [Section 2(x)]: “Key pair”, in an asymmetric crypto system, means a private key and its mathematically related public key, which are so related that the public key can verify a digital signature created by the private key.

Private Key [Section 2(zc)]: “Private key” means the key of a key pair used to create a digital signature.

Public Key [Section 2(zd)]: “Public key” means the key of a key pair used to verify a digital signature and listed in the Digital Signature Certificate.

Secure System [Section 2(ze)]: “Secure system” means computer hardware, software, and procedure that—
- are reasonably secure from unauthorised access and misuse
- provide a reasonable level of reliability and correct operation
- are reasonably suited to performing the intended functions and
- adhere to generally accepted security procedures

Security Procedure [Section 2(zf)]: “Security procedure” means the security procedure prescribed under section 16 by the Central Government.

Verify [Section 2(zh)]: “Verify” in relation to a digital signature, electronic record or public key, with its grammatical variations and cognate expressions means to determine whether—
- the initial electronic record was affixed with the digital signature by the use of private key corresponding to the public key of the subscriber
- the initial electronic record is retained intact or has been altered since such electronic record was so affixed with the digital signature

7.6 Digital Signature

Digital signature is recognised as one of the types of electronic signature only. Therefore, very soon all references to digital signature in the IT Act may be substituted with electronic signature. Digital signature works in the same fashion as the written signature does on documents. Digital signature refers to authentication of electronic record through an electronic method or procedure by a subscriber. Digital signature is a digital method in order to authenticate the record. Digital signature certificate is issued to a subscriber through his application to Certifying Authority and by following the required procedures. After obtaining the certificate from the concerned authority, the electronic signature provided by the subscriber carries authenticity or validity.

- Any commercial transaction necessarily requires an agreement between two parties. For having a more secure transaction, people prefer having the agreement written and signed. With the advent of information technology and movement of the business on the Internet, it became necessary that there should be a secure form of entering into online contracts. In an online environment, the same is done through digital signatures.

- Affixing a digital signature implies the electronic authentication of an electronic document. It has a two-fold purpose: (a) identification of the person who is signing the document; (b) authentication of the contents of the document which is being signed.

- In the Act, Chapters II, VI, VII and VIII are devoted to digital signatures. In these chapters have been laid down the mechanism for issuance, modification and revocation of digital signatures, the authorities who would be assigned the task related to digital signatures, their powers and functions, and the duties of the subscribers of the digital signatures.
The whole system creates a hierarchy in which at the top is the Controller of Certifying Authorities who has the power to appoint Certifying Authorities and grant them the licence to issue Digital Signature Certificates. In turn, the Certifying Authorities can issue such Certificates to the subscribers. The process of application, renewal, suspension and revocation of licence of the Certifying Authorities has been provided. Likewise, the power to issue, suspend and revoke digital signature certificates is given in the hands of the Certifying Authorities.

A hierarchy of digital signature certificates too has been provided for the purpose of verification of genuineness of digital signatures which ultimately can be verified by the Controller of Certifying Authorities who under the Act is the highest authority for digital signatures and related matters.

*Section 2(p) of the Act defines ‘digital signature’ as ‘authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provisions of section 3’. Chapter II of the Act has a single section that is section 3 providing for authentication of electronic records.*

*Sub-section (1) of section 3 states that ‘any subscriber may authenticate an electronic record by affixing his digital signature’. This forms the base of use of digital signature. Section 3(1) of the Act gives a legal sanctity to the usage of digital signatures in the country. A person can, if he/she wishes, use digital signatures to authenticate an electronic record and such authentication is now recognisable under the law.*

*Role of digital signature in E-Commerce security system is highly important. For this reason the Information Technology Act, 2000 has made detailed provision on digital signature. Section 2(1)(p) of the Act has defined digital signature as – “digital signature means authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with provisions of Section 3”.*

*Section 3(2) states, “The authentication of the electronic record shall be effected by the use of asymmetric crypto system and hash function which envelop and transform the initial electronic record into another electronic record”.*

*Section 2(1)(f) defines ‘asymmetric crypto system’, as – “asymmetric crypto system means a system of a secure key pair consisting of a private key for creating digital signature and a public key to verify the digital signature”, Section 2(1)(ze) and Section 2(1)(zd) defines ‘private key’ and ‘public key’ as - “private key means the key of a key pair used to create digital signature” and “public key means the key of a key pair used to verify a digital signature and listed in the Digital Signature Certificate”.*

*It may be noted that digital signature is unlike a conventional signature. It is nothing but transformation of an electronic record into another electronic record with the help of private key.*

*Cryptography- In Greek, it means secret writing. It is the science of codification, which converts a normal text into junk characters (known as cipher text). The process of coding is called encryption and the process of decoding is called decryption. Encryption and decryption is done through software. This software is called Public Key and Private Key. Private Key is kept secret and the Public Key is made public.*

*Explanation to Section 3(2) states, “hash function means an algorithm mapping or translation of one sequence bits into another, generally a smaller set, known as ‘hash result’ such that an electronic record yields the same hash result every time the algorithm is executed with the same electronic record as its input making it computationally infeasible – (a) to derive or reconstruct the original electronic record from the hash result produced by the algorithm; (b) that two electronic records can produce the same hash result using the algorithm.”*

*In short, it can be said that the process of digital signature involves the converting electronic record into secret code first, and then translating the codes into a small number by applying a formula. Each licensed Subscriber uses unique secret code and formula, which is known to him only. This is done through private key. Based on private key techniques, public key is designed.*

### 7.6.1 Digital Signature Certificate

Digital Signature Certificate is an electronic file that contains personal information related to its owner like name or the email address including public key of the owner. Digital Signature Certificate is the digital equivalent of a paper certificate. For example, the nature of driver’s license, passport and the membership cards is same as digital signature certificate.
The certificate helps in serving as a proof of identity for an individual to meet certain purpose. It introduces sender to all the participants of the information, email or report. It reflects the proof of ownership of a public key. A digital certificate could be presented electronically, in order to prove access information or identity on the internet or even sign certain documents digitally.

A Certifying Authority (CA) issues certificate, which is responsible for the content. After signing of the certificates by the CA, users would be able to rely on the information related to the certificate.

7.6.2 Authentication of Electronic Records
All the subscribers could authenticate an electronic record by making their digital signature. With digital signature, the initial electronic record gets converted into another electronic record.

7.6.3 Authentication of Creation of Digital Signature
In order to sign an electronic record or any item that includes information, the signer has to first put hash function in the signer’s software. The hash function helps in computing hash result of standard length that is unique to the electronic record. The signer’s software transforms the hash result into Digital Signature by using the signer’s private key. The resultant Digital Signature is unique to both private key and electronic record that is used to create it. The Digital Signature has to be attached to its electronic record and transmitted or stored with its electronic record.

7.6.4 Authentication of Verification of Digital Signature
Subscribers are made available with the public key as well as private key after registration along with the component authority. The person who is using the public key of the subscriber can verify the electronic records. While making electronic transmission of business or legal document, it becomes necessary to verify that they are authentic and they are not tampered by any person during transmission. In order to achieve this, the authentication of the electronic record gets effected by using asymmetric crypto system, which means by making use of encryption (coding) and decryption (decoding) methodologies as well as software tools. Encryption stands for decryption and coding for decoding.

An encryption software program uses the normal, readable text message and then scrambles it into unreadable coded text. Next, different software program is used by the recipient in order to decode the scrambled messages into normal plaintext message.

7.7 Electronic Governance
Information system refers to changing the way in which the society functions. The impact of IT is seen in all the economic as well as social activities. The up coming forms of communications on the digital playfield have opened up lot of new possibilities in order to achieve speed, versatility and space-time independence.

Governments are also included into this phenomenon. Governments throughout the country are involved in improving responsiveness, internal efficiencies, coordination as well as integration between different sectors or government and external agencies, businesses and citizens. The IT revolution has also led to emergence of e-Governance.

• The use of IT by the government to facilitate services like filling the forms online, payment of bills (electricity, water supply etc.), distant education for its citizens, filing the tax returns, registration of land records and birth and death rates in India, and tele-medicines, and the services like e-chaupal have lead to an efficient, and easy to use of system for the citizens irrespective of any disparity among them. Government can provide services and information electronically to its citizens and business enterprises.

• Business transactions with the government can be done by Government to Business Transactions (G2B) where the information is delivered and transactions are made electronically with the businesses.

• It even helps in government to government transactions, or inter-departmental transactions within the government, and with government employees called, Inter Government Administration, (G2G).

• Through e-governance the transactions would be more efficient, effective and transparent. E-governance can also help increasing the exports and tourism and raise foreign trade of the country through G2X Transactions.
E-governance is a scheme to connect the citizens, businesses and other arms of the government and help them interact in a better way to improve the economy of the country as a whole. Not only this, it also helps in the empowerment of the citizens, as all the new government policies, rules etc. would be put on the forefront through e-governance. This would facilitate right to information to the citizens enshrined under Article 19 of the Constitution, and empower them to avail of their rights in better way, as before it was hard to keep themselves updated with policies and rules adopted by the government. So the system has not only made the administration better but also helped citizens get updated with the new policies, processes and the help-lines been offered by the government at all levels.

The e-governance has made the system more transparent, by cutting down the practice of red-tapism, corruption by the officials, as now the government can reach the citizens directly. E-governance in a long run would surely bring the benefit of improving the revenue collections, and therefore would help the government to gain higher revenue for enhancing the welfare of citizens.

Not only this it would also at the same time reduce the cost of running the government as every service offered by the government would be governed through the technology, at the same time there wouldn’t be un-employment as the employees previously employed would be transferred to alternative jobs for their livelihood.

The first e-governance project on Land records computerisation was BHOOMI in the state of Karnataka, and then we also have Rural Access to Services through internet (RA) in the state of Tamil Nadu.

Andhra Pradesh has introduced a project called e-Seva, for services like payment of bills, certificates, permits/licenses, reservation of tickets etc., and has also introduced a system for registration for the registration of all the services. There are also many other states also which have introduced the e-governance services, and lot more to join.

Meghalaya has now been providing services like social welfare, food civil supplies and consumer affairs, housing transport etc through the use of websites. We also have online complaint management system in Mumbai, which is called as SETU.

Even Indian Government has taken an initiative to provide for the e-governance services through the means of internet, the same has been provided on http://egov.mit.gov.in/ and in addition to this there is also an e-governance framework been prepared by the National Informatics Centre (NIC)

7.7.1 Legal Recognitions of Electronic Records
The Indian government has developed and implemented the Information Technology (IT) Act, which addresses the issues of cyber transactions and cyber crimes in India. The cyber activities pertaining to e-commerce and e-governance in India are also governed by the cyber laws that are enacted by the government of India.

Cyber law: legal requirement for written format
Due to the tremendous growth of Internet services, more than 90 percent of the records created at present are in electronic form. However, cyber laws across the world did not recognise electronic communication as legally valid.

The two main legal barriers of e-commerce and e-governance were
- necessity to record information on tangible medium
- requirement of hand written signatures

However, Section 4, of the IT Act provides that, if there is a legal requirement for any information to be in written from, such a requirement shall be considered to be satisfied, in case where the information is
- made available in an electronic form; and
- accessible for subsequent uses

Cyber law: absence of legal recognition of electronic records in some cases
Some documents in electronic form are not considered to be legally valid under Indian cyber laws. These include:
- in case of a will
- in case of a negotiable instrument
• trusts and powers of attorney (excluding constructive and resulting trusts)
• in case of contract pertaining to immovable property
• in case of documents of title
• any other document issued by the Central Government

Indian laws require these above mentioned documents to be legally valid only when they are in written form.

7.7.2 Legal Recognition of Digital Signatures

Section 5 states where any law provides that information or any other matter shall be authenticated by affixing the signature or any document shall be signed or bear the signature of any person then, notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied, if such information or matter is authenticated by means of digital signature affixed in such manner as may be prescribed by the Central Government. Explanation.-For the purposes of this section, “signed”, with its grammatical variations and cognate expressions, shall, with reference to a person, mean affixing of his hand written signature or any mark on any document and the expression “signature” shall be construed accordingly.

Under Section 10, the Central Government has powers to make rules prescribing the type of digital signature, the manner in which it shall be affixed, the procedure to identify the person affixing the signature, the maintenance of integrity, security and confidentiality of electronic records or payments and rules regarding any other appropriate matters.

7.7.3 Electronic Records and Use of Electronic Record and Digital Signatures in Government and Its Agencies

Where any law provides that information or any other matter shall be in writing or in the typewritten or printed form, then, notwithstanding contained in such law, such requirement shall be deemed to have been satisfied if such information or matter is –
• rendered or made available in an electronic form
• accessible so as to be usable for a subsequent reference

Section 6 states where any law provides for-
• the filing of any form, application or any other document with any office authority, body for agency owned or controlled by the appropriate Government in a particular manner
• the issue or grant of any licence, permit. Sanction or approval by whatever name called in a particular manner
• the receipt or payment of money in a particular manner, the, notwithstanding anything contained in any other law for the time being in force, such requirement shall be deemed to have been satisfied if such filing, issue, grant, receipt or payment, as the case be, is effected by means of such electronic form as may be prescribed by the appropriate Government.

The appropriate Government may, for the purposes of sub-section (1), by rules, prescribe-
• the manner and format in which such electronic records shall be filed, created or issued
• the manner or method of payment of any fee or charges for filing, creation or issue any electronic record clause (a).
7.7.4 Retention of Electronic Records
Where any law provides that documents, records or information shall be retained for any specific period, the, that requirement shall be deemed to have been satisfied if such documents, records or information are retained in the electronic form, if-
- the manner and format therein remains accessible so as to be usable for a subsequent reference
- the electronic record is retained in the format in which it was originally generated, sent or received or in a format which can be demonstrated to represent accurately the information originally generated, sent or received
- the details which will facilitate the identification of the origin, destination, date and time of dispatch or receipt of such electronic record

Provided that this clause does not apply to any information which is automatically generated solely for the purpose of enabling a record to be dispatched or received.

Nothing in this section shall apply to any law that expressly provides for the retention of documents, records or information in the form of electronic records.

7.7.5 Publication in Electronic Gazette
Where any law provides that any rule, regulation, order, bye-law, notification or any other matter shall be published in the Official Gazette, then, such requirement shall be deemed to have been satisfied if such rule, regulation, order, bye-law, notification or any other matter is published in the Official Gazette or Electronic Gazette.

Provided that where any rule, regulation, order, by-law, notification or any other matter is published in the Official Gazette or Electronic Gazette, the date of publication shall be deemed to be the date of the Gazette which was first published in any form.

7.7.6 Protected System
The appropriate Government may, by notification in the official gazette, declare that any computer, computer system or computer network to be a protected system.

The appropriate Government may, by order in writing, authorise the persons who are authorised to access protected systems notified under sub-section.

Any person who secures access or attempts to secure access to a protected system in contravention of the provisions of this section shall be punished with imprisonment of either description for a term which may extend to ten years and shall also be liable to fine.

7.7.7 Power of Central Government to Make Rules in respect Of Digital Signature
The Central Government may, for the purposes of this Act, by rules, prescribe
- the type of digital signature
- the manner and format in which the digital signature shall be affixed
- the manner or procedure which facilitates identification of the person affixing the digital signature
- control processes and procedures to ensure adequate integrity, security and confidentiality of electronic records or payments
- any other matter which is necessary to give legal effect to digital signatures.

7.8 Attribution, Acknowledgement and Despatch of Electronic Records
In this chapter of I.T. Act of 2000, under the heading “Attribution Acknowledgement and Despatch of Electronic Records, provisions have been made relating to attribution of electric records [Section 11], acknowledgement of receipt [Section 12] and time and place of despatch and receipt of re-electronic record [Section 13]. These sections are as follows
7.8.1 Attribution of Electronic Records [Sec11]
Section 11 states that an electronic record has to be attributed to the originator as of it was sent by him or by a person system programmed to operate on behalf of the originator.

Electronic record refers to the data, record or data generated, image or sound stored, received or sent in an electronic form or microfilm or computer generated micro fiche [Sec. 299(s)].

An electronic record shall be attributed to the originator
- if it was sent by the originator himself
- by a person who had the authority to act on behalf of the originator in respect of that electronic record
- by an information system programmed by or on behalf of the originator to operate automatically

7.8.2 Mode of Acknowledgement of Receipt [Sec12]
As per section 12, the addressee may acknowledge the receipt of the electronic record either in particular manner or form as desired by the originator and in the absence of such regimen, by communication of the acknowledge to the addresses or by any conduct that would sufficiently constitute acknowledgement [Sec. 12(1)].

7.8.3 Time and place of dispatch and receipt of electronic record [Sec13]
- Subject to the agreement between the originator and the addressee, the dispatch of an electronic record
- Subject to an agreement between the originator and the addressee, the time of receipt of an electronic record shall be determined as follows
  - if the addressee has designated a computer resource for the purpose of receiving electronic records
  - if the electronic record is sent to a computer resource along with specified timings, if any, receipt recurs when the electronic record enters the computer resource of addressee

An electronic record is deemed to be dispatched at the place where the originator has his place of business, and in deemed to be received at the place where addressee has his place of business.

7.9 Secure Electronic Records and Secure Digital Signatures
Security of electronic records and digital signatures is quiet necessary. Certain security procedure needs to be prescribed from that point of view. The provisions that are relating to these aspects have been made in Section 14, 15 and 16 of the I.T. Act, 2000 under the heading “Secure Electronic Records and Secure Digital Signatures”. These provisions are as follows

7.9.1 Secure Electronic Record [Sec14]
Section 14 states that where any security procedure has been applied to an electronic record at a specified point of time, then such record shall be considered to be a secure electronic record from such point of time to the point of verification.

