

## 1.5 TYPES OF COMPANY

Joint stock company can be of various types. The following are the important types of company:

### 1. Classification of Companies by Mode of Incorporation

Depending on the mode of incorporation, there are three classes of joint stock companies.

**A. Chartered companies.** These are incorporated under a special charter by a monarch. The East India Company and The Bank of England are examples of chartered incorporated in England. The powers and nature of business of a chartered company are defined by the charter which incorporates it. A chartered company has wide powers. It can deal with its property and bind itself to any contracts that any ordinary person can. In case the company deviates from its business as prescribed by the charter, the Sovereign can annul the charter and close the company. Such companies do not exist in India.

**B. Statutory Companies.** These companies are incorporated by a Special Act passed by the Central or State legislature. Reserve Bank of India, State Bank of India, Industrial Finance Corporation, Unit Trust of India, State Trading corporation and Life Insurance Corporation are some of the examples of statutory companies. Such companies do not have any memorandum or articles of association. They derive their powers from the Acts constituting them and enjoy certain powers that companies incorporated under the Companies Act have. Alterations in the powers of such companies can be brought about by legislative amendments.

## **1.8 SELFASSESSMENT QUESTIONS**

1. Define 'Company'. What are its essential characteristics ?
2. Explain the special privileges of a private company as compared to a public company.
3. Bring out the difference between partnership and company form of organization.
4. Write notes on :
  - a) Chartered Companies
  - b) Government Companies
5. Classify company form of organization on the basis of liability of members.

## **1.9 SUGGESTED READINGS**

P.P.S. Gogna, Mercantile Law, S.Chand & Company, New Delhi.

N.D. Kapoor, Company Law, Sultan Chand & Sons, New Delhi.

S.C. Aggarwal, Company Law, Manpat Rai Publications, New Delhi.

S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.

O.C. Zarsiney, Elements of Business Law, S Chand & Co., New Delhi.

## LESSON : 2

### INCORPORATION OF COMPANIES; MEMORANDUM OF ASSOCIATION AND ARTICLES OF ASSOCIATION

#### STRUCTURE

- 2.0 Objective
- 2.1 Introduction
- 2.2 Incorporation
  - 2.2.1 Promotion
  - 2.2.2 Incorporation
  - 2.2.3 Capital Subscription
  - 2.2.4 Commencement of Business
- 2.3 Memorandum of Association
- 2.4 Articles of Association
- 2.5 Difference between Memorandum of Association and Articles of Association
- 2.6 Constructive Notice of Memorandum and Articles of Association
- 2.7 Summary
- 2.8 Key Words
- 2.9 Self Assessment Questions
- 2.10 Suggested Readings

#### 2.0 OBJECTIVE

After reading this lesson, you should be able to

- (a) Describe the process of formation of a company.
- (b) Explain the different clauses of memorandum of association and the alterations thereof.
- (c) Discuss the contents of articles of association.
- (d) highlight the importance of constructive notice of memorandum and articles of association.

within 120 days of the issue of prospectus, no allotment can be made and all money received will be refunded.

If a public company having share capital decides to make private placement of shares, then, instead of a 'prospectus' it has to file with the Registrar of Companies a 'statement in lieu of prospectus' at least three days before the directors proceed to pass the first share allotment resolution.

The contents of a prospectus and a statement in lieu of a prospectus are almost alike.

#### **2.2.4 Commencement of Business**

A private company can commence business immediately after the grant of certificate of incorporation, but a public limited company will have to undergo some more formalities before it can start business. The certificate for commencement of business is issued by Registrar of Companies, subject to the following conditions.

1. Shares payable in cash must have been allotted up to the amount of minimum subscription.
2. Every director of the company had paid the company in cash application and allotment money on his shares in the same proportion as others.
3. No money should have become refundable for failure to obtain permission for shares or debentures to be dealt in any recognized stock exchange.
4. A declaration duly verified by one of directors or the secretary that the above requirements have been complied with which is filed with the Registrar.

The certificate to commence business granted by the Registrar is a conclusive evidence of the fact that the company has complied with all legal formalities and it is legally entitled to commence business. It may also be noted that the court has the

power to wind up a company, if it fails to commence business within a year of its incorporation [Sec. 433 (3)]

### **2.3 MEMORANDUM OF ASSOCIATION**

The formation of a public company involves preparation and filing of several essential documents. Two of basic documents are :

1. Memorandum of Association
2. Articles of Association

The preparation of Memorandum of Association is the first step in the formation of a company. It is the main document of the company which defines its objects and lays down the fundamental conditions upon which alone the company is allowed to be formed. It is the charter of the company. It governs the relationship of the company with the outside world and defines the scope of its activities. Its purpose is to enable shareholders, creditors and those who deal with the company to know what exactly is its permitted range of activities. It enables these parties to know the purpose, for which the money is going to be used by the company and the nature and extent of risk they are undertaking in making investment. Memorandum of Association enable the parties dealing with the company to know with certainty as whether the contractual relation to which they intend to enter with the company is within the objects of the company.

#### **Form of Memorandum (Sec. 14)**

Companies Act has given four forms of Memorandum of Association in Schedule I. These are as follows :

- |         |   |
|---------|---|
| Table B | Memorandum of a company limited by shares                                   |
| Table C | Memorandum of a company limited by guarantee and not having a share capital |

The procedure for the alteration of share capital and the power to make such alteration are generally provided in the Articles of Association. If the procedure and power are not given in the Articles of Association, the company must change the articles of association by passing a special resolution. If the alteration is authorized by the Articles, the following changes in share capital may take place :

1. Alteration of share capital [Section 94-95]
2. Reduction of capital [Section 100-105]
3. Reserve share capital or reserve liability [Section 99]
4. Variation of the rights of shareholders [Section 106-107]
5. Reorganization of capital [Section 390-391]

#### **5. Alteration of Liability Clause**

Ordinarily the liability clause cannot be altered so as to make the liability of members unlimited. Section 38 states that the liability of the members cannot be increased without their consent. It lays down that a member cannot by changing the memorandum or articles, be made to take more shares or to pay more the shares already taken unless he agrees to do so in writing either before or after the change.

A company, if authorized by its Articles, may alter its memorandum to make the liability of its directors or manager unlimited by passing a special resolution. This rule applies to future appointees only. Such alteration will not effect the existing directors and manager unless they have accorded their consent in writing. [Section 323].

Section 32 provides that a company registered as unlimited may register under this Act as a limited company. The registration of an unlimited company as a limited company under this section shall not affect any debts, liabilities, obligations or contracts incurred or entered into by the company before such registration.

## **2.4 ARTICLES OF ASSOCIATION**

operations beyond which its actions cannot go. The memorandum of association of every clause, objects clause, liability clause, Memorandum of association cannot be altered by the sweet will of the members of the company. It can be altered only by following the procedure prescribed in the Companies Act. Articles of association contain the rules and regulations which are granted for the internal management of the company. The company may alter its articles of association any time by following the procedure as prescribed in the Companies Act. Every person dealing with the company is presumed to have read the memorandum and articles of association and understood them in their time perspective. This is known as doctrine of constructive notice.

## 2.8 KEYWORDS

**Promotion:** Promotion means the discovery of business opportunities and the subsequent organization of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.

**Promoter:** A promoter is a person who undertakes to form a company with reference to a given object and brings it into actual existence.

**Preliminary Contract:** Preliminary contract refers to those agreements or contracts entered into between different parties on behalf and for the benefit of the company prior to its incorporation.

**Certificate of Commencement of Business:** A public company, having a share capital and issuing a prospectus inviting the public to subscribe for shares, will have to file a few documents with the registrar who shall scrutinize them and if satisfied will issue a certificate to commence business.

**Memorandum of Association:** It is the document which defines the objects and lays down the fundamental conditions upon which along the company is allowed to be incorporated.

**Articles of Association:** Articles of association are the rules, regulation and bye-laws for governing the internal affairs of the company.

## 2.9 SELF ASSESSMENT QUESTIONS

1. Explain the process of formation of a company under the Companies Act, 1956.
2. “A certificate of incorporation is conclusive evidence that all the requirements of the Companies Act have been complied with”. Comment.
3. What is a Memorandum of Association ? Discuss its clauses.
4. How the alteration in the different clauses of Memorandum of Association can be made?
5. What is Articles of Association ? What are its contents ?
6. Distinguish between Memorandum of Association and Articles of Association.

## 2.10 SUGGESTED READINGS

S.K. Aggarwal, Business Law, Galgotia Publishing Company, New Delhi.

G.K. Varshney, Elements of Business Law, S Chand & Co., New Delhi.

R.H. Pandia, Principles of Mercantile Law, N.M. Tripathi Pvt. Ltd., Mumbai.

S.R. Davar, Mercantile Law, Progressive Corporation Pvt. Ltd., Mumbai.

K.R. Balchandari, Business Law for Management, Himalaya Publication House, New Delhi.

change.

## **7. Personation for Acquisition etc. of Shares**

The provision, consequences of applying for shares in fictitious names to be prominently displayed must be reproduced in every prospectus and every application form issued by the company to any person.

A person who makes in a fictitious name to a company for acquiring shares or subscribing any shares or subscribing any shares shall be liable to imprisonment which may extend to five years similarly, a person who induces a company to allot any shares or to register any transfer of shares in a fictitious name is also liable to the same punishment. [Section 68(a)]

## **8. Contents as per Schedule II**

Every prospectus must disclose the matters as required in Schedule II of the Act. It is to be noted that if any condition binding on the applicant for shares or debentures in a company to waive compliance with any requirements of the Act as to disclosure in the prospectus or purporting to affect him with notice of any contract, document or matter not specifically referred to in the prospectus shall be void [Section 56(2)].

If a prospectus is issued without a copy thereof, the necessary documents or the consent of the experts the company and every person, who is knowingly a part to the issue of the prospectus, shall be punishable with fine which may extend to Rs. 5,000/-.

## **3.5 CONTENTS OF PROSPECTUS**

Muggeridge [(1860) 3 LT 651]. The true nature of company's venture should be disclosed. The statements which do not qualify to the particulars mentioned in the prospectus or any information is intentionally and willfully concealed by the directors of the company, would be considered as mis-statement.

Thus, the term 'venture statement' as 'mis-statement' is used in a broader sense. It includes not only false statements which produce a impression of actual facts. Concealment of a material fact also comes within the category of mis-statement.

A statement included in a prospectus shall be deemed to be untrue, if

- The statement is misleading in the form and context in which it is included; and
- the omission from a prospectus of any material fact is calculated to mislead (Section 19).

If there is any misstatement of a material fact in a prospectus as if the prospectus is wanting in any material fact, this may arise-

1. Civil Liability
  2. Criminal Liability
- 1. Civil Liability**

A person who has induced to subscribe for shares (or debentures) on the faith of a misleading prospects has remedies against the company, directors,

promoters, and experts. Every person who is a director and promoter of the company, and who has authorized the issue of the prospectus [Section (2)].

**a) Compensation**

The above persons shall be liable to pay compensation to every person who subscribes for any shares or debentures for any loss or damage sustained by him by reason of any untrue statement included therein [Section 62(1)].

In *McConnel V. Wright* (1903 1 Ch 5460) it has been held that the measure of the damages is the loss suffered by reason of the untrue statement, omissions, etc. the difference between the value which the shares would have had and the true value of the shares at the time of the allotment.

**b) Rescission of the Contract on Misrepresentation**

Avoiding the contract is rescission. Any person can apply to the court for rescission of the contract if the statements on which he has taken the shares are false or caused by misrepresentation whether innocent or fraudulent.

The contract can be rescinded if the following conditions are satisfied:

- 1) The statement must be a material misrepresentation of fact
- 2) It must have induced the shareholder to take the shares.
- 3) The deceived shareholder is an allottee and he must have relied on the statement in the prospectus.
- 4) The omission of material fact must be misleading before rescission is granted.

A director or other person responsible shall be liable for damage for non-compliance with or contravention of any of the matters to be stated and reports to be set out in the prospectus as provided [by Section 56(41)].

**e) Damages for Fraud under General Law**

Any person responsible for the issue of prospectus may be held liable under the general law or under the Act for misstatements or fraud.

**f) Penalty for Contravening Section 57 & 58**

If any prospectus is issued in contravention of Section 57, (experts to be unconnected with formation or management of company), or Section 58 (expert's consent to issue of prospectus containing statement by him), the company and every person who is knowingly party to the issue thereof, shall be punishable with fine which may extend to Rs. 5,000/-

**g) Penalty for issuing the Prospectus without Registration**

If a prospectus is issued without a copy of thereof being delivered to the Registrar, the company and every person who is knowingly a party to the issue of the prospectus shall be punishable with fine which may extend to Rs 5,000 [Section 60(5)].

**Defence against Civil Liability**

Every person made liable to pay compensation for any loss or damages may escape such liability by proving that :

- I. Having consented to become a director of the company, he withdrew his consent before the issue of the prospectus and that it was issued without

### 3. **Within a reasonable time**

The allotment must be made within a reasonable time after the receipt of the application. Otherwise the applicant shall not be bound to accept it.

In *Ramasgate Victoria Hotel Co. v. Monterfiore*, Monterfiore applied for shares on June 28. But allotment was made on November 23 and he refused to take the shares. In this case it was held that the offer had lapsed and the applicant was not liable to pay for the allotment.