7.9.2 Secure Digital Signature [Sec15]
If, by application of a security procedure agreed to by the parties concerned, it can be verified that a digital signature, at the time it was affixed.
- unique to the subscriber affixing it
- capable of identifying such subscriber
- created in a manner or using a means under the exclusive control of the subscriber and is linked to the electronic record to which it relates in such a manner that if the electronic record was altered the digital signature would be invalidated
Then such digital signature shall be deemed to be a secure digital signature.

### 7.9.3 Security Procedures [Sec16]

The Central Government shall for the purposes of this Act prescribe the security procedure having regard to commercial circumstances prevailing at the time when the procedure was used.

- the nature of the transaction
- the level of sophistication of the parties with reference to their technological capacity
- the volume of similar transactions engaged in by other parties
- the availability of alternatives offered to but rejected by any party
- the cost of alternative procedures, and
- the procedures in general use for similar types of transactions or communications

### 7.10 Regulation of Certifying Authorities

The IT Act, 2000 provides the regulations for the appointment of Certifying Authorities, their powers, functions and duties. The Central Government, by notification in the official gazette, appoints a Controller of Certifying Authorities. The controller discharges the functions under the Act, subject to the control and discretion of the Central Government. Deputy Controllers and Assistance Controllers would support the Controller as deemed necessary by Central Government.

#### 7.10.1 Appointment of the Controller of Certifying Authorities and Other Officers

- The Central Government may, by notification in the Official Gazette, appoint a Controller of Certifying Authorities for the purposes of this Act and may also by the same or subsequent notification appoint such number of Deputy Controllers and Assistant Controllers as it deems fit.
- The Controller shall discharge his functions under this Act subject to the general control and directions of the Central Government.
- The Deputy Controllers and Assistant Controllers shall perform the functions assigned to them by the Controller under the general superintendence and control of the Controller.
- The qualifications, experience and terms and conditions of service of Controller, Deputy Controllers and Assistant Controllers shall be such as may be prescribed by the Central Government.
- The Head Office and Branch Office of the office of the Controller shall be at such places as the Central Government may specify, and these may be established at such places as the Central Government may think fit.
- There shall be a seal of the Office of the Controller.

#### 7.10.2 Functions of the Controller of Certifying Authorities

The Controller may perform all or any of the following functions.

- exercising supervision over the activities of the Certifying Authorities
- certifying public keys of the Certifying Authorities
- laying down the standards to be maintained by the Certifying Authorities
- specifying the qualifications and experience which employees of the Certifying Authorities should possess
- specifying the conditions subject to which the Certifying Authorities shall conduct their business
- specifying the contents of written, printed or visual materials and advertisements that may be distributed or used in respect of a Digital Signature Certificate and the public key
- specifying the form and content of a Digital Signature Certificate and the key
- specifying the form and manner in which accounts shall be maintained by the Certifying Authorities
- specifying the terms and conditions subject to which auditors may be appointed and the remuneration to be paid to them
• facilitating the establishment of any electronic system by a Certifying Authority either solely or jointly with other Certifying Authorities and regulation of such systems
• specifying the manner in which the Certifying Authorities shall conduct their dealings with the subscribers
• resolving any conflict of interests between the Certifying Authorities and the subscribers
• laying down the duties of the Certifying Authorities
• maintaining a data base containing the disclosure record of every Certifying Authority containing such particulars as may be specified by regulations, which shall be accessible to public

7.10.3 Appointment of Certifying Authorities to Issue Digital Signature

Subject to the provisions of sub-section (2), any person may make an application to the Controller for a licence to issue Digital Signature Certificates.

No licence shall be issued under sub-section (1), unless the applicant fulfils such requirements with respect to qualification, expertise, manpower, financial resources and other infrastructure facilities, which are necessary to issue Digital Signature Certificates as may be prescribed by the Central Government.

A licence granted under this section shall
• be valid for such period as may be prescribed by the Central Government;
• not be transferable or heritable;
• be subject to such terms and conditions as may be specified by the regulations

7.10.4 Procedure to Issue Digital Signature Certificate

Every certifying authority has to follow certain procedures relating to security of system, in performance of its services.

The certifying authority has the following duties.
• To ensure that every person employed or otherwise engaged by it complies, in the course of his employment or engagement, with the provisions of the Act, rules, regulations and order made thereunder.
• To display its licence at a conspicuous place of the premises in which it carries on its business.
• To surrender the licence to the controller, immediately, after its suspension or revocation.
• To make reasonable efforts to notify any person who is likely to be affected by the occurrence of any event, which, in the opinion of the certifying authority may materially and adversely affect the integrity of its computer system or the conditions subject to which a Digital Signature Certificate has been granted. He may also act in accordance with the procedure specified in its ‘certification practice statement’ to deal with such event or situation.

7.11 Terms and Conditions of Licence to Issue Digital Signature Certificate

Every licence to issue Digital Signature Certificates shall be granted subject to terms and conditions set out in Regulation 3 of Information Technology (Certifying Authorities) Regulations, 2001

7.11.1 Issuance of Licence

The controller may, within four weeks from the date or receipt of the application after considering the documents accompanying the application and such other factors, as he may deem fit, grant or renew the license or reject the application.

Provided that in exceptional circumstances and for reasons to be recorded in writing, the period of four weeks may be extended to such period, not exceeding eight weeks in all as the Controller may deem fit.
If the application for licensed Certifying Authority is approved, the applicant shall
• submit a performance bond or furnish a banker’s guarantee within one month from the date of such approval
  to the Controller in accordance with sub-rule (2) of rule 8; and
• execute an agreement with the Controller binding himself to comply with the terms and conditions of the license
  and the provisions of the Act and the rules made thereunder

7.11.2 Validity of Licence
• A license shall be valid for a period of five years from the date of its issue.
• The license shall not be transferable [Rule 14].
• A license shall be subject to such terms and conditions as may be specified by the Regulations [Sec.21]
• Every Certifying Authority shall display its license at a conspicuous place of premises in which it carries on
  its business [Sec32].

7.11.3 Commencement of Operation by Licensed Certifying Authorities
The licensed Certifying Authority shall commence its commercial operation of generation and issue of Digital
Signature only after
• it has confirmed to the Controller the adoption of Certification Practice Statement;
• it has generated its key pair, namely, private and corresponding public key, and submitted the public key to the
  Controller
• the installed facilities and infrastructure associated with all functions of generation, issue and management of
  Digital Signature Certificate have been audited by the accredited auditor in accordance with the provisions of
  rule 31
• it has submitted the arrangement for cross certification with other licensed Certifying Authorities within India
  to the Controller

7.11.4 Renewal of Licence
An application for renewal of license shall be
• in such forms as may be prescribed by the Central Government
• in the form of electronic record subject to such requirements as the Controller may deem fit [Rule 16(3)]
• accompanies by such fees not exceeding Rs. 500 as may be prescribed by the Central, [Rule 12(2)]
• shall be made not less than 45 days before the date of expiry of the period of validity of the license [Sec.23
  and Rule 16]
• However, an application for the renewal of the license made after expiry of the license may be entertained on
  payment of such late fee, not exceeding Rs. 500.

7.11.5 Provisions of Sec 24 Relating to the procedure for Grant / Rejection of Licence
The Controller may, on receipt of an application under sub-section (1) of section 21, after considering the documents
accompanying the application and such other factors, as he deems fit, grant the licence or reject the application.

Provided that no application shall be rejected under this section unless the applicant has been given a reasonable
opportunity of presenting his case, the Controller may refuse to grant or renew a license if
• the applicant has not provided the Controller with such information relating to its business, and to any
  circumstance likely to affect its method of conducting business, as the Controller may require
• the applicant is in the course of being wound up or liquidated
• a receiver or manager has been appointed by the court in respect of the applicant
• the applicant or any trusted person has been convicted, whether in India or out of India, of an offence the conviction
for which involved a finding that the applicant or such trusted person acted fraudulently or dishonestly, or has
been convicted of an offence under the Act or these rules
• the controller has invoked performance bond or banker’s guarantee
• a certifying authority commits breach of or fails to observe and comply with the procedures and practices as per the certification practice statement
• a certifying authority fails to conduct, or does not submit the returns of the audit
• the audit report recommends that the certifying authority is not worthy of continuing certifying authority’s
operation
• a certifying authority fails to comply with the directions of the controller [Rule 18]

7.11.6 Revocation of Licence
The controller may revoke the license, if he is satisfied after making such inquiry as he may think fit, that a certifying
authority has
• made a statement in the application for issue or renewal of the license, which is incorrect or false in material
particulars
• fail to comply with the terms and conditions subject to which the license was granted
• failed to maintain the procedures and standards specified
• contravened any provision of this Act, rule, regulation, or order made thereunder

7.11.7 Suspension of Licence
• The Controller may, if he is satisfied after making such inquiry, as he may think fit, that a Certifying Authority
has,
  • made a statement in, or in relation to, the application for the issue or renewal of the licence, which is incorrect
or false in material particulars
  • failed to comply with the terms and conditions subject to which the licence was granted
  • failed to maintain the standards specified under clause (b) of sub-section (2) of section 20
  • contravened any provisions of this Act, rule, regulation or order made thereunder, revoke the licence
• Provided that no licence shall be revoked unless the Certifying Authority has been given a reasonable opportunity
of showing cause against the proposed revocation.
• The Controller may, if he has reasonable cause to believe that there is any ground for revoking a licence under
sub-section (1), by order suspend such licence pending the completion of any inquiry ordered by him:
• Provided that no licence shall be suspended for a period exceeding ten days unless the Certifying Authority has
been given a reasonable opportunity of showing cause against the proposed suspension.
• No Certifying Authority whose licence has been suspended shall issue any Digital Signature Certificate during
such suspension.

7.11.8 Notice of Suspension or Revocation of Licence
Where the licence of the Certifying Authority is suspended or revoked, the Controller shall publish notice of such
suspension or revocation, as the case may be, in the database maintained by him.

Where one or more repositories are specified, the Controller shall publish notices of such suspension or revocation, as
the case may be, in all such repositories:
• Provided that the data base containing the notice of such suspension or revocation, as the case may be, shall be
made available through a web site which shall be accessible round the clock:
• Provided further that the Controller may, if he considers necessary, publicise the contents of database in such
electronic or other media, as he may consider appropriate.
7.11.9 Surrender of Licence
Every certifying authority whose license is suspended or revoked shall immediately after such suspension or revocation, surrender the license to the controller. Where any certifying authority fails to surrender a license, the person in whose favour a license is issued, shall be guilty of an offence and shall be punished with imprisonment, which may extend up to six months or fine which may extend up to Rs. 10,000 or with both.

7.12 Powers of Controller of Certifying Authorities
In Sections 27, 28 and 29, certain important powers have been given to the controller of certifying authorities, which are given below.

Recognition of foreign certifying authorities [Section 19]
Subject to such conditions and restrictions as may be specified, by regulations, the Controller may, with the previous approval of the Central Government, and by notification in the Official Gazette, recognise any Certifying Authority as a Certifying Authority for the purposes of this Act. Where any Certifying Authority is recognised under sub-section (1), the Digital Signature Certificate issued by such Certifying Authority shall be valid for the purposes of this Act. The Controller may if he is satisfied that any Certifying Authority has contravened any of the conditions and restrictions subject to which it was granted recognition under sub-section (1), he may, for reasons to be recorded in writing, by notification in the Official Gazette, revoke such recognition.

Controller to act as Repository [Section 20]
The controller shall be the repository of all Digital Signature Certificates issued under this act. The controller shall

- make use of hardware, software and procedures that are secure from intrusion and misuse
- observe such other standards as may be prescribed by the central government to ensure that the secrecy and security of the digital signatures are assured. The controller shall maintain a computerised database of all public keys in such manner that such database and public key are available to any member of the public

To delegate [Section 27]
The controller, any, in writing, authorise the deputy controller, assistant controller or any officer to exercise any of the powers of the controller.

To investigate contraventions [Section 28]
The Controller or any officer authorised by him in this behalf shall take up for investigation any contravention of the provisions of this Act, rules or regulations made thereunder.

The controller or any officer authorised by him in this behalf shall exercise the like powers, which are conferred on Income-tax authorities under Chapter XIII of the Income-tax Act, 1961, (43 of 1961), and shall exercise such powers, subject to such limitations laid down under that Act.

Access to computers and data [Section 29]
Without prejudice to the provisions of sub-section (1) of section 68, the Controller or any person authorised by him shall, if he has reasonable cause to suspect that any contravention of the provisions of this Act, rules or regulations made thereunder their has been committed, have access to any computer system, any apparatus, data or any other material connected with such system, for the purpose of searching or causing a search to be made for obtaining any information or data contained in or data contained in or available to such computer system.

For the purposes of sub-section (1), the Controller or any person authorised by him may, by order, direct any person in charge of, or otherwise concerned with the operation of, the computer system, data apparatus or material, to provide him with such reasonable technical and other assistance as he may consider necessary.
To give directions [Section 68]
The Controller may, by order, direct a Certifying Authority or any employee of such Authority to take such measures or cease carrying on such activities as specified in the order if those are necessary to ensure compliance with the provisions of this Act, rules or any regulations made thereunder.

Any person who fails to comply with any order under sub-section (1) shall be guilty of an offence and shall be liable on conviction to imprisonment for a term not exceeding three years or to a fine not exceeding two lakhs rupees or to both.

To direct any agency to intercept any information [Section 69]
If the Controller is satisfied that it is necessary or expedient so to do in the interest of the sovereignty or integrity of India, the security of the State, friendly relations with foreign States or public order or for preventing incitement to the commission of any cognisable offence, for reasons to be recorded in writing, by order, direct any agency of the Government to intercept any information transmitted through any computer resource.

The subscriber or any person in charge of the computer resource shall, when called upon by any agency which has been directed under sub-section (1), extend all facilities and technical assistance to decrypt the information. The subscriber or any person who fails to assist the agency referred to in sub-section (2) shall be punished with an imprisonment for a term which may extend to seven years.

7.13 Duties and Responsibilities of Certifying Authority
Important duties and responsibilities of certifying authority are mentioned in this topic and are also included in the Rules of the I.T. (C.A.) Rules of 2000. These duties and responsibilities are given below.

7.13.1 The Need for a Certification Authority
People use public keys to verify signatures or encrypt messages. For a public key cryptography system to function, an independent trusted third party is needed to authorise people’s name and addresses with their public keys and sign the bundle with its own private key. Such parties are called Certification Authorities (CA).

7.13.2 Duties of Certifying Authorities
The certifying authority has the following duties
- every Certifying Authority shall ensure that every person employed or otherwise engaged by it complies, in the course of his employment or engagement, with the provisions of this Act, rules, regulations and orders made thereunder
- every Certifying Authority shall display its licence at a conspicuous place of the premises in which it carries on its business
- to surrender the license to the controller, immediately after its suspension or revocation
- to make reasonable efforts to notify any person who is likely to be affected by that occurrence of any event, which, in the opinion of the certifying authority, may materially and adversely affect the integrity of its computer system or the conditions subject to which a Digital Signature Certificate has been granted. He may also act in accordance with the procedure specified in its ‘certification practice statement’ to deal with such event or situation.

7.13.3 Certification Practice Statement
Certification Practice Statement is a statement issued by the certifying authority specifying the practices it would employ while issuing digital signature certificates.

7.13.4 Display of License
Every certifying authority shall display its license at a conspicuous place of the premises in which it carries on its business.
7.13.5 Surrender of License

- Every Certifying Authority whose licence is suspended or revoked shall immediately after such suspension or revocation, surrender the licence to the Controller.
- Where any Certifying Authority fails to surrender a licence under sub-section (1), the person in whose favour a licence is issued, shall be guilty of an offence and shall be punished with imprisonment which may extend up to six months or a fine which may extend up to ten thousand rupees or with both.

7.13.6 Service Charges

The service providers may be authorised by the central government or the state government to set up, maintain and upgrade the computerised facilities and also collect appropriate service charges for providing such services at such scale as may be specified by the central government or the state government.

7.14 Digital Signature Certificates

A digital signature authenticates electronic documents in a similar manner a handwritten signature authenticates printed documents. This signature cannot be forged and it asserts that a named person wrote or otherwise agreed to the document to which the signature is attached. The recipient of a digitally signed message can verify that the message originated from the person whose signature is attached to the document and that the message has not been altered either intentionally or accidentally since it was signed. Also, the signer of a document cannot later disown it by claiming that the signature was forged. In other words, digital signatures enable the “authentication” and “non-repudiation” of digital messages, assuring the recipient of a digital message of both the identity of the sender and the integrity of the message.

A digital signature is issued by a Certification Authority (CA) and is signed with the CA’s private key. A digital signature typically contains the: Owner’s public key, the Owner’s name, Expiration date of the public key, the Name of the issuer (the CA that issued the Digital ID), Serial number of the digital signature, and the digital signature of the issuer. Digital signatures deploy the Public Key Infrastructure (PKI) technology.

If the user files electronically using digital signature he does not have to submit a physical copy of the return. Even if he does not have a digital signature, he can still e-File the returns. However, he must also physically submit the printed copy of the filled up Form along with the copy of the Provisional Acknowledgement Number of his e-Return

7.14.1 Procedure to be Followed by Certifying Authorities to Issue Digital Signature Certificates

Every certifying authority has to follow certain procedures relating to security of system in performance of its services.

- every certifying authority shall make use of hardware, software and procedures that are secure from intrusion and misuse
- it has to provide a reasonable level of reliability in its services, which are reasonably suited to the performance of intended functions
- the certifying authority has to ensure that the security and secrecy of the digital signatures are assured
- the certifying authority has to observe such standards as may be specified by the information technology regulations
- digital signature certificate shall be granted after the certifying authority is satisfied that
  - the applicant holds the private key corresponding to the public key to be listed in the digital signature certificate
  - the applicant holds a private key, which is capable of creating a digital signature
  - the public key to be listed in the certificate can be used to verify a digital signature affixed by the private key held by the applicant
- a certifying authority, while issuing a digital signature certificate, shall certify that
  - it has complied with the provisions of this Act and the rules and regulations made thereunder
it has published the digital signature certificate or otherwise made it available to such person relying on it and the subscriber has accepted it

- the subscriber holds the private key corresponding to the public key, listed in the Digital Signature Certificate

- the subscriber’s public key and private key constitute a functioning key pair

- the information contained in the Digital Signature Certificate is accurate

- it has no knowledge of any material fact, which if it had been included in the Digital Signature Certificate would adversely affect the reliability of the representations made in clause (a) to (d)

### 7.15 Duties of Subscribers

The duties of the subscribers, while availing digital signature certificate, are as under.

**Generating key pair**

Where any Digital Signature Certificate, the public key of which corresponds to the private key of that subscriber which is to be listed in the Digital Signature Certificate has been accepted by a subscriber, then, the subscriber shall generate the key pair by applying the security procedure.

**Acceptance of Digital Signature Certificate.**

A subscriber shall be deemed to have accepted a Digital Signature Certificate if he publishes or authorises the publication of a Digital Signature Certificate

- to one or more persons

- in a repository, or otherwise demonstrates his approval of the Digital Signature Certificate in any manner.

By accepting a Digital Signature Certificate the subscriber certifies to all who reasonably rely on the information contained in the Digital Signature Certificate that

- the subscriber holds the private key corresponding to the public key listed in the Digital Signature Certificate and is entitled to hold the same

- all representations made by the subscriber to the Certifying Authority and all material relevant to the information contained in the Digital Signature Certificate are true

- all information in the Digital Signature Certificate that is within the knowledge of the subscriber is true.

**Control of private key**

- Every subscriber shall exercise reasonable care to retain control of the private key corresponding to the public key listed in his Digital Signature Certificate and take all steps to prevent its disclosure to a person not authorised to affix the digital signature of the subscriber.

- If the private key corresponding to the public key listed in the Digital Signature Certificate has been compromised, then, the subscriber shall communicate the same without any delay to the Certifying Authority in such manner as may be specified by the regulations.

- Explanation - For the removal of doubts, it is hereby declared that the subscriber shall be liable till he has informed the Certifying Authority that the private key has been compromised.
7.16 Penalties and Adjudication

The provisions relating to penalties, adjudication are given in Sections 43 to 47 of the I.T. Act, 2000 under the heading ‘Penalties and Adjudication’.

7.16.1 Penalty for Damage to Computer, Computer System, etc.

If any person without permission of the owner or any other person who is in charge of a computer, computer system or computer network

- accesses or secures access to such computer, computer system or computer network
- downloads, copies or extracts any data, computer data base or information from such computer, computer system or computer network including information or data held or stored in any removable storage medium
- introduces or causes to be introduced any computer contaminant or computer virus into any computer, computer system or computer network
- damages or causes to be damaged any computer, computer system or computer network, data, computer data base or any other programmes residing in such computer, computer system or computer network
- disrupts or causes disruption of any computer, computer system or computer network
- denies or causes the denial of access to any person authorised to access any computer, computer system or computer network by any means
- provides any assistance to any person to facilitate access to a computer, computer system or computer network in contravention of the provisions of this Act, rules or regulations made thereunder
- charges the services availed of by a person to the account of another person by tampering with or manipulating any computer, computer system, or computer network, he shall be liable to pay damages by way of compensation not exceeding one crore rupees to the person so affected.

7.16.2 Penalty for Failure to Furnish Information Return, etc.

If any person who is required under this Act or any rules or regulations made thereunder to

- furnish any document, return or report to the Controller or the Certifying Authority fails to furnish the same, he shall be liable to a penalty not exceeding one lakh and fifty thousand rupees for each such failure
- file any return or furnish any information, books or other documents within the time specified therefore in the regulations fails to file return or furnish the same within the time specified therefore in the regulations, he shall be liable to a penalty not exceeding five thousand rupees for every day during which such failure continues
- maintain books of account or records, fails to maintain the same, he shall be liable to a penalty not exceeding ten thousand rupees for every day during which the failure continues.

7.16.3 Residuary Penalty

Whoever contravenes any rules or regulations made under this Act, for the contravention of which no penalty has been separately provided, shall be liable to pay a compensation not exceeding twenty-five thousand rupees to the person affected by such contravention or a penalty not exceeding twenty-five thousand rupees.

7.16.4 Power to Adjudicate

The power to adjudicate is explained below.

- for the purpose of adjudging under this Chapter whether any person has committed a contravention of any of the provisions of this Act or of any rule, regulation, direction or order made thereunder the Central Government shall, subject to the provisions of sub-section (3), appoint any officer not below the rank of a Director to the Government of India or an equivalent officer of a State Government to be an adjudicating officer for holding an inquiry in the manner prescribed by the Central Government
- the adjudicating officer shall, after giving the person referred to in sub-section (1) a reasonable opportunity for making representation in the matter and if, on such inquiry, he is satisfied that the person has committed the contravention, he may impose such penalty or award such compensation as he thinks fit in accordance with the provisions of that section.
• No person shall be appointed as an adjudicating officer unless he possesses such experience in the field of Information Technology and legal or judicial experience as may be prescribed by the Central Government.
• Where more than one adjudicating officers are appointed, the Central Government shall specify by order the matters and places with respect to which such officers shall exercise their jurisdiction.
• Every adjudicating officer shall have the powers of a civil court which are conferred on the Cyber Appellate Tribunal under sub-section (2) of section 58,
  • all proceedings before it shall be deemed to be judicial proceedings within the meaning of sections 193 and 228 of the Indian Penal Code
  • shall be deemed to be a civil court for the purposes of sections 345 and 346 of the Code of Criminal Procedure, 1973.

7.16.5 Factors to be Taken into Account by the Adjudicating Officer
While adjudging the quantum of compensation under this Chapter, the adjudicating officer shall have due regard to the following factors, namely
• the amount of gain of unfair advantage, wherever quantifiable, made as a result of the default
• the amount of loss caused to any person as a result of the default
• the repetitive nature of the default

7.17 Offences under I.T. Act
Where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of business of the company as well as the company, shall be guilty of the contravention and shall be liable to be proceeded against and punished accordingly:
Provided that nothing contained in this sub-section shall render any such person liable to punishment if he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent such contravention.

Notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

7.18 Miscellaneous Provisions of the I.T. Act

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
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<tbody>
<tr>
<td>Section-80</td>
<td>says any police officer, not below the rank of a deputy superintendent of police, or any other officer of the central government or a state government authorised by the central government in this behalf may enter any public place and search and arrest without warrant any person found therein who is reasonably suspected or having committed or of committing or of being about to commit any offence under this Act.</td>
</tr>
<tr>
<td>Section-81</td>
<td>enumerates that this act shall have overriding effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.</td>
</tr>
<tr>
<td>Section-82</td>
<td>declares that Controller, Deputy Collector and Assistant Controllers to be public servants.- The Presiding Officer and other officers and employees of a Cyber Appellate Tribunal, the Controller, the Deputy Controller and the Assistant Controllers shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860 ).</td>
</tr>
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</table>
**Legal Aspects of Business**

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
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<tbody>
<tr>
<td>83</td>
<td>empowers the Central Government to give directions to any State Government as to the carrying into execution in the State of any of the provisions of this Act or of any rule, regulation or order made thereunder.</td>
</tr>
<tr>
<td>84</td>
<td>provides that no suit, prosecution or other legal proceeding shall lie against the Central Government, the State Government, the Controller or any person acting on behalf of him, the Presiding Officer, adjudicating officer and the staff of the Cyber Appellate Tribunal for anything which is in good faith done or intended to be done in pursuance of this Act or any rule, regulation or order made thereunder.</td>
</tr>
<tr>
<td>85</td>
<td>makes a specific provision in the case of companies</td>
</tr>
<tr>
<td>86</td>
<td>empowers the Central Government to make provisions when the difficulty arises in giving affect to the provision of the act</td>
</tr>
<tr>
<td>87</td>
<td>provides power of Central Government to make rules under the act</td>
</tr>
<tr>
<td>88</td>
<td>provides for constitutions of the cyber regulation advisory committee</td>
</tr>
<tr>
<td>89</td>
<td>empowers the Controller to make regulations under the act</td>
</tr>
<tr>
<td>90</td>
<td>empowers the State Government to make rules</td>
</tr>
<tr>
<td>91 to 94</td>
<td>provides for the amendment of the Indian Penal Code 1860, the Indian Evidence Act 1872, the Banker’s Books Evidences Act 1891 and the Reserve Bank of India Act 1934.</td>
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</tbody>
</table>

**Table 7.2 Provisions of the I.T. Act**

### 7.19 Drawbacks of the Act

Information Technology Act came into existence in order to alleviate certain problems arising out of communication over computer network. Accordingly, Evidence Act of 1872 and Indian Penal Code, 1860 have been amended. Also, Banker’s Book Evidence Act, 1891 has been duly amended in order to facilitate admissibility and collection of evidences needed to fight electronic crimes. Hence, the legislature has performed its role by adopting the up coming technology into the statue book. After the adoption of Information Technology Act, 2000, contract and business has become easier and faster. The Information Technology Act has achieved greater importance after proliferation of information technology using services like e-commerce, e-governance and e-transactions, implementation of security practices and procedures relating to the applications of electronic communications and protection of personal data and information.

Due to rapid increase in the computer and internet usage, new forms of crimes like video voyeurism, publishing sexually explicit materials in electronic form and breach of confidentiality as well as leakage of data through intermediary, e-commerce frauds like personation, which is commonly known as phishing, identity theft and offensive messages through communication services. Hence, penal provisions are provided in the Information Technology Act, the Indian Evidence Act, the Indian Penal Code and the Code of Criminal Procedure in order to prevent the above mentioned crimes.

### Inapplicability

The first and foremost setback is that the provisions of the act does not apply to the following

- a negotiable instrument as defined in section 13 of the Negotiable Instruments Act, 1881
- power of attorney as defined in section 1A of the Powers-of-Attorney Act, 1882
- a trust as defined in section 3 of the Indian Trusts Act, 1882
- a will as defined in section(h) of section 2 of the Indian Succession Act, 1925, including any other testamentary disposition by whatever more called
- any contract for the sale or conveyance of immovable property or any interest in such property
It is envisaged that the efficacy of the act may not be considerable owing to its restrictive applicability.

**No intellectual property rights protection guaranteed**
The act deals with the commercial and criminal areas of law as affected information technology and, does not deal with certain other issues, such as intellectual property rights, particularly copyright on the internet. The act does not discuss the implications of any copyright violations over the net. It has no provisions to penalise copyright infringers for their activities over the net. Internet privacy is a major problem has not been tackled by this act.

**Digital signatures**
Act deal only with public key infrastructure (PKI) framework for authentication, it does not recognise any other authentication procedure though the ambit of legal record is wide. This may cause problems for e-commerce transactions that may not necessarily use the public key infrastructure system for authentication and security purpose.

**Qualification and powers of adjudicating unclear**
The Act is unclear as to the qualifications of an adjudicating officer and the manner in which he shall adjudicate.

The Act does not indicate the powers of the adjudicating officers when a person commits a cyber crime or violates any provisions of the law from outside India. The Act does not lay down any provisions where by extradition treaties can be formed with countries where the cyber criminal is located.

- The Information Technology Act 2000 is silent as regards taxation of goods and services traded through e-commerce.
- The Information Technology Act makes no provision for jurisdictional aspects of electronic controls, i.e., jurisdictional of courts and tax authorities
- No provision has been made for payment of stamp duty on electronic documents

**Misuse of police powers**
The search arrest powers given to Police Officers are without any definite guidelines and may be ill used. However, if the Act did give the Police Department Powers to enter people’s houses without search warrants, it would amount to an invasion of the right to privacy and create pandemonium. Keeping this in mind, the legislature has tried to balance this provision so as to serve the ends of justice and at the same time, avoid any chaos.

On being arrested, the accused person must, without any necessary delay, be taken or sent to the magistrate having jurisdiction or to the officer-in-charge of a police station. The provisions of the Code of Criminal Procedure, 1973 shall apply in relation to any entry search or arrest made by police officer.

**Possible violation of fundamentals rights**
The provision that no order of the Central Government appointing any person as the presiding officer of a CRAT shall be called into question in any manner and no act or procedure before a CRAT shall be called into question in any manner merely because there is a defect in the constitution of the CRAT may violate the fundamental rights of citizens under the Constitution of India. This provision could be misused by the Central Government in an unfair and arbitrary manner. It is recommended that is provision be modified so that the interests of the public at large are safeguarded.

**Qualification and powers of adjudicating officers unclear**
The Act is unclear as to the qualifications of an adjudicating officer and the manner in which he shall adjudicate.

Moreover, though the statute is supposedly a ‘long arm statute’, it does not indicate the powers of the adjudicating officers when a person commits a cyber crime or violates any provisions of the law from outside India. Several practical difficulties may also arise in importing the cyber criminal to India. The Act does not lay down any provisions whereby extradition treaties can be formed with countries where the cyber criminal is located. Therefore, the extra-territorial scope of the Act may be difficult to achieve.
Furthermore, the powers to impose a penalty for a computer crime up to Rs. 1 crore offers a large discretion to adjudicating officers and may turn out to be harmful.

**ISP liability – responsibility for content regulation not attributable**
While Section 78 absolves a network service provider of its liability if it can prove its ignorance and due diligence, it fails to specify as to who would be held liable for such contravention in such an event. This provision will certainly cause problems when an offence regarding third party information or provision of data is committed.
Summary

• Information Technology Act has become important because computer related wrongs know no boundaries.
• The IT Act has introduced certain new concepts such as “digital signature” and “e-governance”
• The Act gives legal recognition to the electronic records and treats it at par with the paper based system if all the safeguards are followed.
• The act has helped in the electronic filing of documents at the Government agencies.
• The Act is an alternative to the conventional paper based methods of communication and storage of information.
• It helps in providing legal recognition to the digital signatures as well as electronic records, which facilitates e-commerce.
• After the adoption of Information Technology Act, 2000, contract and business has become easier and faster.
• The Information Technology Act has achieved greater importance after proliferation of information technology using services like e-commerce, e-governance and e-transactions, implementation of security practices and procedures relating to the applications of electronic communications and protection of personal data and information.
• The Act is applicable to whole of India. The Act is also applicable to any offence that is committed outside India by any person.
• The whole system creates a hierarchy in which at the top of is the Controller of Certifying Authorities who has the power to appoint Certifying Authorities and grant them the licence to issue Digital Signature Certificates.
• Verification of genuineness of digital signatures which ultimately can be verified by the Controller of Certifying Authorities who under the Act is the highest authority for digital signatures and related matters.
• Digital signature is authentication of any electronic record by a subscriber by means of an electronic method or procedure in accordance with the provisions of section 3.
• Encryption and decryption is done through software. This software is called Public Key and Private Key. Private Key is kept secret and the Public Key is made public.
• The process of digital signature involves the converting electronic record into secret code first, and then translating the codes into a small number by applying a formula.
• Digital signature certificate is issued to a subscriber through his application to Certifying Authority and by following the required procedures.