### 4. **Must be communicated**

The allotment must be communicated to the person making the application so that it is legally complete. Communication need not be in a particular form unless the articles of the company provide otherwise. Whatever is the mode of communication, it must be made to the applicant or his agent who is duly authorised to receive it. In case of postal communication, allotment is complete as soon as the letter of allotment is posted even though it is never received (*Household Fire Insurance Co. v. Grant*).

### 5. **Revocation of the offer**

An offer to take shares can be revoked at any time before the allotment is communicated.

H applied for shares in a company which were allotted to him. The letter of allotment was sent by the company's agent to be delivered by hand to H. Before the delivery of the letter of allotment, H withdrew his application. It was held that H was not a shareholder of the company. [*Re National Savings Bank Association (1867) L.R. 4E9.9*]

In the same way, the allotment can be withdrawn by the company before it is communicated completely to the applicant.

### 4.3 RULES OF ALLOTMENT

The Companies Act, 1956 does not prescribe any restriction as to the allotment of shares and debentures when issued by private companies. However, the Companies Act prescribes certain restrictions regarding the allotment of shares and debentures by public companies. Such restriction may be discussed under the following two heads :

(A) When no public offer is made.

(B) When public offer is made.

(A) **When no public offer is made**

A public company having share capital, which does not issue a prospectus or has issued 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 a statement in lieu of prospectus has been delivered to the Registrar at least three days before the first allotment of shares or debentures. The statement must be signed by every person who is a director or proposed director of the company or by his agent authorised in writing. (Section 70 (1))

If the company contravenes the above provision, the allotment shall be irregular and voidable at the option of the allottee. Further, the company, and every director of the company who willfully authorises or permits the contravention, shall be punishable with fine which may extend to Rs. 1000. [Section 70(4)]

of the shares is not bound to procure registration. He will simply hand over to the transferee a duly executed transfer form and the share certificate or the letter of allotment.

### **Power of Directors to refuse transfer**

Where the articles do not contain any clause, allowing the directors to reject the transfer, the shareholder may freely transfer his share and can compel the directors for registering of shares. On the other hand, if the articles contain a clause empowering the directors to reject the transfer, the directors can reject such transfer but subject to the following conditions :

- (a) Power must be exercised by the directors in the interest of the company as a whole and not in the interest of a section of shareholders.
- (b) For rejection, the conditions given in the articles must be followed.
- (c) Refusal must be exercised within a reasonable time.
- (d) Refusal must be exercised by the board and not by one of the directors.
- (e) The court cannot compel the directors to supply the reasons of rejection but if supplied can examine and if inadequate can reject the order of the directors.

The following are the grounds on which the board may refuse registration of transfer :

- (a) If partly paid up shares are being transferred and transferee is known to be financially incapable of paying balance calls.

- (i) If the true owner has been removed from the register, he can compel the company to replace him.
- (ii) If the company has issued a new certificate to the so called transferee, it can not deny his title to the shares, the certificate stops it (the company) from doing so.
- (iii) The person lodging the transfer must indemnify the company against loss by forgery.

Companies normally notify the transferor of the transfer so that he can object if he wishes. The transferor is, however, under no legal obligation to reply and therefore no estoppel can be raised against the owner on his failure to reply.

### **Blank Transfer**

A blank transfer is an instrument of transfer signed by the transferor in which the name of the transferee is not filled.

Since the name of the transferee is not filled, the shares in such cases may further be transferred merely by delivering the blank instrument of transfer. Thus, stamp duty and registration fee is saved. Only the last transferee has to bear these expenses. The results are :

- (i) this helps in avoiding or reducing liability of tax thereon; and
- (ii) these may act as clear security for creditors.

But blank transfer does not confer the ownership of shares on the transferee. If he wants to retain the shares, he can fill in his name and date in the transfer deed and get himself registered as shareholder. Until such registration, the original transferor continues to be the owner and remains liable for any amount remaining unpaid on the shares. Morally, he is a trustee for the dividends declared and received. But it does not confer

## 5.1 INTRODUCTION

A company is composed of certain persons who constitute it as a corporate body. However, the identity of the company is different from the persons composing it. The persons composing the company are the 'members' or 'shareholders' of the company. A member is a person who has signed company's memorandum of association. Any other person who agrees in writing to become a member and whose name is entered in company's register of members is also a member of the company [Section 41].

It is important to note here that the terms 'member' and 'shareholder' are used inter-changeably in the Companies Act. A shareholder means a person who holds the shares of the company. Apart from a few exceptional cases, the terms member and shareholder are synonymous. In these exceptional cases, a person may be a member but not a shareholder, or he may be a shareholder but not a member. In the following cases, a person is a member, but not a shareholder:

- (a) A person who signs company's memorandum of association, immediately becomes the member on registration of the memorandum before any shares are allotted to him.
- (b) A person who transfers his shares, continues to be the member of the company until his name is replaced by the name of the transferee. But he is no more a shareholder.
- (c) A person who has ceased to be a shareholder by reason of forfeiture, surrender or transfer of shares, may be held liable as member, for the payment of unpaid amount on shares in case of default by the present shareholder.
- (d) A company limited by guarantee or an unlimited company having no share capital will have only members but no shareholders.

2. Every registered shareholder is a member but every registered member may not be a shareholder because the company may or may not have share capital.
3. The transferor or the deceased person is a member so long as his name is on the register of members whereas he cannot be termed as shareholder.
4. Similarly, a shareholder by transfer is not a member until his name is entered in the company's register of members.
5. A person who misrepresents himself to be a member is estopped from denying his position subsequently. He is said to have become a member by estoppel.
6. A person may become a member by an order or decree of a court.

### 5.3 CAPACITY OF A MEMBER

We know that the capacity means the competency of a person to enter into a contract. A contract to purchase shares in a company is like any other contract. Therefore, the membership of a company is open to any person who is competent to enter into a valid contract. The Companies Act does not prescribe any qualifications for becoming a member of a company. However, only such a person who is competent to contract as per the Indian Contract Act, 1872 may become a member. This is, however, subject to the provisions of the memorandum and articles of the company. The articles may provide that certain persons cannot become members of the company. The membership rights of certain persons and organisations are discussed hereunder :

Preview from Notesale.co.uk  
Page 111 of 404

- (h) by the winding-up of the company, of course he remains liable as a contributory.
- (i) by redemption of redeemable preference shares.
- (j) by issue of share warrants to him in exchange of fully paid shares.