References

Recommended Reading

- Sharma., V. *Information Technology Law and Practice.*, Universal Law Publishing.
Self Assessment

1. Asymmetric crypto system means a system of a secure key pair consisting of a _________ key for creating a digital signature and a public key to verify the digital signature.
   a. private
   b. public
   c. split
   d. verified

2. Certifying Authority means a person who has been granted a licence to issue a Digital Signature Certificate under section 24.
   a. denied
   b. revoked
   c. granted
   d. annulled

3. Certification practice statement means a statement issued by a __________ Authority to specify the practices that the Certifying Authority employs in issuing Digital Signature Certificates.
   a. Verifying
   b. Certifying
   c. Supreme
   d. Hierarchical

4. Security procedure means the security procedure prescribed under section 16 by the __________ Government.
   a. State
   b. Authorised
   c. Ruling
   d. Central

5. Public key means the key of a key pair used to _________ a digital signature and listed in the Digital Signature Certificate.
   a. reject
   b. verify
   c. invoke
   d. create

6. Which of the following is false?
   a. Secure system means computer hardware, software, and procedure that are reasonably secure from unauthorised access and misuse
   b. Secure system means computer hardware, software, and procedure that provide a reasonable level of reliability and correct operation
   c. Secure system means computer hardware, software, and procedure that are reasonably unsuitable for performing the intended functions
   d. Secure system means computer hardware, software, and procedure that adhere to generally accepted security procedures
7. Private Key means the key of a key pair used to create a ____________ signature.
   a. digital
   b. original
   c. verified
   d. rejected

8. Key pair, in an asymmetric crypto system, means a private key and its mathematically related public key, which are so related that the public key can verify a digital signature created by the ____________.
   a. authorised officer
   b. digital signature
   c. electronic form
   d. private key

9. Cyber Appellate Tribunal means the Cyber ____________ Appellate Tribunal established under subsection (1) of section 48.
   a. Rules
   b. Regulations
   c. Methods
   d. Operations

10. Match the following:

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<table>
<thead>
<tr>
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<tbody>
<tr>
<td>1. Electronic form</td>
<td>A. means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche</td>
</tr>
<tr>
<td>2. Electronic Gazette</td>
<td>B. the Official Gazette published in the electronic form</td>
</tr>
<tr>
<td>3. Electronic record</td>
<td>C. a computer program version of a paper form</td>
</tr>
<tr>
<td>4. Electronic message</td>
<td>D. any information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film, computer generated micro fiche or similar device</td>
</tr>
</tbody>
</table>

   a. 1-C, 2-D, 3-A, 4-B
   b. 1-D, 2-B, 3-A, 4-C
   c. 1-A, 2-C, 3-D, 4-B
   d. 1-B, 2-A, 3-C, 4-D
Chapter VIII

The Patents Act, 1970

Aim

The aim of this chapter is to:

- introduce the Patents Act, 1970
- enlist the rights of the patentee
- highlight the salient features of the Indian Copyright Act, 1957 and Designs Act, 2000

Objectives

The objectives of this chapter are to:

- elucidate the meaning and developments in intellectual property
- explain the provisions of the various legislations (acts) covering the IPR
- identify the terms and conditions applicable for various Acts

Learning outcome

At the end of this chapter, you will be able to:

- understand the provisions of the Patents Act, 1970
- distinguish between Patent and Copyright Act
8.1 Introduction

The term ‘Patent’ is defined as a monopoly right, which is granted to a person who has invented a new and useful article, or an improvement of existing article, or a new process of making an article.

- It consists of an exclusive right to manufacture the new invented article or manufacture an article according to the invented process for a limited period. Inventions that consist of products or new alloy is called product invention and the corresponding patent to this is referred to as ‘product patent’. Whereas, inventions that consist of process or processes of making a known or new alloy is a process invention and patent for this is called a ‘process patent’. This Act is only provided for process patent and for product like food, pharmaceutical and chemicals, the inventors were granted only EMR (exclusive marketing rights).

- Examples of particular species of patents for inventions include biological patents, business method patents, chemical patents and software patents.

- Some other types of intellectual property rights are referred to as patents. In some jurisdictions, industrial design rights are called design patents in some jurisdictions (they protect the visual design of objects that are not purely utilitarian)

- Patent right is obtained by applying to the proper authority under the Act and is registered for a certain period.

The main provisions of the Act:

- The Controller General of Patents, Designs and Trade Marks appointed under the Trade and Merchandise Marks Act, 1958, shall be the Controller of Patents for the purposes of this Act. Also, there shall be a ‘patent office’ for the purpose of facilitating the registration of patents at such places as the Central Government may specify.

- There shall be kept at the patent office; a ‘register of patents’ wherein shall be entered

  - The names and addresses of grantees of patents;
  - Notifications of assignments, extensions, and revocations of patents; and
  - Particulars of such other matters affecting the validity or proprietorship of patents as may be prescribed.

8.1.1 Meaning of “Property’ and ‘Intellectual Property’

As a matter of fact, the concept of ‘Property’ has undergone sweeping changes from ancient time to modern days. In the early period, property was understood as property of tangible nature only, example, animals, money, buildings, goods etc. i.e. moveable or immovable property. The other way of classifying property is corporeal property and incorporeal property or tangible property and intangible property. Corporeal property indicates the material, tangible things owned by the human beings, organisations, associations etc. They are the physical objects and hence they are perceptible by touch. On the other hand, incorporeal property is intangible which can be a subject matter of right. Such property does not have a physical existence and hence cannot be perceived by touch. From this point of view, actionable claims, goodwill, easementary rights, intellectual property rights such as patents, copyrights, trademarks etc. are considered as ‘Intangible or Incorporeal property’

‘Intellectual property’ as a type or a form of property has come into existence in recent times and its importance is great and is growing. In fact, intellectual property is a right pervading some material object. The intangible products of a man’s brain are as valuable as his land, building, goods, money, belongings etc. It is quite different from real property or a formal property. In fiction, it is property. Hence, it is called as intellectual property. The rights relating to the intellectual property are recognised by law as the subject matter of rights of various intangible or immaterial products like human intelligence, skills and labour. In short, it can be said that intellectual property is basically a creation of intellect or relates to intellect. It is a right pervaded in some property of real nature, and as such it is only a property in fiction or a fictional property example, patent rights, copyrights, design rights etc.

From the following important attributes of intellectual property, you will come to know the nature of intellectual property.

- Intellectual property is only a property in fiction or fictional property and not a real property though it is pervading some real property. It cannot be perceived by touch.
• Intellectual property includes the rights relating to scientific discoveries, industrial designs, trade marks, service marks, literary, artistic and scientific works and all other rights resulting from intellectual activity in the industrial scientific, literary or artistic field.

• Intellectual property rights are legal rights governing the use of creations of the human mind. Legal protection is granted to the owner or creator of the intellectual property under different Acts such as Patents Act, Trade Marks Act etc.

• Intellectual property can be divided mainly into four kinds or types, i.e, Patent Right, Copy Right, Trade Marks Right and Design Right.

• Intellectual property rights are protected under related Acts,

• The owner of an intellectual property can earn income by selling the rights or using the same. Such rights can be confined or extended to some prescribed period according to the provisions of the related Acts.

8.1.2 Intellectual Property Rights
The term ‘Intellectual Property Rights’ means the exclusive right that the owner has over his intellectual property, within the limits of the law, to use and enjoy it in the same way as the owner of other kinds of properties, movable or immovable. Nobody else can use intellectual property without the consent of the owner of the property. The rights are granted by the state under the relevant Acts for the period specified therein. Intellectual Property Rights (IPR) broadly include: Patents, Copyrights, Trademarks, Industrial Designs, Geographical Indications, Layout Design of Integrated Circuits, Protection of Undisclosed Information (Trade Secrets), Protection of Plant Varieties and Farmers’ Rights.

IPR comprise the legal rights that are granted to a person for any creative and artistic work, for any invention or discovery, or for any literary work or words, phrases and symbols or designs for a stipulated period of time. The owners of Intellectual Property are granted certain exclusive rights through which they use their property without any disturbance and can prevent the misuse of their property. Intellectual property is any innovation, commercial or artistic, or any unique name, symbol, logo or design used commercially.

In India, Intellectual Property is governed under the Patents Act, 1970; Trademarks Act, 1999; Copyright Act, 1957; Designs Act, 2001, etc. The various kinds of intellectual properties are Patents, Trademarks, Copyrights, Trade Secrets, Industrial Designs, Lay out Designs of Integrated Circuits and Geographical Indications. The core area dealt with in this article lies at Patents, Trademarks and Copyright. Patents protect the inventions, Trademarks prevent the infringement of the marks or the logos under which the business is carried on or the goods are manufactured or sold and Copyright grants protection to the authors of original work which can be artistic, literary, dramatic or musical.

The legislations which cover IPR in India are:
• The Patents Act, 1970 (last amended in 2005).
• The Designs Act, 2000 which superseded the earlier Designs Act of 1911.
• The Trademarks Act, 1999 which superseded the earlier Trade and Merchandise Marks Act, 1958. (The Merchandise Marks Act of 1958 is yet to be enforced).
• The Copyright Act, 1957 (last amended in 1999).

For ‘Protection of Undisclosed Information’ no specific legislation exists and the subject is generally covered under relevant national laws like the Indian Contract Act, 1889).

The Protection of Plant varieties and Farmer’ Rights, 2001
8.2 The Patents Act, 1970

Patent system in India is administered under the superintendence of the Controller General of Patents, Designs, Trademarks and Geographical Indications. The Office of the Controller General functions under the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry. The Controller General directs and supervises the functioning of the Patent Office and the Patent Information System (PIS). The Patent Office performs the statutory duties in connection with the grant of patents for new inventions under the Patents Act. The Head Office of Patents is at Kolkata with branches at Mumbai, Chennai and Delhi. The branches deal with the applications for patents originating within their respective territorial jurisdiction. The Patent Information System (PIS) at Nagpur has been functioning as patent information base for the users. The PIS maintains a comprehensive collection of patent specification and patent related literature, on a world-wide basis and provides technological information contained in patent or patent related literature through search services and patent copy supply services to various users of R&D establishments, Government offices, private industries, business, inventors and other users within India.

Final changes to Indian patent law were made for compliance with India’s obligations under the Trade Related Intellectual Property Systems (TRIPS) Agreement. Pharmaceutical products and not just processes are now patentable subject matter while computer software is not patentable subject matter even when there is technical application for industry and/or it is embedded in hardware. An old repealed law has been revived which prohibits anyone resident in India from filing for a patent outside of India unless they first file for the same invention in India or they obtain the Controller’s permission to do so six weeks in advance. A Traditional Knowledge Digital Library is being compiled to document centuries-old healing remedies and medical treatments in order to prevent patenting of ancient indigenous practices and techniques.

By joining the World Trade Organisation, India became obligated to comply with the TRIPS Agreement by January 1, 1995. Extensive changes would be required to the Indian patent system in order to comply, including the addition of products as well as the existing processes to patentable subject matter in all fields of technology.


A brief analysis of the same is mentioned below:-
At the very end of the ten-year transition period, changes were finally made to the Indian patent law for compliance with India’s obligations under the TRIPS Agreement. The changes implemented in the Patents (Amendments) Act 2005 have been highly controversial in India, were previously pharmaceutical products were not patentable subject matter, only the process of making a pharmaceutical product could be protected by patent. Because pharmaceutical products were not protected by patent law, Indian companies developed alternate processes to make the pharmaceutical products that were patented in other countries, thus establishing a large thriving generic drug industry in India. Intense political pressure necessitated a dramatic last minute presidential decree instituted on January 1, 2005 in order to comply just in time for the World Trade Organisation deadline.

- The subsequent political debate was extremely heated, resulting in protests, walkouts by members of parliament, and in the end numerous amendments to the highly controversial bill were enacted. The amendments included: tightened standards for the granting of patents; restoration of procedures for opposing patents; introduction of protection for existing producers of 1995-2005 medicines; the allowance of parallel importation; limitations on the negotiation of voluntary licenses; and, the expansion of rights to export post-1995 generic medicines produced according to provisions contained in the compulsory licenses.
- India was required to collect drug product patent applications filed between 1995 and 2005, and to begin their examination when the new law is in place. There is a backlog of approximately 8,000 such drug products patent applications being dealt with at the Indian Patent Office.
The final implications and effects of the changes to the Indian patent law are still unfolding, with details and their implications only slowly becoming clear. Much about the new patent law remains uncertain and probably will remain so until tested in the courts, including significant ambiguities relating to patentability, and somewhat vague provisions for compulsory licensing. What is clear now is that software, even embedded software is out while drugs are in as patentable subject matter.

The period for filing a request for examination has been increased from 36 months to 48 months from the date of earliest priority or date of filing of the application, whichever is earlier.

The time to amend an application to place it in condition for grant has been increased from 6 months to 9 months and can be extended to 12 months. This applies only to cases that will be examined after the rules came into effect.

The new Act provides for expedited prosecution of a patent application wherein a patent may be granted within a period of just six to nine months. To provide an opportunity of any third party to submit objections, no patent shall be granted until six months from the date of publication of the application. The time for completion of formalities has been increased from 3 months to 6 months and may be extended further if required.

Previously there was no requirement for when an application was to be referred to the examiner once the request for examination had been filed. Now, once a request for examination is filed the application must be referred to the Examiner within 30 days from the date of request.

Previously the mere discovery of any new property or new use of a known substance or the mere use of a known process, machine or apparatus was non-patentable unless the known process resulted in a new product or employs at least one new reactant.

The Ordinance now clarifies non-patentability of new uses of known substances by adding that an apparent or obvious new use of a known substance will not be an invention.

When a patent application has been published before it is granted, any person may in writing represent to the Controller against the grant on grounds of lack of patentability including novelty, inventive step and industrial applicability or nondisclosure, or wrongful disclosure of source and geographical origin of biological material used in the invention and anticipation of invention by the knowledge oral or otherwise, available within any local or indigenous community in India or elsewhere.

The Controller is then required to consider and dispose of the representation within a prescribed period through an ex-parte proceeding.

Cross border compulsory licensing in implemented to enable the manufacture as well as export of patented pharmaceutical products to any country having insufficient or no manufacturing capacity in the pharmaceutical field to address public health problems provided a compulsory license has been granted by that country. ‘Pharmaceutical product’ means any patented product or product manufactured through a patented process and includes diagnostic kits.

8.2.1 Application of Patent

An application for a patent for an invention may be made by any of the following persons:

- By any person claiming to be the true and first inventor of the invention;
- By any person being the assignee of the person claiming to be the true and first inventor in respect of the right to make such an application;
- By the legal representative of any deceased person who immediately before his death was entitled to make such an application.

The following are not inventions within the meaning of this Act:

- An invention which is frivolous or which claims anything obvious contrary to well established natural laws;
- An invention; the primary or intended use of which would be contrary to law or morality or injurious to public health;
- The mere discovery of a scientific principle or the formulation of an abstract theory;
• The mere discovery of any new property of new use for a known substance or of the mere use of a known process, machine or apparatus unless such known process results in a new product or employs at least one new reactant;
• A substance obtained by a mere admixture resulting only in the aggregation of the properties of the components thereof or a process for producing such substance;
• The mere arrangement or re-arrangement or duplication of known devices each functioning independently of one another in a known way;
• A method or process of testing applicable during the process of manufacture for rendering the machine, apparatus or other equipment more efficient or for the improvement or restoration of the existing machine, apparatus or other equipment or for the improvement or control of manufacture;
• A method of agriculture or horticulture;
• Any process for the medicinal, surgical, curative, prophylactic or other treatment of human beings or any process for a similar treatment of animals or plants to render them free of disease or to increase their economic value or that of their products.

Every application for a patent shall be for one invention only and shall be made in the prescribed form and filed in the patent office. Every application shall state that the applicant is in possession of the invention and shall name the owner claiming to be the true and first inventor; and where the person so claiming is not the applicant or one of the applicants, the application shall contain a declaration that the applicant believes the person so named to be the true and first inventor. Every such application shall be accompanied by a provisional or a complete specification.

Where an application for a patent (not being a convention application) is accompanied by a provisional specification, a complete specification shall be filed within twelve months from the date of filing of the application, and if the complete specification is not so filed the application shall be deemed to be abandoned. Every complete specification shall:-
• Fully and particularly describe the invention and its operation or use and the method by which it is to be performed;
• Disclose the best method of performing the invention which is known to the applicant and for which he is entitled to claim protection; and
• End with a claim or claims defining the scope of the invention for which protection is claimed.

At any time within four months from the date of advertisement of the acceptance of a complete specification under this Act (or within such further period not exceeding one month in the aggregate as the Controller may allow on application made to him in the prescribed manner before the expiry of the four months aforesaid) any person interested may give notice to the Controller of opposition to the grant of the patent on any of the following grounds, namely:
• That the applicant for the patent or the person under or through whom he claims, wrongfully obtained the invention or any part thereof from him or from a person under or through whom he claims;
• That the invention so far as claimed in any claim of the complete specification has been published before the priority date of the claim:
  • in any specification filed in pursuance of an application for a patent made in India on or after the 1st day of January, 1912; or
  • in India or elsewhere, in any other document;
• That the invention so far as claimed in any claim of the complete specification is claimed in a claim of a complete specification published on or after the priority date of the applicant’s claim and filed in pursuance of an application for a patent in India, being a claim of which the priority date is earlier than that of the applicant’s claim;
• That the invention so far as claimed in any claim of the complete specification was publicly known or publicly used in India before the priority date of that claim;
• That the invention so far as claimed in any claim of the complete specification is obvious and clearly does not involve any inventive step;
• That the subject of any claim of the complete specification is not an invention within the meaning of this Act, or is not patentable under this Act;
• That the complete specification does not sufficiently and clearly describe the invention or the method by which it is to be performed;
• That in the case of a convention application, the application was not made within twelve months from the date of the first application for protection for the invention made in a convention country by the applicant or a person from whom he derives title, etc.
• Where any such notice of opposition is duly given, the Controller shall notify the applicant and shall give to the applicant and the opponent an opportunity to be heard before deciding the case.
• Where a complete specification in pursuance of an application for a patent has been accepted and either:
  - the application has not been opposed and the time for the filing of the opposition has expired; or
  - the application has been opposed and the opposition has been finally decided in favour of the applicant; or
  - the application has not been refused by the Controller by virtue of any power vested in him by this Act; then the the patent shall, on request made by the applicant in the prescribed form, be granted to the applicant or, in the case of a joint application, to the applicants jointly, and the Controller shall cause the patent to be sealed with the seal of the patent office and the date on which the patent is sealed shall be entered in the register.
• The term of every patent granted and the term of every patent which has not expired and has not ceased to have effect under this Act, shall be twenty years from the date of filing of the application for the patent.
• Where an application is made for a patent in respect of any improvement in or modification of an invention described or disclosed in the complete specification filed thereof and the applicant also applies or has applied for a patent for that invention or is the patentee in respect thereof, the Controller may, if the applicant so requests, grant the patent for the improvement or modification as a patent of addition. A patent of addition shall be granted for a term equal to that of the patent for the main invention.
• At any time after the expiration of three years from the date of the sealing of a patent, any person interested may make an application to the Controller alleging that the reasonable requirements of the public with respect to the patented invention have not been satisfied or that the patented invention is not available to the public at a reasonable price and praying for the grant of a compulsory licence to work the patented invention.
• If any person fails to comply with any direction given under the Act or makes or causes to be made an application for the grant of a patent in contravention of the Act, he shall be punishable with imprisonment or with fine or with both.
• This Act has been amended by the Patents (Amendment) Act, 2002 and the Patents (Amendment) Act, 2005 to take care of India’s obligations under the TRIPS Agreement. After the amendments, product patent (instead of process patent) is being granted for food, pharmaceutical and chemical products. Also, along with post grant opposition to patents, pre-grant opposition is also permissible.

### 8.2.2 Grant of Patents and Rights Conferred Thereby

In Chapter VIII of this Act, there are important provisions from which we come to know various aspects relating to Patents, example, grant of patents, data of patents, rights of patentees, rights of co-owners of patents, term of patent etc. There are in all Ten Sections, i.e., from 43 to 53 included in this Chapter VIII of the act. These sections are as follows.
Grant and sealing of patents[Section 43]

- Where a complete specification in pursuance of an application for a patent has been accepted and either - the application has not been opposed under section 25 and the time for the filing of the opposition has expired; or the application has been opposed and the opposition has been finally decided in favour of the applicant; or the application has not been refused by the Controller by virtue of any power vested in him by this Act, the patent shall, on request made by the applicant in the prescribed form, be granted to the applicant or, in the case of a joint application, to the applicants jointly, and the Controller shall cause the patent to be sealed with the seal of the patent office and the date on which the patent is sealed shall be entered in the register.

- Subject to the provisions of sub-section (1) and of the provisions of this Act with respect to patents of addition, a request under this section for the sealing of a patent shall be made not later than the expiration of a period of six months from the date of advertisement of the acceptance of the complete specification:

Provided that where at the expiration of the said six months any proceeding in relation to the application for the patent is pending before the Controller or the High Court, the request may be made within the prescribed period after the final determination of that proceeding; where the applicant or one of the applicants has died before the expiration of the time within which under the provisions of this sub-section the request could otherwise be made, the said request may be made at any time within twelve months after the date of the death or at such later time as the Controller may allow.

- The period within which under sub-section (2) a request for the sealing of a patent may be made, may, from time to time, be extended by the Controller to such longer period as may be specified in an application made to him in that behalf, if the application is made and the prescribed fee paid within that longer period:

Provided that the first mentioned period shall not be extended under this sub-section by more than three months in the aggregate.

Explanation – For the purposes of this section a proceeding shall be deemed to be pending so long as the time for any appeal therein (apart from any future extension of that time) has not expired, and a proceeding shall be deemed to be finally determined when the time for any appeal therein (apart from any such extension) has expired without the appeal being brought.

Amendment of patent granted to deceased applicant[Section 44]

Where at any time after a patent has been sealed in pursuance of an application under this Act, the Controller is satisfied that the person to whom the patent was granted had died, or, in the case of a body corporate, had ceased to exist, before the patent was sealed, the Controller may amend the patent by substituting for the name of that person the name of the person to whom the patent ought to have been granted, and the patent shall have effect, and shall be deemed always to have had effect, accordingly.

Date of patent[Section 45]

- Subject to the other provisions contained in this Act, every patent shall be dated as of the date on which the complete specification was filed: Provided that a patent which is granted in pursuance of an application to which any directions issued under section 78C of the Indian Patents and Designs Act, 1911 applied immediately before the commencement of this Act, shall be dated as of the date of the filing of the complete specification or the date of such commencement whichever is later.

- The date of every patent shall be entered in the register.

- Notwithstanding anything contained in this section, no suit or other proceeding shall be commenced or prosecuted in respect of an infringement committed before the date of advertisement of the acceptance of the complete specification.
Form, extent and effect of patent. [Section 46]

- Every patent shall be in the prescribed form and shall have effect throughout India.
- A patent shall be granted for one invention only:
- Provided that it shall not be competent for any person in a suit or other proceeding to take any objection to a patent on the ground that it has been granted for more than one invention.

Grant of patents be subject to certain conditions[Section 47]
The grant of a patent under this Act shall be subject to the condition that -

- Any machine, apparatus or other article in respect of which the patent is granted or any article made by using a process in respect of which the patent is granted, may be imported or made by or on behalf of the Government for the purpose merely of its own use;
- Any process in respect of which the patent is granted may be used by or on behalf of the Government for the purpose merely of its own use;
- Any machine, apparatus or other article in respect of which the patent is granted or any article made by the use of the process in respect of which the patent is granted, may be made or used, and any process in respect of which the patent is granted may be used, by any person, for the purpose merely of experiment or research including the imparting of instructions to pupils; and
- In the case of a patent in respect of any medicine or drug, the medicine or drug may be imported by the Government for the purpose merely of its own use or for distribution in any dispensary, hospital or other medical institution maintained by or on behalf of the Government or any other dispensary, hospital or other medical institution which the Central Government may, having regard to the public service that such dispensary, hospital or medical institution renders, specify in this behalf by notification in the Official Gazette.

Rights of patentees[Section 48]

- Subject to the other provisions contained in this Act, a patent granted before the commencement of this Act, shall confer on the patentee the exclusive right by himself, his agents or licensees to make, use, exercise, sell or distribute the invention in India.
- Subject to the other provisions contained in this Act and the conditions specified in section 47, a patent granted after the commencement of this Act shall confer upon the patentee -
  - Where the patent is for an article or substance, the exclusive right by himself, his agents or licensees to make, use, exercise, sell or distribute such article or substance in India;
  - Where a patent is for a method or process of manufacturing an article or substance, the exclusive right by himself, his agents or licensees to use or exercise the method or process in India.

Patents rights not infringed when used on foreign vessels, etc., temporarily or accidentally in India[Section 49]

- Where a vessel or aircraft registered in a foreign country or a land vehicle owned by a person ordinarily resident in such country comes into India (including the territorial waters thereof) temporarily or accidentally only, the rights conferred by a patent for an invention shall not be deemed to be infringed by the use of the invention -
  - In the body of the vessel or in the machinery, tackle, apparatus or other accessories thereof, so far as the invention is used on board the vessel and for its actual needs only; or
  - In the construction or working of the aircraft or land vehicle or of the accessories thereof, as the case may be.
- This section shall not extend to vessels, aircraft or land vehicles owned by persons ordinarily resident in a foreign country the laws of which do not confer corresponding rights with respect to the use of inventions in vessels, air crafts or land vehicles owned by persons ordinarily resident in India while in the ports or within the territorial waters of that foreign country or otherwise within the jurisdiction of its courts.
Rights of co-owners of patents[Section 50]

- Where a patent is granted to two or more persons, each of those persons shall, unless an agreement to the contrary is in force, be entitled to an equal undivided share in the patent.
- Subject to the provisions contained in this section and in section 51, where two or more persons are registered as grantee or proprietor of a patent, then, unless an agreement to the contrary is in force, each of those persons shall be entitled, by himself or his agents, to make, use, exercise and sell the patented invention for his own benefit without accounting to the other person or persons.
- Subject to the provisions contained in this section and in section 51 and to any agreement for the time being in force, where two or more persons are registered as grantee or proprietor of a patent, then, a licence under the patent shall not be granted and a share in the patent shall not be assigned by one of such persons except with the consent of the other person or persons.
- Where a patented article is sold by one of two or more persons registered as grantee or proprietor of a patent, the purchaser and any person claiming through him shall be entitled to deal with the article in the same manner as if the article had been sold by a sole patentee.
- Subject to the provisions contained in this section, the rules of law applicable to the ownership and devolution of movable property generally shall apply in relation to patents; and nothing contained in sub-section (1) or sub-section (2) shall affect the mutual rights or obligations of trustees or of the representatives of a deceased person or their rights or obligations as such.
- Nothing in this section shall affect the rights of the assignees of a partial interest in a patent created before the commencement of this Act.

Power of controller to give directors to co-owners[Section 51]

- Where two or more persons are registered as grantee or proprietor of a patent, the Controller may, upon application made to him in the prescribed manner by any of those persons, give such directions in accordance with the application as to the sale or lease of the patent or any interest therein, the grant of licences under the patent, or the exercise of any right under section 50 in relation thereto, as he thinks fit.
- If any person registered as grantee or proprietor of a patent fails to execute any instrument or to do any other thing required for the carrying out of any direction given under this section within fourteen days after being requested in writing so to do by any of the other persons so registered, the Controller may, upon application made to him in the prescribed manner by any such other person, give directions empowering any person to execute that instrument or to do that thing in the name and on behalf of the person in default.
- Before giving any directions in pursuance of an application under this section, the Controller shall give an opportunity to be heard -
  - In the case of an application under sub-section (1), to the other person or persons registered as grantee or proprietor of the patent;
  - In the case of an application under sub-section (2), to the person in default.
- No direction shall be given under this section so as to affect the mutual rights or obligations of trustees or of the legal representatives of a deceased person or of their rights or obligations as such, or which is inconsistent with the terms of any agreement between persons registered as grantee or proprietor of the patent.

Grant of patent to true and first inventor where it has been obtained by another in fraud of him[Section 52]

- Where a patent has been revoked on the ground that the patent was obtained wrongfully and in contravention of the rights of the petitioner or any person under or through whom he claims, or, where in a petition for revocation, the court, instead of revoking the patent, directs the complete specification to be amended by the exclusion of a claim or claims in consequence of a finding that the invention covered by such claim or claims had been obtained from the petitioner, the court may, by order passed in the same proceeding, permit the grant to the petitioner of the whole or such part of the invention which the court finds has been wrongfully obtained by the patentee, in lieu of the patent so revoked or is excluded by amendment.
Where any such order is passed, the Controller shall, on request by the petitioner made in the prescribed manner grant to him -

• in cases where the court permits the whole of the patent to be granted, a new patent bearing the same date and number as the patent revoked;

• in cases where the court permits a part only of the patent to be granted, a new patent for such part bearing the same date as the patent revoked and numbered in such manner as may be prescribed:

Provided that the Controller may, as a condition of such grant, require the petitioner to file a new and complete specification to the satisfaction of the Controller describing and claiming that part of the invention for which the patent is to be granted.

No suit shall be brought for any infringement of a patent granted under this section committed before the actual date on which such patent was granted.

**Term of Patent [Section 53]**

- Subject to the provisions of this Act, the term of every patent granted under this Act shall:
  - In respect of an invention claiming the method or process of manufacture of a substance, where the substance is intended for use, or is capable of being used, as food or as a medicine or drug, be five years from the date of sealing of the patent, or seven years from the date of the patent whichever period is shorter; and
  - In respect of any other invention, be fourteen years from the date of the patent.

- A patent shall cease to have effect notwithstanding anything therein or in this Act on the expiration of the period prescribed for the payment of any renewal fee, if that fee is not paid within the prescribed period or within that period as extended under this section.

- The period prescribed for the payment of any renewal fee shall be extended to such period, not being more than six months longer than the prescribed period, as may be specified in a request made to the Controller if the request is made and the renewal fee and the prescribed additional fee paid before the expiration of the period so specified.

**8.3 Patents of Addition [Section 54]**

From the provisions of Section 54, we come to know the meaning, certain conditions relating to ‘Patent of Addition’ etc. These provisions are as under:

- Subject to the provisions contained in this section, where an application is made for a patent in respect of any improvement in or modification of an invention described or disclosed in the complete specification filed therefore (in this Act referred to as the “main invention”) and the applicant also applies or has applied for a patent for that invention or is the patentee in respect thereof, the Controller may, if the applicant so requests, grant the patent for the improvement or modification as a patent of addition. [Section 54(1)]

- Subject to the provisions contained in this section, where an invention, being an improvement in or modification of another invention, is the subject of an independent patent and the patentee in respect of that patent is also the patentee in respect of the patent for the main invention, the Controller may, if the patentee so requests, by order, revoke the patent for the improvement or modification and grant to the patentee a patent of addition in respect thereof, bearing the same date as the date of the patent so revoked. [Section 54(2)]

- A patent shall not be granted as a patent of addition unless the date of filing of the complete specification was the same as or later than the date of filing of the complete specification in respect of the main invention. [Section 54(3)]

- A patent of addition shall not be sealed before the sealing of the patent for the main invention; and if the period within which, but for the provisions of this sub-section, a request for the sealing of a patent of addition could be made under section 43 expires before the period within which a request for the sealing of the patent for the main invention may be so made, the request for the sealing of the patent of addition may be made at any time within the last mentioned period. [Section 54(4)].
8.3.1 Term of Patents of addition [Section 55]

- A patent of addition shall be granted for a term equal to that of the patent for the main invention, or so much thereof as has not expired, and shall remain in force during that term or until the previous cesser of the patent for the main invention and no longer:

  Provided that if the patent for the main invention is revoked under this Act, the court, or, as the case may be, the Controller, on request made to him by the patentee in the prescribed manner, may order that the patent of addition shall become an independent patent for the remainder of the term for the patent for the main invention and thereupon the patent shall continue in force as an independent patent accordingly. [Section 55(1)]

- (2) No renewal fee shall be payable in respect of a patent of addition, but, if any such patent becomes an independent patent under sub-section (1), the same fee shall thereafter be payable, upon the same dates, as if the patent had been originally granted as an independent patent. [Section 55(2)]

8.3.2 Validity of Patents of Addition [Section 56]

- The grant of a patent of addition shall not be refused, and a patent granted as a patent of addition shall not be revoked or invalidated, on the ground only that the invention claimed in the complete specification does not involve any inventive step having regard to any publication or use of -
  - the main invention described in the complete specification relating thereto; or
  - any improvement in or modification of the main invention described in the complete specification of a patent of addition to the patent for the main invention or of an application for such a patent of addition, and the validity of a patent of addition shall not be questioned on the ground that the invention ought to have been the subject of an independent patent. [Section 56(1)]

- For the removal of doubts it is hereby declared that in determining the novelty of the invention claimed in the complete specification filed in pursuance of an application for a patent of addition regard shall be had also to the complete specification in which the main invention is described. [Section 56(2)]

8.3.3 Advantages of Patents

The exclusive right to commercially exploit an invention provides the patent owner with the legal right to stop others from making, using, or selling the patented (i.e. claimed) invention and the right to collect damages for any such unlawful activity - so long as the patent (i.e. the claims) is not found invalid. Obtaining this exclusive right is the fundamental motivation for seeking a patent and affords several benefits to the patent owner.

Patents help insure that the payoff from R and D and a business’s competitive advantage are maximised. Patents are also valuable for generating interest and investment in new and growing businesses.

However, because patent protection can involve significant expense, an appropriate patent filing strategy that balances the speculative value of an invention with the costs of patent filings is required.

Most inventions involve considerable research and development (R&D) investment and efforts. Patenting an invention serves to prevent competitors from simply copying or reverse engineering the invention and thereby appropriating those R&D efforts for their own benefit. Furthermore, even if a competitor independently develops the same invention at a later stage, the patent may be used to stop the competitor’s entry into the market. Thus, a patent helps insure that the payoff from R&D and the patent owner’s competitive advantage are maximised.

Patents are also valuable for generating interest and investment in new and growing businesses. This is particularly important for companies attempting to establish themselves in high-tech industries. Start-up companies are often based on the development of a specific new, sometimes potentially ground-breaking, technology. Without securing rights for their technology, these companies may find themselves unable to obtain sufficient resources to bring that technology to market.
Patents may also be licensed to other parties allowing these parties to exploit the invention in exchange for royalty payments. In some situations, where claims of patent infringement have been made by one patent owner against another, the latter patent owner may be able to rely on its patent rights to launch a counterclaim for patent infringement.

This type of dispute is often settled with some form of cross licensing in which each party licenses the other under its patents, thereby avoiding costly litigation.

Finally, a patent serves as a readily accessible public record of the innovative developments made and owned by the patent owner. The existence of a patent may serve as a warning to competitors to stay clear of a protected technology. In addition, a patent stakes out a patentee’s technological territory, precluding others who develop technology at a later stage from attempting to claim or patent that technology as their own.

**8.4 The Copyright Act, 1957**

The Indian Copyright Act of 1914 was mainly based on the Copyright Act, 1911 of the United Kingdom. But there felt the need to enact an independent self-contained law on the subject of copyright due to the changing circumstances. Hence, after independence, the Government of India enacted the Copyright Act of 1957 and also framed the Copyright Act of 1958. Thus, the Law of Copyright in India is contained in the Copyright Act of 1957 as amended subsequently in 1983, 1984, 1992, 1994 and 199999 as per requirements. It is very important to note that, many important changes have been made so far in the Copyright Act of 1957 after entering the World Trade Organisation (WTO) and signing the purpose of conceptual understanding of ‘Copyright’, we have to consider certain provisions of the Copyright Act of 1957 as amended from time to time. But let us begin with the meaning of copyright.

**8.4.1 Meaning of ‘Copyright’**

Copyright is a form of protection provided to the authors of “original works of authorship” including literary, dramatic, musical, artistic, and certain other intellectual works, both published and unpublished. The Copyright Act, 1957 generally gives the owner of copyright the exclusive right to reproduce the copyrighted work, to prepare derivative works, to distribute copies or phonorecords of the copyrighted work, to perform the copyrighted work publicly, or to display the copyrighted work publicly.

- Statute-based, no registration necessary
- Copyright = intellectual property
- Combines different rights (literary works: the right to reproduce in hardback and paperback editions, the right of translation adaptation)

**8.4.2 Works in which Copyright Subsists and Works in which Copyright Does not Subsist [Section 13]**

Works in which copyright subsists.