## 5.6 DUTIES AND LIABILITIES OF MEMBERS

### Duties

It is the duty of a shareholder :

- (a) as a subscriber of the memorandum, to take the share written opposite his name direct from the company and pay for them ;
- (b) to take shares when they are duly allotted to him and pay for them according to the terms of issue of the shares ;
- (c) to pay all valid calls as and when they are made ;
- (d) to abide by the decisions of the majority of members unless the majority acts vindictively, oppressively, mala fide or fraudulently;
- (e) to contribute to the asset of the company when it goes into liquidation.

### Liability

The liability of the members of a company depends upon the nature of the company.

*Company limited by shares.* In the case of a company limited by shares, the liability of a member of company is the amount, if any unpaid on his shares. If his shares are fully paid, his liability is nil for all purposes.

*Company limited by guarantee.* The liability of the members of a company limited by guarantee is limited to the amount they undertook to contribute to the assets of the company in the event of winding up.

20. Right to have notice of any resolution requiring a special notice in the meeting.
21. Right to inspect the shareholders' minutes book and get copies thereof on payment of the prescribed fees.

**(B) Documentary Rights**

These rights are the rights given by the two basic documents i.e. memorandum of association and articles of association. The company may also give certain rights to its members by expressly providing for them in the memorandum or the articles of the company.

**(C) Legal Rights**

These rights are given to members under general law. For example, a person who has taken shares of a company on the faith of a misleading prospectus can avoid the contract and claim damages under the general law.

**5.8 REGISTER OF MEMBERS (SEC. 150)**

It is the statutory obligation of every company to maintain a register of its members containing the following particulars :

- (a) The name and address and the occupation, if any, of each member ;
- (b) In the case of a company having share capital, the shares held by each member and the amount paid or agreed to be considered as paid on those shares;
- (c) The date on which each person was entered in the register as a member;
- (d) The date on which any person ceased to be a member.

**(b) Subrogation**

If the money borrowed has been used by company in paying off its lawful debts, the lender will rank as a creditor upto the amount so used, and can recover it from the company. He can sue the company by virtue of principle of subrogation. But the lender will have no priority over other creditors even though the debts paid off had priority.

**Example :** A company had exhausted its borrowing powers by issuing three different series of debentures A, B and C. A had priority over B and B had priority over C. The company took a loan from the plaintiff to pay interest on A debentures. The borrowing by the company was ultra vires. It was held that plaintiff was a legal creditor of the company to the extent his loan was used to pay-off legal debts, but he was not entitled to the priority of A debentures. (Re Wrexham Mold C. Ltd. (1899) 1 Ch. 440).

**(c) Tracing**

If the lender is in a position to trace the property purchased with his money, he can get a tracing order from the court and follow the property. If traced, the company will be deemed as a trustee for the property on behalf of the lender.

In the case of *Sinclair v. Brougham*, (1914) A.c. 398, the Memorandum of a building society empowered it to borrow or to lend on the security of land. But the building society also developed a large banking business which was ultravires of the society. The company was wound up and the company's assets were composed partly of the shareholder's money (i.e. the money of the members of the society) and partly of the depositors money (i.e. the money of the ultravires lenders). The company had to pay the outside creditors, the shareholders of the society (i.e. members) and the depositors of money. The outside creditors were paid in-full with the

as the charge is void against the liquidator and the creditors.

7. If default is made in filing the particulars of charges, the company and every officer of the company or any other person who is in default shall be punishable with fine which may extend to Rs. 500 for every day during which the default continues. A further fine of upto Rs. 1000 may be imposed on the company and every officer of the company for other defaults relating to the registration of charges (Sec. 142).

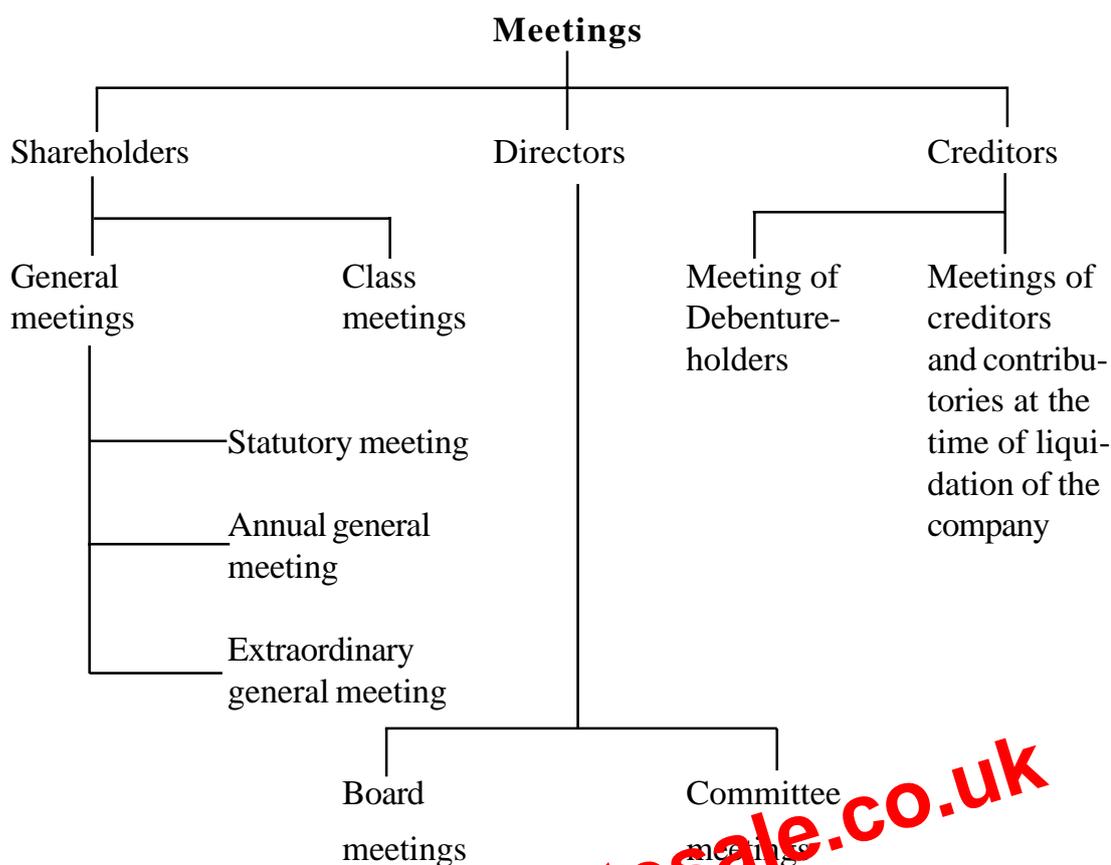
### **The Company's Register of Charges (Sec. 143)**

Every company has to keep at its registered office a register of charges and enter therein all charges specifically affecting property of the company and all floating charges on the undertaking or on any property of the company, giving in each case :

- (a) a short description of the property charged;
- (b) the amount of charge; and
- (c) the names of the persons entitled to charge.