1. Subject to the provisions of this section and the other provisions of this Act, copyright shall subsist throughout India in the following classes of works, that is to say,
   - original literary, dramatic, musical and artistic works;
   - cinematograph films;
   - [sound recordings;]

2. Copyright shall not subsist in any work specified in sub-section (1), other than a work to which the provisions of section 40 or section 41 apply, unless, in the case of a published work, the work is first published in India, or where the work is first published outside India, the author is at the date of such publication, or in a case where the author was dead at that date, was at the time of his death, a citizen of India;

   in the case of an unpublished work other than a work of architecture the author is at the date of the making of the work a citizen of India or domiciled in India; and
in the case of [work of architecture] the work is located in India.

Explanation.- in the case of a work of joint authorship, the conditions conferring copyright specified in this sub-
section shall be satisfied by all the authors of the work.

3. Copyright shall not subsist- in any cinematograph film a substantial part of the film is an infringement of the
copyright in any other work; in any [sound recording] made in respect of a literary, dramatic or musical work,
if in making the [sound recording], copyright in such work has been infringed.

4. The copyright in a cinematograph film or a [sound recording] shall not affect the separate copyright in any
work in respect of which or a substantial part of which, the film, or as the case may be, the [sound recording]
is made.

5. In the case of a [work of architecture] copyright shall subsist only in the artistic character and design and shall
not extent to processes or methods of construction.

There is the reference of the provisions of Section 40 and 41 in the above mentioned Section 13(2) and certain
words or terms are also used in the provisions of Section 13. Unless we know the provisions of Sections 40 and 41,
meaning of the terms or words used, we cannot understand the provisions of Section 13 properly. Hence, let us first
know the provisions of Section 40 and 41 of this Act.

In Chapter IX of this Act, under the heading ‘International Copyright’, provisions of sections from 40 to 43 are
given which are as follows:

Provisions of Section 40:
Power to extend copyright to foreign works -- The Central Government may, by order published in the
Official Gazette, direct that all or any provisions of this Act shall apply- to work first published in any
class territory outside India to which the order relates in like manner as if they were first published within
India; to unpublished works, or any class thereof, the authors whereof were at the time of the making of the
work, subjects or citizens of a foreign country to which the order relates, in like manner as if the authors were
citizens of India;

in respect of domicile in any territory outside India to which the order relates in like manner as if such domicile
were in India; to any work of which the author was at the date of the first publication thereof, or, in a case where
the author was dead at that date, was at the time of his death, a subject or citizen of a foreign country to which the
order relates in like manner as if the author was a citizen of India at that date or time; and thereupon, subject to the
provisions of this Chapter and of the order, this Act shall apply accordingly:

Provided that-
before making an order under this section in respect of any foreign country (other than a country with which India
has entered into a treaty or which is a party to a convention relating to copyright to which India is also a party), the
Central Government shall be satisfied that that foreign country has made, or has undertaken to make, such provisions
if any, as it appears to the Central Government expedient to require for the protection in that country of works entitled
to copyright under the provisions of this Act; the order may provide that the provisions of this Act shall apply either
generally or in relation to such classes of works or such classes of cases as may be specified in the order; the order
may provide that the term of copyright in India shall not exceed that conferred by the law of the country to which
the order relates; the order may provide that the enjoyment of the rights conferred by this Act shall be subject to the
accomplishment of such conditions and formalities, if any, as may be prescribed by the order; in applying the
provisions of this Act as to ownership of copyright, the order may make such exceptions and modifications as appear
necessary, having regard to the law of the foreign country; the order may provide that this Act or any part thereof
shall not apply to works made before the commencement of the order or that this Act or any part thereof small not
apply to works first published before the commencement of the order.
Provisions of Section 40-A:
1. If the Central Government is satisfied that a foreign country (other than a country with which India has entered into a treaty or which is a party to a convention relating to rights of broadcasting organisations and performers to which India is also a party) has made or has undertaken to make such provisions, if any, as it appears to the Central Government expedient to require, for the protection in that foreign country, of the rights of broadcasting organisations and performers as is available under this Act, it may, by order published in the Official Gazette, direct that the provisions of Chapter VIII shall apply - to broadcasting organisations whose headquarters is situated in a country to which the order relates or, the broadcast was transmitted from a transmitter situated in a country to which the order relates as if the headquarters of such organisation were situated in India or such broadcast were made from India; to performances that took place outside India to which the order relates in like manner as if they took place in India; to performances that are incorporated in a sound recording published in a country to which the order relates as if it was published in India; to performances not fixed on a sound recording broadcast by a broadcasting organisation the headquarters of which is located in a country to which the order relates or where the broadcast is transmitted from a transmitter which is situated in a country to which the order relates as if the headquarters of such organisation were situated in India or such broadcast were made from India.

2. Every order made under sub-section (1) may provide that -the provisions of Chapter VIII shall apply either generally or in relation to such class or classes of broadcasts or performances or such other class or classes of cases as may be specified in the order; the term of the rights of broadcasting organisations and performers in India shall not exceed such term as is conferred by the law of the country to which the order relates; the enjoyment of the rights conferred by Chapter VIII shall be subject to the accomplishment of such conditions and formalities, if any, as may be specified in that order; Chapter VIII or any part thereof shall not apply to broadcast and performances made before the commencement of the order or that Chapter VIII or any part thereof shall not apply to broadcasts and performances broadcast or performed before the commencement of the order; in case of ownership of rights of broadcasting organisations and performers, the provisions of Chapter VIII shall apply with such exceptions and modifications as the Central Government may, having regard to the law of the foreign country, consider necessary."

Provisions as to works of certain international organisations [Section 41]. -
(1) Where- any work is made or first published by or under the direction or control of any organisation to which this section applies, and there would, apart from this section, be no copyright in the work in India at the time of the making or, as the case may be, of the first publication thereof, and either- the work is published as aforesaid in pursuance of an agreement in that behalf with the author, being an agreement which does not reserve to the author the copyright, if any, in the work, or under section 17 any copyright in the work would belong to the organisation; there shall, by virtue of this section, be copyright in the work throughout India.

3. Any organisation to which this section applies which at the material time had not the legal capacity of a body corporate shall have and be deemed at all material times to have had the legal capacity of a body corporate for the purpose of holding, dealing with, and enforcing copyright and in connection with all legal proceedings relating to copyright.

4. The organisation to which this section applies are such organisations as the Central Government may, by order published in the Official Gazette, declare to be organisations of which one or more sovereign powers or the Government or Governments thereof are members to which it is expedient that this section shall apply.

Provisions of Section 42.
Power to restrict rights in works of foreign authors first published in India. -If it appears to the Central Government that a foreign country does not give or has not undertaken to give adequate protection to the works of Indian authors, the Central Government may, by order published in the Official Gazette, direct that such of the provisions of this Act as confer copyright on works first published in India shall not apply to works, published after the date specified in the order, the authors whereof are subjects or citizens of such foreign country and are not domiciled in India, and thereupon those provisions shall not apply to such works.
Provisions of Section 42A.
If it appears to the Central Government that a foreign country does not give or has not undertaken to give adequate protection to rights of broadcasting organisations or performers, the Central Government may, by order published in the Official Gazette, direct that such of the provisions of this Act as confer right to broadcasting organisations or performers, as the case may be, shall not apply to broadcasting organisations or performers whereof are based on incorporated in such foreign country or are subjects or citizens of such foreign country and are not incorporated or domiciled in India, and thereupon those provisions shall not apply to such broadcasting organisations or performers.”

Provisions of Section 43.
Orders under this Chapter to be laid before Parliament.- Every order made by the Central Government under this Chapter shall, as soon as may be after it is made, be laid before both Houses of Parliament and shall be subject to such modifications as Parliament may make during the session in which it is so laid or the session immediately following.

8.4.3 Ownership of Copyright and the Rights of the Owner [Section 17]
“Owner of copyright” shall include an exclusive licensee; in the case of an anonymous or pseudonymous literary, dramatic, musical or artistic work, the publisher of the work, until the identity of the author or, in the case of an anonymous work of joint authorship, or a work of joint authorship published under names all of which are pseudonyms, the identity of any of the authors, is disclosed publicly by the author and the publisher or is otherwise established to the satisfaction of the Copyright Board by that author or his legal representatives.

[Section 17] Subject to the provisions of this Act, the author of a work shall be the first owner of the copyright therein Provided that- in the case of a literary, dramatic or artistic work made by the author in the course of his employment by the proprietor of a newspaper, magazine or similar periodical under a contract of service or apprenticeship, for the purpose of publication in a newspaper, magazine or similar periodical, the said proprietor shall, in the absence of any agreement to the contrary, be the first owner of the copyright in the work in so far as the copyright relates to the publication of the work in any newspaper, magazine or similar periodical, or to the reproduction of the work for the purpose of its being so published, but in all other respects the author shall be the first owner of the copyright in the work; subject to the provisions of clause (a), in the case of a photograph taken, or a painting or portrait drawn, or an engraving or a cinematograph film made, for valuable consideration at the instance of any person, such person shall, in the absence of any agreement to the contrary, be the first owner of the copyright therein; in the case of a work made in the course of the author’s employment under a contract of service or apprenticeship, to which clause (a) or clause (b) does not apply, the employer shall, in the absence of any agreement to the contrary, be the first owner of the copyright therein; [(cc)in the case of any address or speech delivered in public, the person who has delivered such address or speech or if such person has delivered such address or speech on behalf of any other person, such other person shall be the first owner of the copyright therein notwithstanding that the person who delivers such address or speech, or, as the case may be, the person on whose behalf such address or speech is delivered, is employed by any other person who arranges such address or speech or on whose behalf or premises such address or speech is delivered;] in the case of a Government work, Government shall, in the absence of any agreement to the contrary, be the first owner of the copyright therein; [(dd) in the case of a work made or first published by or under the direction or control of any public undertaking, such public undertaking shall, in the absence of any agreement to the contrary, be the first owner of the copyright therein.]

Explanation - For the purposes of this clause and section 28A, “public undertaking” means- an undertaking owned or controlled by Government; or Government company as defined in section 617 of the Companies Act, 1956; or body corporate established by or under any Central, Provincial or State Act; in the case of work to which the provisions of section 41 apply, the international organisation concerned shall be the first owner of the copyright therein.

The owner of the copyright can assign the copyright to any person subject to the provisions of Section 18. The provisions relating to assignment, mode of assignment, right to relinquish copyright are continued in Sections 18, 19, 20 and 21 of this Act. The provisions of these sections are as under.
Assignment of copyright[Section 18]

- The owner of the copyright in an existing work or the prospective owner of the copyright in a future work may assign to any person the copyright either wholly or partially and either generally or subject to limitations and either for the whole term of the copyright or any part thereof: Provided that in the case of the assignment of copyright in any future work, the assignment shall take effect only when the work comes into existence.
- Where the assignee of a copyright becomes entitled to any right comprised in the copyright, the assignee as respects the rights so assigned, and the assignor as respects the rights not assigned, shall be treated for the purposes of this Act as the owner of copyright and the provisions of this Act shall have effect accordingly.
- In this section, the expression “assignee” as respects the assignment of the copyright in any future work includes the legal representatives of the assignee, if the assignee dies before the work comes into existence.

Mode of assignment[Section 19]

- [(1)]No assignment of the copyright in any work shall be valid unless it is in writing signed by the assignor or by his duly authorised agent.
- The assignment of copyright in any work shall identify such work, and shall specify the rights assigned and the duration and territorial extent of such assignment.
- The assignment of copyright in any work shall also specify the amount of royalty payable, if any, to the author or his legal heirs during the currency of the assignment and the assignment shall be subject to revision, extension or termination on terms mutually agreed upon by the parties.
- Where the assignee does not exercise the rights assigned to him under any of the other subsections of this section within a period of one year from the date of assignment, the assignment in respect of such rights shall be deemed to have lapsed after the expiry of the said period unless otherwise specified in the assignment.
- If the period of assignment is not stated, it shall be deemed to be five years from the date of assignment.
- If the territorial extent of assignment of the rights is not specified, it shall be presumed to extend within India.
- Nothing in sub-section (2) or sub-section (3) or sub-section (4) or sub-section (5) or sub-section (6) shall be applicable to assignments made before the coming into force of the Copyright (Amendment) Act, 1994.

Disputes with respect to assignment of copyright[Section 19A]

- If an assignee fails to make sufficient exercise of the rights assigned to him, and such failure is not attributable to any act or omission of the assignor, then, the Copyright Board may, on receipt of a complaint from the assignor and after holding such inquiry as it may deem necessary, revoke such assignment.
- If any dispute arises with respect to the assignment of any copyright the Copyright Board may, on receipt of a complaint from the aggrieved party and after holding such inquiry as it considers necessary, pass such order as it may deem fit including an order for the recovery of any royalty payable: Provided that the Copyright Board shall not pass any order under this sub-section to revoke the assignment unless it is satisfied that the terms of assignment are harsh to the assignor in case the assignor is also the author: Provided further that no order of revocation of assignment under this sub-section, be made within a period of five years from the date of such assignment.

Transmission of copyright in manuscript by testamentary disposition[Section 20]

Where under a bequest a person is entitled to the manuscript of a literary, dramatic or musical work, or to an artistic work, and the work was not published before the death of the testator, the bequest shall, unless the contrary intention is indicated in the testator’s will or any codicil thereto, be construed as including the copyright in the work in so far as the testator was the owner of the copyright immediately before his death.

Explanation - In this section, the expression “manuscript” means the original document embodying the work, whether written by hand or not.
Right of author to relinquish copyright [Section 21]

- The author of a work may relinquish all or any of the rights comprised in the copyright in the work by giving notice in the prescribed form to the Registrar of Copyrights and thereupon such rights shall, subject to the provisions of sub-section (3), cease to exist from the date of the notice.
- On receipt of a notice under sub-section (1), the Registrar of Copyrights shall cause it to be published in the Official Gazette and in such other manner as he may deem fit.
- The relinquishment of all or any of the rights comprised in the copyright in a work shall not affect any rights subsisting in favour of any person on the date of the notice referred to in sub-section (1).

8.4.4 Term of Copyright

The provisions relating to “Term of Copyright” are found in sections from 22 to 29 [Chapter V] of the Copyright Act of 1957. These provisions are as under:

Term of copyright in published literary, dramatic, musical and artistic works [Section 22]:-
Except as otherwise hereinafter provided, copyright shall subsist in any literary, dramatic, musical or artistic work (other than a photograph) published within the lifetime of the author until fifty years from the beginning of the calendar year next following the year in which the author dies.

Explanation.- In this section the reference to the author shall, in the case of a work of joint authorship, be construed as a reference to the author who dies last.

Term of copyright in anonymous and pseudonymous works [Section 23]

‘Psedonym’ means a fictitious name

- In the case of a literary, dramatic, musical or artistic work (other than a photograph), which is published anonymously or pseudonymously, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the work is first published:
- In sub-section (1), references to the author shall, in the case of an anonymous work of joint authorship, be construed, where the identity of one of the authors is disclosed, as references to that author; where the identity of more authors than one is disclosed, as references to the author who dies last from amongst such authors.
- In sub-section (1), references to the author shall, in the case of a pseudonymous work of joint authorship, be construed, where the names of one or more (but not all) of the authors are pseudonyms and his or their identity is not disclosed, as references to the author whose name is not a pseudonym, or, if the names of two or more of the authors are not pseudonyms, as references to such of those authors who dies last; where the names of one or more (but not all) of the authors are pseudonyms and the identity of one or more of them is disclosed, as references to the author who dies last from amongst the authors whose names are not pseudonyms and the authors whose names are pseudonyms and are disclosed; and where the names of all the authors are pseudonyms and the identity of one of them is disclosed, as references to the author whose identity is disclosed or if the identity of two or more of such authors is disclosed, as references to such of those authors who dies last.

Explanation-For the purposes of this section, the identity of an author shall be deemed to have been disclosed, if either the identity of the author is disclosed publicly by both the author and the publisher or is otherwise established to the satisfaction of the Copyright Board by that author.
Term of copyright in posthumous work[Section 24]
- In the case of literary, dramatic or musical work or an engraving, in which copyright subsists at the date of the death of the author or, in the case of any such work of joint authorship, at or immediately before the date of the death of the author who dies last, but which, or any adaptation of which, has not been published before that date, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the work is first published or, where an adaptation of the work is published in any earlier year, from the beginning of the calendar year next following that year.
- For the purposes of this section a literary, dramatic or musical work or an adaptation of any such work shall be deemed to have been published, if it has been performed in public or if any records made in respect of the work have been sold to the public or have been offered for sale to the public.

Term of copyright in photographs[Section 25]:- In the case of a photograph, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the photograph is published.

Term of copyright in cinematograph films[Section 26]:- In the case of a cinematograph film, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the film is published.

Term of copyright in records[Section 27]:- In the case of a record, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the record is published.

Term of copyright Government works[Section 28]:- In the case of Government work, where Government is the first owner of the copyright therein, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the work is first published.

Term of copyright in works of international organisation: In the case of a work of an international organisation to which the provisions of section 41 apply, copyright shall subsist until fifty years from the beginning of the calendar year next following the year in which the work is first published.

8.4.5 Registration of Copyright
Copyright registration in India gives the creators of a wide range of material, such as literature, art, music, sound recordings, films and broadcasts; economic rights; enabling them to control use of their material in a number of ways, such as by making copies, issuing copies to the public, performing in public, broadcasting and use on-line. It also gives moral rights to be identified as the creator of certain kinds of material and to object to its distortion or its mutilation. (Material protected by copyright is termed a “work”.)