If any officer of the company knowingly omits or wilfully authorises or permits the omission of any of the above entries, he shall be punishable with fine which may extend to Rs. 500.

Further, under Sec. 136, every company must keep at its registered office a copy of every instrument creating any charge requiring registration. But in the case of a series of uniform debentures, a copy of only one debenture of the series is sufficient. The register of charges and the documents must be open for inspection by any person.



Preview from Notesale.co.uk  
Page 140 of 404

In this lesson, the discussion will be confined to the meetings of the shareholders.

### 6.3 STATUTORY MEETING

Every public company limited by shares and every company limited by guarantee and having a share capital, shall, within a period of not less than one month nor more than six months from the date on which the company is entitled to commence business hold a general meeting of the members of the company. This meeting is called 'the statutory meeting'. [Sec. 165 (1)]

A meeting held prior to the statutory period of one month from the date of entitlement of a company to commence business can not be called the statutory meeting. The notice for such a meeting should state it

## Statutory Report

The Board of Directors is required to prepare a report which is known as the 'statutory report' and must send this report to the members at least 21 days before the day on which the meeting is to be held [Section 165(2)]. If the report is sent later than is required, it will be deemed to have been duly forwarded if it is so agreed to by all the members entitled to attend and vote at the meeting. Thus the delay in sending the report can be condoned by unanimous consent of all the members present at the meeting. The statutory report is required to be certified as correct by at least two directors of the company, one of whom must be a Managing Director, if there is any. Thereafter the auditor must certify the report to be correct in so far as it relates to the shares allotted by the company, the cash received in respect of such shares and the receipts and payments of the company [Section 165(4)]. A copy of the report must be sent to the Registrar also [Section 165(5)].

### Content of Statutory Report

The statutory report shall set out :

- (a) The total number of shares allotted, distinguishing those allotted as fully or partly paid-up otherwise than in cash, the extent to which they are partly paid up and the consideration for which they have been allotted.
- (b) The total amount of cash received by the company in respect of all the shares allotted.
- (c) An abstract of the receipts and payments made thereout up to a date within 7 days of the date of the report.

- (a) A public company or a private company which is a subsidiary of a public company, may by its Articles fix the time for its annual general meetings and may also by a resolution passed in preceding annual general meeting fix the time for its subsequent annual general meetings and
- (b) A private company which is not a subsidiary of a public company may in like manner and also by a resolution agreed to by all the members thereof, fix the time as well as the place for its annual general meetings [Sec. 166(2)]

### **Adjournment**

Where an annual general meeting is held but adjourned, the adjourned meeting is nothing but continuance of the earlier meeting and therefore if in the adjourned meeting the Balance Sheet and the Profit and Loss Account of the company are laid and adopted and thereafter sent to the Registrar, Section 220(I) is not violated.

### **Holding of annual general meeting where the annual accounts are not ready**

According to Central Government instructions, in case the annual accounts are not ready for laying at the appropriate annual general meeting, the company must hold the annual general meeting within the time limit, transact all business other than the consideration of the accounts, announce when the accounts are expected to be ready for laying and pass a suitable resolution adjourning the said annual general meeting to a specific date or to a date to be specified later on. Thus the company cannot take the plea that the annual general meeting was not held because the accounts were not ready.

## 6.7 REQUISITES OF A VALID MEETING

A meeting to be in order must fulfil certain requirements.

### 1. Proper Authority

The Board of Directors is the proper authority to convene a general meeting of a company and for this purpose the board should pass a resolution at a duly convened meeting of the board. However, if the board fails to call a general meeting of the company, the members or the Central Government or the Central Government may call such a meeting. Some defects in appointment or qualification of the directors present at the meeting of the board will not necessarily be fatal to the validity of the resolution passed at the meeting provided the board has acted bonafide.

### 2. Notice of Meetings (Sec. 171)

A proper notice of the meetings must be given to the members of the company. The notice must be given 21 days before the date of the meeting. The period of 21 days excludes the day of service of the notice and also the day in which the meeting is to be held.

The length of the notice may be waived :

- (a) in the case of an annual general meeting by the consent of all members;
- (b) in the case of any other meeting by the consent of the holders of not less than 95% of the paid-up share capital or the total voting power where the company has no share capital.

### Notice to whom (Sec. 172)

The notice is required to be given to

- (a) all the members of the company who are entitled to vote on the

Chairman will count the hands raised and will declare the result accordingly. Chairman's declaration of the result of voting by the show of hands to be conclusive evidence [Sec. 178].

## 2. Voting by poll [Sec. 179]

If there is dissatisfaction among the members about the result of voting by the show of hands, they can demand a poll. 'Poll' means counting the number of votes cast for and against a motion. The voting rights of a member on a poll shall be in proportion to his share of the paid-up equity capital of the company. Before or on the declaration of the result of voting on any resolution by a show of hands, a poll may be ordered to be taken by the Chairman of the meeting of his own motion, and shall be ordered to be taken by him on a demand made in that behalf by the person or persons specified below :

- (a) In the case of a public company having a share capital, by any member or members present in person or by proxy and holding shares in the company:
- (i) which confer a power to vote on the resolution not being less than one tenth of the total voting power in respect of the resolution, or
  - (ii) on which an aggregate sum of not less than fifty thousand rupees has been paid-up,
- (b) In the case of a private company having a share capital, by one member having the right to vote on the resolution and present in person or by proxy if not more than seven such members are personally present, and by two such members present in person or by proxy, if more than seven such members are personally present,

- (c) In the case of any other company, by any member or members present in person or by proxy and having not less than one tenth of the total voting power in respect of the resolution [Sec. 179(1)].

The demand for a poll may be withdrawn at any time by the person or persons who made the demand. [Sec. 179(2)]. The provisions of Section 179 apply to a private company, which is not a subsidiary of a public company unless the articles provide otherwise.

A poll demanded on the question of adjournment or the election of the Chairman shall be taken forth with. A poll demanded on any other question shall be taken at such time not being later than forty eight hours from the time when the demand was made, as the Chairman may direct. Where a poll is taken, the meeting will be deemed to continue until the ascertainment of the result of the poll. Even a voter who was not present at the meeting when the poll was demanded to be taken may vote personally in a poll held on the next day.

The Chairman of the meeting shall have the power to regulate the manner in which a poll shall be taken [Sec. 185(1)]. Where a poll is to be taken, the Chairman of the meeting shall appoint two scrutiner to scrutinise the votes given on the poll and to report thereon to him [Sec. 184 (1)]. Of the two scrutiner, one shall always be a member present at the meeting, provided such a member is available and willing to the appointed [Sec.184 (3)].

The Articles of a company may provide that no member shall exercise any voting right in respect of any shares registered in his name on which calls or other sums presently payable by him have not been paid (Sec. 181).

3. Voluntary winding up subject to the supervision of the Court [Sec. 425].

### **7.3 WINDING UP BY THE COURT**

A company may be wound up by an order of the Court. This is called compulsory winding up or winding up by the Court. Section 433 lays down the following grounds where a company may be wound up by the Court.

A petition for winding up may be presented to the Court on any of the grounds stated below :

#### **1. Special resolution**

A company may be wound up by the Court if it has, by a special resolution, resolved that it be wound up by the Court. But it is to be noted that the Court is not bound to order for winding up merely because the company by a special resolution has so resolved. Even in such a case it is the discretion of the Court to order for winding up or not.

#### **2. Default in filing statutory report or holding statutory meeting**

If a company has made a default in delivering the statutory report to the Registrar or in holding the statutory meeting, a petition for winding up of the company may be presented to the Court. A petition on this ground may be presented to the Court by a member or Registrar (with the previous sanction of the Central Government) or a creditor. The power of the Court is discretionary and generally it does not order for winding up in first instance. The Court may, instead of making an order for winding up, direct the company to file the statutory report or to hold the statutory meeting but if the company fails to comply with the order, the Court will wind up the company.

company is said to have disappeared when the object for which it was incorporated has substantially failed, or when it is impossible to carry on the business of the company except at a loss, or the existing and possible assets are insufficient to meet the existing liabilities.

The substratum of a company will be deemed to have gone when

- (i) The object for which it was incorporated has substantially failed or has become impossible or (ii) it is impossible to carry on business except at a loss or (iii) the existing and possible assets are insufficient to meet the existing liabilities of the company.
- (b) When there is oppression by the majority shareholders on the minority, or there is mismanagement.
- (c) When the company is formed for fraudulent or illegal objects or when the business of the company becomes illegal.
- (d) When there is a deadlock in the management of the company. When there is a complete deadlock in the management of the company, it will be wound up even if it is making good profits. In *Re Yenidjee Tobacco Co. Ltd.* A and B the only shareholders and directors of a private limited company became so hostile to each other that neither of them would speak to the other except through the secretary. Held, there was a complete deadlock and consequently the company be wound up.
- (e) When the company is a 'bubble', i.e. it never had any real business.

#### 7.4 PERSONS ENTITLED TO APPLY FOR WINDING UP

The Court does not choose to wind up a company at its own motion. It has to be petitioned. Section 439 of the Companies Act enumerates the persons those can file a petition to the Court for the winding

- (e) if the Court is of opinion that it is just and equitable that the company should be wound up.

Note that the Registrar can file a petition for winding up only with prior approval of the Central Government. The Central Government before sanctioning approval must give an opportunity to the company for making its represent actions, if any.

Again a petition on the ground of default in delivering the statutory report or holding the statutory meeting cannot be presented before the expiration of 14 days after the last day on which the statutory meeting ought to have been held.

#### **5. Petition by any Person Authorised by the Central Government**

If it appears to the Central Government from any report of the inspectors appointed to investigate the affairs of the company, that it is expedient to wind up the company because its business is being conducted with intent to defraud creditors, members or any other person, or its business is being conducted for a fraudulent or unlawful purpose, or the management is guilty of fraud, misfeasance or other misconduct, the Central Government may authorise any person to present to the Court a petition for winding up of the company that is just and equitable that the company should be wound up.

#### **7.5 COMMENCEMENT OF WINDING UP (SECTION 441)**

Where before the presentation of a petition for the winding up of a company by the Court, a resolution has been passed by the company for voluntary winding up, the winding up of the company will be deemed to have commenced from the date of the resolution. In all other cases (i.e. where the company has not previously passed a resolution for voluntary

- (b) in the case of voluntary winding up, with the Registrar.

Note that when the statement is filed in the Court, a copy must simultaneously be filed with the Registrar and must be kept by him along with the other records of the company [Sec. 551].

### **Powers of The Liquidator**

A liquidator has two types of powers under the Act :

- (a) Powers exercisable with the sanction of the Court ; and
- (b) Powers exercisable without the sanction of the Court.

### **Powers with the Sanction of the Court**

- (a) to institute or defend any suit, prosecution or other legal proceedings, civil or criminal, on behalf of the company ;
- (b) to carry on the business of the company for the beneficial winding up of the company ;
- (c) to sell the immovable and movable property and actionable claims of the company by public auction or private contract ;
- (d) to raise any money required on the security of the assets of the company ;
- (e) to appoint an advocate, attorney or pleader to assist him in the performance of his duties ;
- (f) to do all such other things as may be necessary for winding up the affairs of the company and distributing its assets.

Note that the Court may by order provide that the liquidator may exercise any of the above powers without the sanction of the Court [Sec. 458).

contributory may, subject to the control of the Court inspect the books which are maintained by the liquidator. The liquidator is also required to print and send a copy of the audited accounts to each creditor and contributory.

## **2. Control by Court**

The liquidator shall apply to the Court for directions in relation to any matter arising in the winding up. The Court has the power to confirm, reserve or modify any act or decision of the liquidator if complained by any aggrieved person. The Court has the power to cause the accounts of the liquidator to be audited in such manner as it thinks fit.

## **3. Supervision by committee of inspection**

The committee of inspection can inspect the accounts of the liquidator at all reasonable times. The liquidator is under an obligation to have directions from the committee of inspection.

## **4. Control by Central Government**

Section 463 seeks to bring the conduct of the liquidators of companies under the control and scrutiny of the Central Government. Where a liquidator does not faithfully perform his duties and duly observe all the requirements imposed upon him by the Act or the rules thereunder with respect to the performance of his duties, or if any complaint is made to the Central Government by any creditor or contributory in regard thereto, the Central Government shall enquire into the matter, and take such action thereon as it may think fit. The power includes the power to remove the liquidator from office.

The Central Government may at any time require any liquidator of a company which is being wound up by the Court to answer any inquiry in

Preview from Notesale.co.uk  
Page 192 of 404

## **Kinds of Voluntary Winding up**

Voluntary winding up may be :

- (a) A members' voluntary winding up; or
- (b) A creditors' voluntary winding -up.

### **7.7.1 Members' voluntary winding up**

A members' voluntary winding up takes place only when the company is solvent. It is initiated by the members and is entirely managed by them. The liquidator is appointed by the members. No meeting of creditors is held and no committee of inspection is appointed. To obtain the benefit of this form of winding up, a declaration of solvency must be filed.