However, copyright does not protect ideas, names or titles. The purpose of copyright law in India is to allow copyright registrants to gain economic rewards for their efforts and so encourage future creativity and the development of new material which benefits us all. Copyright material is usually the result of creative skill and/or significant labour and/or investment and without protection, it would often be very easy for others to exploit material without paying the creator. Most uses of copyright material therefore require permission from the copyright owner. However there are exceptions to copyright, so that some minor uses may not result in copyright infringements. Copyright protection is automatic as soon as there is a record in any form of the material that has been created. Under the Indian Copyright Act there is a provision to register copyright although this is voluntary.

Owner of copyright
- In the case of a literary, dramatic, musical or artistic work, the general rule is that the author, i.e. the person who created the work, is the first owner of the economic rights under copyright. However, where such a work is made in the course of employment, the employer is the first owner of these rights, unless an agreement to the contrary has been made with the author.
• In the case of a film, the principal director and the film producer are joint authors and first owners of the economic rights and similar provisions as referred to above apply where the director is employed.
• In the case of a sound recording the record producer is the author and first owner of copyright; in the case of a broadcast, the broadcaster; and in case of a published edition, the publisher.

Copyright is, however, a form of property which, like physical property, can be bought or sold, inherited or otherwise transferred, wholly or in part. So, some or all of the economic rights may subsequently belong to someone other than the first owner. In contrast, the moral rights accorded to authors of literary, dramatic, musical and artistic works and film directors remain with the author or director or pass to his or her heirs on death. Copyright in material produced by a Government department belongs to the Government of India. Copyright owners generally have the right to authorise or prohibit any of the following things in relation to their works:
• Copying of the work in any way, example, photocopying / reproducing a printed page by handwriting, typing or scanning into a computer / taping live or recorded music.
• Issuing copies of the work to the public.
• Public delivery of lectures or speeches etc.
• Broadcasting of the work, audio / video or including it in a cable programme.
• Making an adaptation of the work such as by translating a literary or dramatic work, transcribing a musical work and converting a computer program into a different computer language or code.

Copyright is infringed when any of the above acts are done without authorisation, whether directly or indirectly and whether the whole or a substantial part of a work, unless what is done falls within the scope of exceptions to copyright permitting certain minor uses of material.

There are a number of exceptions to copyright that allow limited use of copyright works without the permission of the copyright owner. For example, limited use of works may be possible for research and private study, criticism or review, reporting current events, judicial proceedings, teaching in schools and other educational establishments and not for profit playing of sound recordings.

But if you are copying large amounts of material and/or making multiple copies then you may still need permission. Also where a copyright exception covers publication of excerpts from a copyright work, it is generally necessary to include an acknowledgement. Sometimes more than one exception may apply to the use you are thinking of.

Exceptions to copyright do not generally give you rights to use copyright material; they just state that certain activities do not infringe copyright. So it is possible that an exception could be overridden by a contract you have signed limiting your ability to do things that would otherwise fall within the scope of an exception.

It is important to remember that just buying or owning the original or a copy of a copyright work does not give you permission to use it the way you wish. For example, buying a copy of a book, CD, video, computer program etc does not necessarily give you the right to make copies (even for private use), play or show them in public. Other everyday uses of copyright material, such as photocopying, scanning, downloading from a CD-ROM or on-line database, all involve copying the work. So, permission is generally needed. Also, use going beyond an agreed licence will require further permission.
8.4.6 Other Provisions of the Copyright Act of 1957

We have considered in detail the provisions of this Act relating to ownership, term of copyright in order to understand the meaning and nature of copyright. Besides these provisions, there are provisions made in the Act relating to licenses (Chapter VI- Sections from 30 to 32.), Copyright Societies (Chapter VII- Sections from 33 to 36), Rights of Broadcasting Organisation and of Performers (Chapter VIII, Sections from 37 to 39), Infringement of Copyright (Chapter XI, Sections from 51 to 53), Civil Remedies (Chapter XII, Sections from 54 to 62), Offences (Chapter XIII, Sections from 63 to 70), Appeals (Chapter XIV, Sections from 71 to 73), Miscellaneous Provisions (Chapter XV, Sections from 74 to 79). This shows that the scope of this Act is quite extensive. But, we have considered only those provisions of the Act which are essential for conceptual understanding of “Copyright”. Now, we are in a position to understand the nature and certain important features of “Copyright.”

8.4.7 Nature and Features of Copyright Act

Copyright is a form of protection provided to the authors of “original works of authorship” including literary, dramatic, musical, artistic, and certain other intellectual works, both published and unpublished. The 1976 Copyright Act generally gives the owner of copyright the exclusive right to reproduce the copyrighted work, to prepare derivative works, to distribute copies or phonorecords of the copyrighted work, to perform the copyrighted work publicly, or to display the copyrighted work publicly.

The copyright protects the form of expression rather than the subject matter of the writing. For example, a description of a machine could be copyrighted, but this would only prevent others from copying the description; it would not prevent others from writing a description of their own or from making and using the machine. Copyrights are registered by the Copyright Office of the Library of Congress.

- Performing rights societies’ rights (for instance, music royalties)
- Definition of categories in which copyright actually subsists
- International copyright
- Definition of infringement

This can be made clear from the provisions of Section 63 and 63-A and B of the Copyright Act of 1857.

Provisions of Section 63

Any person who knowingly infringes or abets the infringement of the copyright in a work, or any other right conferred by this Act, [except the right conferred by section 53A], [shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to three years and with fine which shall not be less than fifty thousand rupees but which may extend to two lakh rupees]: Provided that [where the infringement has not been made for gain in the course of trade or business] the court may, for adequate and special reasons to be mentioned in the judgement, impose a sentence of imprisonment for a term of less than six months or a fine of less than fifty thousand rupees.

Explanation: Construction of a building or other structure which infringes or which, if completed, would infringe the copyright in some other work shall not be an offence under this section.

Provisions of Section 63A: Enhanced penalty on second and subsequent convictions. - Whoever having already been convicted of an offence under section 63 is again convicted of any such offence shall be punishable for the second and for every subsequent offence, with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to two lakh rupees:

Provided that [where the infringement has not been made for gain in the course of trade or business] the court may, for adequate and special reasons to be mentioned in the judgment impose a sentence of imprisonment for a term of less than one year or a fine of less than one lakh rupees:
Provided further that for the purposes of this section, no cognisance shall be taken of any conviction made before the commencement of the Copyright (Amendment) Act, 1984.

**Provisions of Section 63B: Knowing use of infringing copy of computer programme to be an offence**

Any person who knowingly makes use on a computer of an infringing copy of a computer programme shall be punishable with imprisonment for a term which shall not be less than seven days but which may extend to three years and with fine which shall not be less than fifty thousand rupees but which may extend to two lakh rupees: Provided that where the computer programme has not been used for gain or in the course of trade or business, the court may, for adequate and special reasons to be mentioned in the judgment, not impose any sentence of imprisonment and may impose a fine which may extend to fifty thousand rupees.”

The above mentioned provisions of Section 63, 63-A and 63-b makes clear one of the objects of this Act i.e. to give protection to the owners of the copyrights from the infringement of their rights.

**8.4.8 Difference Between Patent and Copyright Act**

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<th>Point of Difference</th>
<th>Copyright</th>
<th>Patent</th>
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<td>1. Subject matter</td>
<td>A copyright covers “works of authorship,” which essentially means literary, dramatic, and musical works, pictorial, graphic, and sculptural works, audio-visual works, sound recordings, pantomimes and choreography.</td>
<td>A patent covers an invention, which essentially means a new and non-obvious useful and functional feature of a product or process.</td>
</tr>
<tr>
<td>2. Requirement for protection</td>
<td>In order for a work to be copyrighted, it must be original and fixed in a tangible medium of expression; no formalities are required</td>
<td>In order for an invention to be patented, it must be novel (i.e., new), non-obvious, and useful and a patent must be issued by the Indian Patent and Trademark Office</td>
</tr>
<tr>
<td>3. Infringement</td>
<td>For a copyright to be infringed, the work itself must have actually been copied from (either wholly or to create a derivative work), distributed, performed, or displayed. If a person other than the copyright owner independently comes up with the same or a similar work, there is no infringement</td>
<td>A patent confers a statutory monopoly that prevents anyone other than the patent holder from making, using, or selling the patented invention. This is true even if that person independently invents the patented invention.</td>
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<td>4. Infringement</td>
<td>Copyright protection begins as soon as a work is created</td>
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<td>5. Start of protection</td>
<td>Copyright is registrable under the Copyright Act of 1957.</td>
<td>Patent is registrable under the Patents Act of 1970.</td>
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Table 8.1 Difference between Patent and Copyright Act
8.5 The Design Act, 2000

The Designs Act of 1911 was passed by the then British Government of India and since then extensive amendments have been made in the Designs Act. In the meanwhile India has made tremendous progress in the field of science and technology. There has been considerable increase in the registration of designs. To provide more effective protection to registered designs and to promote design activity it has become necessary to make the legal system of providing protection to industrial designs in a more efficient manner. It is also intended to ensure that the law does not unnecessarily extend protection beyond what is necessary to create the required incentive for design activity while removing impediments to the free use of available designs. To achieve these objectives and in order to repeal the Designs Act, 1911 which has been extensively amended, the Designs Bill was introduced in the Parliament and the Designs Act of 2000 was passed.

Under section 2 (d) of the Designs Act, 2000 the following features have been added:

- It includes the composition of lines or colours applied to any article
- Such article may be either in two dimensional form or in three dimensional form or both:
- It does not include any artistic work as defined under the copyright Act.

Hence, the Designs Act of 2000 does not include the trade mark and the property mark alone but also includes the ‘artistic works’.

Therefore, the definition under the Act of 2000 is an improved one and more comprehensive. As per Section 5 of Design Act, 2000, any person who claims to be the proprietor of any new or original design can apply for the registration of the design. The foreigner can apply for the registration of the design. However, the convention followed is that if a country does not offer the identical registration right to Indian citizen for their designs in their country, its citizen would not be eligible to apply for registration of design in India.

The application under Section 5 shall be accompanied by four copies of representation of the design and the application shall state the class in which the design is to be registered. The applicant is also to file a brief statement of novelty with the application. There are 31 classes plus miscellaneous class 99 of goods. The procedure for registration of a design is comparatively simple when compared to procedure for registration of a patent and trademark.

- Submission of application
- Acceptance / objections / refusal
- Removal of objections / appeal to central Government
- Decision of Central Government
- Registration of the design

Off late, a new Design Law came into effect in India on May 11, 2001 replacing the old law of 1911. Major changes are listed below:

- Novelty is now to be determined on a world-wide basis.
- The initial term of protection will be for ten years with a subsequent renewal for five further years for a total of fifteen years.
- The validity of a design registration will be able to be challenged before the Controller at any time during its period of protection.
- Convention Priority will be able to be claimed from applications filed in any Paris Convention country and not limited to British Commonwealth countries as previously.
8.5.1 Definition and Meaning
“Design” means only the features of shape, configuration, pattern, ornament or composition of lines or colours applied to any article whether in two dimensional or three dimensional or in both forms, by any industrial process or means, whether manual, mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye; but does not include any mode or principle of construction or anything which is in substance a mere mechanical device, and does not include any trade mark as defined in clause (v) of sub-section 2 of the Trade and Merchandise Marks Act, 1958 or property mark as defined in section 479 of the Indian Penal Code or any artistic work as defined in clause (c) of section 2 of the Copyright Act, 1957.

An article is distinguished not only by its utility but also by its visual appeal which too usually play an important role in shaping the buyers preference for the article. Therefore, the design of an article and even design of its packaging is important from the commercial view point

8.5.2 Nature and Feature of Design
From the definition stated in Section 2(d) of the Act, we come to know that ‘Design’ is an idea or conception as to features of shape, configuration, pattern, ornament applied to an article. Such designs form a special branch of industrial property. A design relating to an article appeals to the eye. It contains certain features or outward appearance. Such features are applicable to an article manufactured by any industrial process or by any means.

Such industrial process can be manual, mechanical, chemical and separate or combined. The features in the finished article produced should appeal to the eye and should be capable of being judged solely by the eye. This is one of the important features or ingredients of design. However, design does not conclude a trade mark, a collective mark or property mark. The term Trade Mark’ has been defined in Section 2(zb) of the Trade Marks Act of1999 extensively.

But, here it can be noted in short that ‘Trade Marks’ means a mark used or proposed to be used in relation to goods for the purpose of indicating or as to indicate a connection in the course of trade between the goods or some person who has the right either as the proprietor or as the registered user to use such mark with or without any indication of the identity of that person. Trade Mark is registrable under valuable property belongs to a particular person [Section 479 of the Indian Penal Code]. It indicates the ownership of property. ‘Collective Mark’ means a trade mark distinguishing goods or services of members of an association of persons (not bring a proprietor within the meaning of the Indian Partnership Act 1932 ) which is the proprietor of the mark from those of others [Section 2(g) of the Trade Marks of 1999]. From the meaning of the above mentioned terms, it becomes clear that design is a different term from a trade mark, “property mark or a collective mark and it does not conclude a trade mark, a property mark or a collective mark.

8.5.3 Prohibition of Registration of certain Designs under the Act
What is not capable to be registered as ‘Design’ under this Act is made clear in the provisions of Section 4 of the Act. These provisions are as under :
“Design which:
- is not new or original; or
- has been disclosed to the public anywhere in India or in any other country by publication in tangible form or by use or in any other way prior to the filing date, or where applicable, the priority date of the application for registration; or
- is not significantly distinguishable from known designs or combination of known designs; or
- comprises or contains scandalous or obscene matter, shall not be registered.
8.5.4 Registration of Design

In India, designs are protected by two legal rights:

- Registered designs and
- Artistic copyright

Design registration in India gives the owner, a monopoly on his or her product, i.e. the right for a limited period to stop others from making, using or selling the product without their permission and is additional to any design right or copyright protection that may exist automatically in the design.

- Legal basis
  - Designs Act, 2000
  - Designs Rules, 2001

‘Article’ under the Designs Act, 2000

Under the Designs Act, 2000 the “article” means any article of manufacture and any substance, artificial, or partly artificial and partly natural and includes any part of an article capable of being made and sold separately.

‘Set of article’ under Designs Act 2000

If a group of articles meets the following requirements then that group of articles may be regarded as a set of articles under the Designs Act, 2000:

- Ordinarily on sale or intended to be used together.
- All having common design even though articles are different (same class).
- Same general character. Generally, an article having the same design and sold in different sizes is not considered as a set of articles. Practical example: “Tea set”, “Pen set”, “Knife set” etc.

Essential requirements for the registration of ‘Design’ under the Designs Act, 2000

- The design should be new or original, not previously published or used in any country before the date of application for registration. The novelty may reside in the application of a known shape or pattern to new subject matter. Practical example: The known shape of “Kutub Minar” when applied to a cigarette holder the same is registrable. However, if the design for which application is made does not involve any real mental activity for conception, then registration may not be considered.
- The design should relate to features of shape, configuration, pattern or ornamentation applied or applicable to an article. Thus, designs of industrial plans, layouts and installations are not registerable under the Act.
- The design should be applied or applicable to any article by any industrial process. Normally, designs of artistic nature like painting, sculptures and the like which are not produced in bulk by any industrial process are excluded from registration under the Act.
- The features of the design in the finished article should, appeal to and are judged, solely by the eye. This implies that the design must appear and should be visible on the finished article, for which it is meant; Thus, any design in the inside arrangement of a box, money purse or almirah may not be considered for showing such articles in the open state, as those articles are generally put in the market in the closed state.
- Any mode or principle of construction or operation or any thing which is in substance a mere mechanical device, would not be registerable design. For instance, a key having its novelty only in the shape of its corrugation or bend at the portion intended to engage with levers inside the lock associated with, cannot be registered as a design under the Act. However, when any design suggests any mode or: principle of construction or mechanical or other action of a mechanism, a suitable disclaimer in respect thereof is required to be inserted on its representation, provided there are other registerable features in the design.
- The design should not include any Trade Mark or property mark or artistic works as defined under the Copyright Act, 1957.
Procedure for Registration of Design

**Applying for registration of design**
The application for registration of design can be filed by the applicant himself/herself or through a professional person (i.e., patent agent, legal practitioner). However, for the applicants not being residents of India, an agent residing in India has to be employed.

**Place of applying for registration of design**
Any person who desires to register a design shall submit the following documents to the Controller of Designs, The Patent Office at Kolkata, or at any of its branch offices at New Delhi, Mumbai and Chennai. For address and contact numbers, click here.
**Duration of the registration of a design and its extension**

The duration of the registration of a design is initially ten years from the date of registration but in uses where claim to priority has been allowed, the duration is ten years from the priority date. This initial period of registration may be extended by further period of 5 years on an application made in Form-3 accompanied by a fee of Rs. 2,000/- to the Controller before the expiry of the said initial period of Copyright. The proprietor of a design may make application for such extension even as soon as the design is registered.

**Cancellation of registration of a design**

The registration of a design may be cancelled at any time after the registration of design, on a petition for cancellation in form 8, with a fee of Rs. 1,500/- to the Controller of Designs, on the following grounds:

- That the design has been previously registered in India or
- That it has been published in India or elsewhere prior to date of registration or
- The design is not new or original or
- Design is not registrable or
- It is not a design under Clause (d) of Section 2.