#### **Declaration of solvency**

Section 88 provides that where it is proposed to wind up the company voluntarily the directors or a majority of them, may, at a meeting of the board, make a declaration verified by an affidavit that the company has no debts or that it will be able to pay its debts in full within a period not exceeding 3 years from the commencement of winding up as may be specified in the declaration. Such declaration shall be made within five weeks immediately preceding the date of the passing of the resolution for winding up and shall be delivered to the Registrar before that date. It shall also be accompanied by a copy of the auditors on the Profit and Loss Account and the Balance Sheet of the company prepared upto the date of the declaration and must embody a statement of the company's assets and liabilities as on that date.

Where such a declaration is duly made and delivered, the winding up following shall be called members' voluntary winding up. Where

shall be the liquidator. If no person is nominated by the creditors, the person, if any, nominated by the company shall be the liquidator.

#### **4. Committee of Inspection**

The creditors at their first or any subsequent meeting may, if they think fit, appoint a committee of inspection of not more than five members. If such committee is appointed, the company may, either at the meeting at which the winding up resolution is passed or at a later meeting, appoint not more than five persons to serve on the committee. If the creditors object to persons appointed by the company, then the matter will be referred to the Court for the final decision. The powers of such committee are the same as those of a committee of inspection appointed in a compulsory winding up.

#### **5. Remuneration [Sec. 504]**

The committee of inspection or if there is no such committee, the creditors may fix the remuneration to be paid to the liquidator or liquidators. Where the remuneration is not fixed, it will be determined by the Court. Any remuneration fixed by the committee of inspection or creditors or the Court shall not be increased.

#### **6. Board's Power to Cease (Sec. 505)**

On the appointment of a liquidator, all the powers of the board of directors shall cease, except in so far as the committee of inspection, or if there is no such committee, the creditors in a general meeting, may sanction the continuance thereof.

#### **7. Vacancy in the Office of Liquidator (Sec. 506)**

If a vacancy occurs by death, resignation, or otherwise in the office of the liquidator (other than a liquidator appointed by or by the

**Power of the Court to appoint liquidator**

In a members' or creditors' voluntary winding up, if for any cause whatever there is no liquidator acting, the Court may appoint the official liquidator or any other person as a liquidator of the company. The Court may also appoint a liquidator on the application of the Registrar. (Section 515).

**Body corporate not to be appointed as liquidator**

A body corporate shall not be qualified for appointment as a liquidator of a company in a voluntary winding up. Any appointment of a body corporate as liquidator shall be void. (Section 513).

**Corrupt inducement affecting appointment as liquidator**

Any person who gives or agrees or offers to give, any member or creditor of the company any solicitation with a view to securing his own appointment or nomination or to securing or preventing the appointment of some other person, as the liquidator is liable to a fine which may extend upto Rs. 1,000. (Section 514).

**Notice by liquidator of his appointment**

When a person is appointed as the liquidator and accepts the appointment, he shall publish in the official gazette a notice of his appointment, in the prescribed form. He shall also deliver a copy of such notice to the Registrar. The liquidator shall do this within 30 days of his appointment. When the liquidator fails to comply with the above provision, he is liable to a fine which may extend to Rs. 50 for each day of default. (Section 516).

affairs; (b) the company is unable to pay its debts; and (c) the Court is of opinion that it is just and equitable that the company should be wound up.

### **7.11 WINDING UP OF FOREIGN COMPANIES**

Where a foreign company which has been carrying on business in India, cease to carry on business in India, it may be wound up as an unregistered company, notwithstanding that the foreign company, has been dissolved or otherwise ceased to exist as such under or by virtue of the laws of the country under which it was incorporated (Section 584).

### **7.12 EFFECTS OF WINDING UP ON ANTECEDENT AND OTHER TRANSACTIONS**

The effects of winding up on antecedent and other transactions are as follows:

#### **1. Fraudulent Preference (Sec. 531)**

Any transfer of property, movable or immovable, delivery of goods, payment, execution or other act relating to property, within six months before the commencement of its winding up, shall be deemed a fraudulent preference of its creditors and be invalid accordingly.

Fraudulent preference here relates similarly to fraudulent preference under insolvency law, where any individual transfers any property or makes any payment within three months before the presentation of an insolvency petition, such transfers shall be deemed a fraudulent preference in his insolvency. Under the Companies Act, 1956, the period is six months instead of three months.

#### **2. Avoidance of the Voluntary Transfer**

Section 531 A introduced by the Amendment Act, 1960, lays down that any transfer of property, movable or immovable, or any delivery

contracts, but it affects every person. Contract is considered as the foundation of the civilised world. Since every one of us enters into a number of contracts from sunrise to sunset. When a person drinks a cup of tea, or rides a bus, or goes to the cinema to see a movie or purchases the goods, or gives a loan to friend, etc. he enters into a contract though he may be unaware of it. Such contracts create legal rights and obligations. The law of contract is mainly concerned with the enforcement of these rights and obligations.

The law of contract determines the circumstances in which a promise or an agreement shall be legally binding on the person making it. It is concerned with rights in personam as distinguished from rights in rem. For example, if X is entitled to receive a sum of money from Y, this right can only be exercised by X and not by others. This is a right in personam. On the other hand, if X owns a plot of land and Y is the immediate neighbour, the right of X to have complete possession and enjoyment of land is available not only against Y but against the whole world. This right of X is known as the right in rem.

## **8.2 THE INDIAN CONTRACT ACT, 1872**

The laws of contract in India is contained in the Indian Contract Act, 1872. This Act is based mainly on English Common Law which is to a large extent made up of judicial precedents. It extends to the whole of India except the State of Jammu and Kashmir and came into force on the first day of September 1872. The Act is not exhaustive. It does not deal with all the branches of the law of contract. There are separate Acts which deal with contracts relating to negotiable instruments, transfer of property, sale of goods, partnership, insurance, etc. Further the Act does not affect any usage or custom of trade (Sec. 1). A minor amendment in Section 28 of the Act was made by the Indian Contract (Amendment) Act, 1996.

promise, the reason being that there had been no intention between Mohan and Ram to create any legal obligation by the agreement as made between them. In the circumstances, there was, in eye of law no contract between Ram and Mohan.

Similarly, an another kind of obligation which does not constitute a contract is the arrangement made between husband and wife. Such agreements are purely domestic and are not intended to create legal relationship.

The Leading case on this point is **Balfour v. Balfour (1919)**

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

#### **Decision of the Case**

- (a) Agreements which do not create legal relations are not contracts.
- (b) Agreements between husband and wife in domestic affairs is not a contract.

It may be noted that the law of contract deals only with such obligations which spring from agreements. Obligations which are not contractual in nature are outside the scope of the law of contract. For example, obligation to maintain wife and children, obligation to comply with the orders of a court and obligation arising from a trust do not fall within the scope of The Contract Act. Sir John

The consideration may be an act (doing something) or forbearance (not doing something) or a promise to do or not to do something. It may be past, present or future. But only those considerations are valid which are lawful. The consideration is lawful, unless - 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 is immoral; or is opposed to public policy (Sec. 23).