**Restoration of the lapsed design due to non-payment of extension fee within prescribed time**

A registration of design will cease to be effective on non-payment of extension fee for further term of five years, if the same is not paid before the expiry of original period of 10 years. However, new provision has been incorporated in the Act so that lapsed designs may be restored, provided the following conditions are satisfied:

- Application for restoration in Form-4 with fee of Rs. 1,000/- is filed within one year from the date of lapse stating the ground for such non-payment of extension fee with sufficient reasons.
- If the application for restoration is allowed, the proprietor is required to pay the extension fee of Rs: 2,000/- and an additional fee of Rs. 1,000/- and finally the lapsed registration is restored.

**Piracy of a design**

Piracy of a design means the application of a design or its imitation to any article belonging to class of articles in which the design has been registered for the purpose of sale or importation of such articles without the written consent of the registered proprietor. Publishing such articles or exposing them for sale with knowledge of the unauthorised application of the design to them also involves piracy of the design.

**Penalty for the piracy of a registered design**

If anyone contravenes the copyright in a design for the every contravention he/she is liable to pay a sum not exceeding Rs. 25,000/- to the registered proprietor subject to a maximum of Rs. 50,000/- recoverable as contract debt in respect of any one design. The registered proprietor may bring a suit for the recovery of the damages for any such contravention and for injunction against repetition of the same. Total sum recoverable shall not exceed Rs. 50,000/- as contract debt as stated in Section 22(2)(a). The suit for infringement, recovery of damage should not be filed in any court below the court of District Judge.

**8.5.5 Powers and Functions of Controller**

The provisions related to powers and duties of the Controller are given in Chapter VII of the Designs Act, 2000. They are as follows:-

**Provisions of Section 32:**

Powers of Controller in Proceedings under Act:-Subject to any rules in this behalf, the Controller in any proceedings before him under this Act shall have the powers of a civil court for the purpose of receiving evidence, administering oaths, enforcing the attendance of witnesses, compelling the discovery and production of under documents, issuing commissions for the examining of witnesses and awarding costs and such award shall be executable in any court having jurisdiction as if it were a decree of that court.
Provisions of Section 33
Exercise of discretionary power by Controller:- Where any discretionary power is by or under this Act given to Controller, he shall not exercise that power adversely to the Exercise of the discretionary power by applicant for registration of a design without (if so required within the prescribed time by the applicant) giving the applicant an opportunity of being heard.

Provisions of Section 34
Power of Controller to take directions of the Central Government:- The Controller may, in any case of doubt or difficulty arising in the administration of any of the provisions of this Act, apply to the Central Government for directions in the matter.

Provisions of Section 35
Refusal to register a design in certain cases:-

- The Controller may refuse to register a design of which the use would, in his opinion, be contrary to public order or morality.
- An appeal shall lie to the High Court from an order of the Controller under this section. Refusal to register a design in certain cases.

Provisions of Section 36
Appeals to the High Court

- Where an appeal is declared by this Act to lie from the Controller to the High Court, the appeal shall be made within three months of the date of the order passed by the Controller.
- In calculating the said period of three months, the time (if any) occupied in granting a copy of the order appealed against shall be excluded.
- The High Court may, if it thinks fit, obtain the assistance of an expert in deciding such appeals, and the decision of the High Court shall be final.
- The High Court may make rules consistent with this Act as to the conduct and procedure of all proceedings under this Act before it.

8.6 The Trade Mark Act, 1999
The trademarks law of India is enshrined the new Trade Marks Act, 1999 that came into vigor with effect from September 15, 2003. The old Trade and Merchandise Marks Act, 1958 was repealed at the same time. The new Trademarks Act of 1999 is in line up with the WTO recommendations and is in conventionality with the TRIPS Agreement to which India is a participant.

Under the new Trademarks Act of 1999:

- Registration of Service Marks allowed in addition to Trademarks for goods.
- No separate application necessary for each category/class of goods or services; a single application would do, however filing fee will be charged separately for each class of goods/services.
- The term of registration of trademark is ten years, subject to renewal thereafter.
- The system of maintaining registration of trademark in Part A and Part B with different legal rights, dispensed away.
- Registration of trademarks which are imitations of well known trademarks not permitted.
- Registration of Collective Marks owned by associations allowed.
- Offences relating to trademark made cognisable.
- Filing Fees enhanced by more than 8 times.
- Extension of application of convention countries.
8.6.1 Meaning of ‘Trade Mark’

A trademark is a word, symbol, or phrase, used to identify a particular manufacturer or seller’s products and distinguish them from the products of another. For example, the trademark “Nike,” along with the Nike “swoosh,” identify the shoes made by Nike and distinguish them from shoes made by other companies (example, Reebok or Adidas). Similarly, the trademark “Coca-Cola” distinguishes the brown-colored soda water of one particular manufacturer from the brown-colored soda of another (example, Pepsi). When such marks are used to identify services (example, “Jiffy Lube”) rather than products, they are called service marks, although they are generally treated just the same as trademarks.

Under some circumstances, trademark protection can extend beyond words, symbols, and phrases to include other aspects of a product, such as its color or its packaging. For example, the pink color of Owens-Corning fiberglass insulation or the unique shape of a Coca-Cola bottle might serve as identifying features. Such features fall generally under the term “trade dress,” and may be protected if consumers associate that feature with a particular manufacturer rather than the product in general. However, such features will not be protected if they confer any sort of functional or competitive advantage. So, for example, a manufacturer cannot lock up the use of a particular unique bottle shape if that shape confers some sort of functional advantage (for instance, it is easier to stack or easier to grip). Qualitex Co. v. Jacobson Products Co., Inc., 115 S. Ct. 1300 (1995).

Trademarks make it easier for consumers to quickly identify the source of a given good. Instead of reading the fine print on a can of cola, consumers can look for the Coca-Cola trademark. Instead of asking a store clerk who made a certain athletic shoe, consumers can look for particular identifying symbols, such as a swoosh or a unique pattern of stripes. By making goods easier to identify, trademarks also give manufacturers an incentive to invest in the quality of their goods. After all, if a consumer tries a can of Coca-Cola and finds the quality lacking, it will be easy for the consumer to avoid Coca-Cola in the future and instead buy another brand. Trademark law furthers these goals by regulating the proper use of trademarks.

8.6.2 Some important Aspects of the Trade Marks Act of 1999

The Trade Marks Act of 1999 is quite exhaustive in which there are 159 sections. The Act extends to the procedure for registration of trade marks, application for registration, registration of trade marks, duration renewal, etc. of registration, Chapters II and III), effect of registration [Chapter IV], assignment and transmission of trade marks [Chapter V], registered users [Chapters VI], rectification and correction of the Register [Chapter VII], special provisions for collective marks and for certification of trade marks [Chapters VIII and IX] etc. Besides these aspects, we find provisions relating to the offences, penalties etc. in Chapter XII of the Act. Mark is not made compulsory requirement of the Act. However, the registration of a trade mark, if valid, gives its proprietor the exclusive legal right to use it in relation to the goods or services in respect of which the trade mark is registered. Registration of a trade mark is prima facie evidence of the validity of the trade mark.
Summary

- Intellectual property is a right pervaded in some property of real nature, and as such it is only a property in fiction or a fictional property.
- Intellectual property can be divided mainly into four kinds or types i.e Patent Right, Copyright Right, Trade Marks Right and Design Right.
- ‘Intellectual Property Rights’ means the exclusive right that the owner has over his intellectual property, within the limits of the law, to use and enjoy it in the same way as the owner of other kinds of properties, movable or immovable.
- The term ‘Patent’ is defined as a monopoly right which is granted to a person who has invented a new and useful article, or an improvement of existing article, or a new process of making an article.
- The Controller General of Patents, Designs and Trade Marks appointed under the Trade and Merchandise Marks Act, 1958, is the concerned Controller of Patents for the purposes of the Patents Act, 1970.
- Copyright is a form of protection provided to the authors of “original works of authorship” including literary, dramatic, musical, artistic, and certain other intellectual works, both published and unpublished.
- The Law of Copyright in India is contained in the Copyright Act of 1957 as amended subsequently in 1983, 1984, 1992, 1994 and 199999 as per requirements.
- If a group of articles meets the following requirements then that group of articles may be regarded as a set of articles under the Designs Act, 2000: (i) Ordinarily on sale or intended to be used together. (ii) All having common design even though articles are different (same class). (iii) exhibit same general character.
- Designs Act of 2000 does not include the trade mark and the property mark alone but also includes the ‘artistic works’.
- The trademarks law of India is enshrined the new Trade Marks Act, 1999 that came into vigor with effect from September 15, 2003.
- A trademark is a word, symbol, or phrase, used to identify a particular manufacturer or seller’s products and distinguish them from the products of another.

References

- Geet, S.D and Deshpande, A., **Legal Aspects of Business**, Nirali Prakashan.
Recommended Reading

1. _______ is a right pervaded in some property of real nature, and as such it is only a property in fiction or a fictional property
   a. Individual property
   b. Intellectual property
   c. Copyright
   d. Patent Right

2. The Law of Copyright in India is contained in the Copyright Act of _______.
   a. 1983
   b. 1984
   c. 1992
   d. 1957

3. The term _______ is defined as a monopoly right which is granted to a person who has invented a new and useful article.
   a. Copyright
   b. Trademark
   c. Patent
   d. IPR

4. _______ is a form of protection provided to the authors of “original works of authorship” including literary, dramatic, musical, artistic, and certain other intellectual works.
   a. Copyright
   b. Patent
   c. Trademark
   d. IPR

5. The _______ Act, 1999 was passed and came into vigor with effect from September 15, 2003.
   a. Design
   b. Patent
   c. Trademark
   d. Copyright

6. The provisions related to powers and duties of the Controller are given in _______ of the Designs Act, 2000
   a. Chapter V
   b. Chapter IV
   c. Chapter IX
   d. Chapter VIII

7. Which statement is true?
   a. Patent protection does not begin until the patent is issued.
   b. Designs Act of 2000 does not include ‘artistic works’.
   d. A design which is not new or original is also capable of being registered as ‘Design’ under the Designs Act, 2000.
8. A ___________ is a word, symbol, or phrase, used to identify a particular manufacturer or seller’s products and distinguish them from the products of another.
   a. Patent
   b. Copyright
   c. Design
   d. Trademark

9. Which statement is false?
   a. An application for a patent for an invention may be made by any person claiming to be the true and first inventor of the invention.
   b. Every patent shall be in the prescribed form and shall have effect throughout India.
   c. “Owner of copyright” may include an exclusive licensee.
   d. The provisions relating to “Rights of the Copyright Owner” are found in sections from 22 to 29[Chapter V] of the Copyright Act, 1957.

10. The Indian Patents Act was last amended in ___________.
    a. 2005
    b. 1970
    c. 1999
    d. 2003
Case Study I

The Indian Contract Act, 1872

Situation 1: Mr. X is a businessman fighting a long drawn Court case with Mr. Y another businessman. To support his case Mr. X signs up the services of Mr. Z a legal expert stating that an amount of Rs. 2 lakhs would be paid, if Mr. Z does not take up the brief of Mr. Y. Mr. Z agrees, but at the end of the litigation Mr. X refuses to pay.

Question: Decide whether Mr. Z can recover the amount promised by Mr. X under the provisions of the Indian Contract Act, 1872.

Situation 2: P hires a taxi of Q and agrees to pay Rs.700 as hire charges. The taxi was unsafe for driving because of its loose footbrake, though Q was unaware of it. P was injured and claims compensation for injuries suffered by him. Q refuses to pay.

Question: Discuss the liability of Q.

Situation 3: X, a minor was pursuing the study of Chartered Accountancy. On 1st July, 2009 he took a loan of Rs. 15,000 from Y for payment of his course fees and to purchase books and agreed to repay by 31st December, 2009. X possesses assets worth Rs. 2 lakhs. On due date X fails to pay back the loan to Y. Y now wants to recover the loan from X out of his (X’s) assets.

Question: Referring to the provisions of Indian Contract Act, 1872 decide whether Y would succeed.

Situation 4: B, at the request of A, sells goods which are in the possession of A, on which A had no right to dispose of. B does not know this fact and hands over the sale proceeds to A. Afterwards C, the true owner to the goods sues B and recovers the value of the goods and costs.

Question:
Advise the remedy available to B.

Solution
1. The problem as asked in the question is based on one of the essentials of a valid contract. Accordingly, one of the essential elements of a valid contract is that the agreement must not be one which the law declares to be either illegal or void. A void agreement is one without any legal effect. Thus, any agreements in restraint of trade, marriage, legal proceedings etc., are void agreements. Thus Mr. Z cannot recover the amount of Rs. 2 lakhs promised by Mr. X because it is an illegal agreement and cannot be enforced by law.

2. Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 150. The Section provides that if the goods are bailed for hire, the bailor is responsible for such damage, whether he was or was not aware of the existence of such faults in the goods bailed. Accordingly, applying the above provisions in the given case Q is responsible to compensate P for the injuries sustained even if he was not aware of the defect in the carriage.
3. Yes, Y can proceed against the assets of X. According to section 68 of the Indian Contract Act 1872 “If a person, incapable of entering into a contract, or any one whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.” Since the loan given to X is for the necessaries of the minor, his assets can be sued for reimbursement to Y.

4. Rights of Bailee: As per Sections 178 and 178A of the Indian Contract Act, 1872 the deposit of title deeds with the bank as security against an advance constitutes a pledge. As a pledge, a banker’s rights are not limited to his interest in the goods pledged. In case of injury to the goods or their deprivation by a third party, the pledgee would have all such remedies that the owner of the goods would have against them. In Morvi Mercantile Bank Ltd. vs. Union of India, the Supreme Court held that the bank (pledgee) was entitled to recover not only the amount of the advance due to it, but the full value of the consignment. However, the amount over and above his interest is to be held by him in trust for the pledgor. Thus, the bank will succeed in this claim of Rs. 50,000 against Roadways.

5. As per the provision given under Section 223 of the Indian Contract Act, 1872, an agent has a right to be reimbursed by the principal for any compensation which he may be required to pay the third party for injuries caused by wrongful acts done within the scope of his authority, in good faith without having any wrong intentions. Thus, in the given problem B has a right to be reimbursed the sum which he has indemnified to C, against the consequences of acts done in good faith.

Case Study II

The Negotiable Instruments Act, 1881

**Situation 1:**
PQR Limited received a cheque for Rs. 50,000 from its customer Mr. LML. After a week the company came to know that the proceeds were not credited to the account of PQR Limited due to some ‘defects’, as informed by the Banker.

**Question:** What according to you are the possible effects?

**Situation 2:** A draws a bill of exchange payable to himself on ‘X’, who accepts the bill without consideration just to accommodate ‘A’. ‘A’ transfers the bill to ‘P’ for good consideration.

**Question:** State the rights of ‘A’ and ‘P’. Would your answer be different if ‘A’ transferred the bill to ‘P’ after maturity?

**Situation 3:**
B issued a cheque of Rs.1, 25, 000 in favour of S. B had sufficient amount in his account with the Bank. The cheque was not presented within reasonable time to the Bank for payment and the Bank in the meantime, became insolvent.

**Question:** Decide, under the provisions of the Negotiable Instrument Act, 1881 whether S can recover the money from B.

**Situation 4:**
‘A’ issues an open ‘bearer’ cheque for Rs.10, 000 in favour of B who strikes out the word ‘bearer’ and crosses the cheque. The cheque is thereafter negotiated to C and D. When it is finally presented by D’s banker, it is returned with remarks “payment countermanded” by drawer. In response to a legal notice from D, A pleads that the cheque was altered after it had been issued and therefore he is not bound to pay the cheque.

**Question:** Referring to the provisions of the Negotiable Instruments Act, 1881 decide, whether A’s argument is valid or not?

Case Study III

The Companies Act, 1956

**Situation 1:**
Mr. Jain, a director in SysInfo Ltd. has been empowered by the Board to make calls on shares of the company.
**Question:** Is this delegation of power to make calls, legal? Also advise him and the Board on the rules relating to making of call.

**Situation 2:**
Softmicro Ltd. was allotted shares of LCH Ltd. But, Softmicro Ltd claimed that it had not been issued a share certificate despite repeated requests for the same. But, LCH Ltd contended that a director of Softmicro Ltd had taken personal delivery of the certificate.
**Question:** How can this matter be resolved? Discuss with reference to case laws, if any.

**Situation 3:**
Mrs. & Mr. Premchand are joint-shareholders in XYZ Ltd. They wish to appoint their minor son Ajay as the nominee.
**Question:** Is such nomination, subsequent to purchase of shares, feasible? Can joint-holders appoint a single nominee? If so, can the proposed nominee be a minor? Explain with reference to the statutory provisions.

**Situation 4:**
The secretary of X Ltd., convened a general meeting for the purpose of making a call. Only one shareholder attended the meeting. The business of the company was carried through including a call on the shareholders. D, a shareholder was sued for the call he had failed to pay. In his defence, D argued that the call had not been validly made at a general meeting.
**Question:** Is the meeting where only one member had attended, valid? Are all such meetings invalid? Substantiate your answer with relevant case law.

**Situation 5:**
Beena Ltd, company wants to buy back its shares.
**Question:** Advise the company as to the rules it has to comply with in this regard,

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Self Assessment Answers

Chapter I
1. a
2. d
3. b
4. c
5. a
6. a
7. c
8. a
9. a
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Chapter II
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Chapter VIII
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5. c
6. d
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8. d
9. d
10. a