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

7. **Lawful Object** : For the formation of a valid contract it is also necessary that the parties to an agreement must agree for a lawful object. The object for which the agreement has been entered into must not be fraudulent or illegal or immoral or opposed to public policy or must not imply injury to the person or property of another (Sec. 23). If the object is unlawful for one or the other reasons mentioned above the agreement is void. Thus, when a landlord knowingly lets a house to a prostitute to carry on protection, he cannot recover the rent through a court of law.

8. **Written and Registered** : According to the Indian Contract Act, a contract may be oral or in writing. But in certain special cases it lays down that the agreement, to be valid, must be in writing or/and registered. For example, it requires that an agreement to pay a time barred debt must be in writing and an agreement to make a gift for natural love and affection must be

void *ab initio* is a case of a void agreement. Void contracts may better be called void agreements to avoid contradiction in terms.

3. **Voidable contract :** According to Section 2(i), "an agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract". Thus, a voidable contract is one which is enforceable by law at the option of one of the parties. Until it is avoided or rescinded by the party entitled to do so by exercising his option in that behalf, it is a valid contract.

Usually a contract becomes voidable when the consent of one of the parties to the contract is obtained by coercion, undue influence, misrepresentation or fraud. Such a contract is voidable at the option of the aggrieved party i.e., the party whose consent was so caused (Secs. 19 and 19A). But the aggrieved party must exercise his option of rejecting the contract (i) within a reasonable time, and (ii) before the rights of third parties intervene, otherwise the contract cannot be repudiated.

**Illustrations :** (a) A. threatens to shoot B if he does not sell his new Bajaj Scooter to A for Rs. 2,000. B agrees. The contract has been brought about by coercion and is voidable at the option of B.

4. **Unenforceable contract :** It is a contract which is otherwise valid, but cannot be enforced because of some technical defect like absence of a written form or absence of a proper stamp. Such contracts must be sued upon by one or both of the parties. Such contracts cannot be proved in the court. Such contracts will not be enforced by the courts until and unless the defect is rectified.

(b) Amar intending to deceive Akabar falsely represents that five hundred quintals of indigo are made annually at Amar's factory and thereby induces

7. X invited Y and his family to dinner on a certain night. Y accepted X's invitation. On the date fixed Y drove with his family from sector 13 to Industrial Area and found his house locked. They waited upto 9.30p.m. but the hosts did not turn up. They left the place and had their meals in Piccadilly in Sector 17. The cost of meal came to Rs. 100. Can Y recover the amount?
8. M agrees to pay N Rs. 100 and in consideration N agrees to write for him 100 pages within five minutes. Is it a valid a contract?

[**Hints** No, it is not a valid contract. It is a avoid agreement because as per Section 56 "an agreement to do an act impossible in itself is void"]

#### 8.9 SUGGESTED READINGS

S.S. Gulshan & G.K. Kapoor, Business Law, New Age International Publishers, New Delhi.

S.C. Kuchhal, Mercantile Law, Vikas Publishing House, New Delhi.

Nirmal Singh, Business Law, Deep and Deep Publication Pvt. Ltd., New Delhi.

M.C. Kuchhal, Mercantile Law, Vikas Publishing House Pvt. Ltd., New Delhi.

Avtar Singh, The Priciples of Mercantile Law, Eastern Book Co., Lucknow.

M.C. Shukla, A Manual of Mercantile Law, S. Chand & Co., New Delhi.

R.S.N. Pillai and Bagavathi, Business Law, S. Chand & Co., New Delhi.

## **LESSON : 10**

### **CAPACITY OF PARTIES**

#### **STRUCTURE**

10.0 Objective

10.1 Introduction

10.2 Minor

10.2.1 Why should minor be protected ?

10.2.2 Effects of minor's agreements

10.3 Persons of Unsound Mind

10.4 Disqualified Persons

10.5 Summary

10.6 Keywords

10.7 Self Assessment Question

10.8 Suggested Readings

**10.0 OBJECTIVE**

After reading this lesson, you should be able to:

- (a) Discuss the capacity of parties to a contract.
- (b) Explain the provisions of law relating to contracts by minors.
- (c) Discuss the law relating to contracts by persons of unsound mind.

#### **10.1 INTRODUCTION**

An essential element of a valid contract according to Section 10, is that the contracting parties must be 'competent to contract'. Section 11 lays down that "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

## **LESSON : 11**

### **FREE CONTENT**

#### **STRUCTURE**

- 11.0 Objective
- 11.1 Introduction
- 11.2 Definition of Free Consent
- 11.3 Elements which affect the consent of the Parties
- 11.4 Mistake
- 11.5 Misrepresentation
- 11.6 Fraud
- 11.7 Coercion
- 11.8 Undue Influences
- 11.9 Summary
- 11.10 Keywords
- 11.11 Self Assessment Questions
- 11.12 Suggested Readings
- 11.7 **OBJECTIVE**

After reading this lesson, you should be able to-

- a) Explain the elements which affect the consent of the parties.
- b) State the circumstances under which a contract can be affected on the ground of mistake.
- c) Discuss the consequences of misrepresentation.
- d) Explain the essentials and legal rules for a fraud.
- e) State the circumstances under which a contract is said to be induced by undue influence.

The mistake must be as to the nature of the contract and not merely as to the contents of the document, and also the mistake must be due to either (a) the blindness, illiteracy, or senility of the person signing, or (b) a trick or fraudulent misrepresentation by the other party as to the nature of the document.

#### **b) Unilateral Mistake**

Unilateral mistake occurs when one of the parties to a contract is mistaken as to some fundamental fact concerning the contract and the other party knows this. This latter requirement is important because if B does not know that A is mistaken, the contract is good. Unilateral mistakes may be of two types: (i) regarding identity of party and (ii) unilateral mistake of offeror.

- (i) Identity of party: The cases of unilateral mistake are mainly concerned with mistake by one party as to the identity of the other party. It is rule of law that if a person intends to contract with A, B cannot give himself any rights under it. Here, when a contract is made in which personalities of the contracting parties are or may be of importance, no other person can interpose and adopt the contract.

For example, where M intends to contract only with A but enters into contract with B, believing him to be A, the contract is vitiated by mistake, as there is no Consensus ad idem.

Remember that mistake as to identity of the person with whom the contract is made will operate to nullify the contract only if:

- (a) the identity is of material importance to the contract, and
- (b) the mistake is known to the other party, i.e. he knows that it is not intended that he should become a party to the contract but some other person is intended.

instead of per piece. In the negotiations preceding the agreement, reference had always been made to prices per piece, and it was also the custom of the trade. Held, the contract was void expressed C's real intention; H must have known that is was made under a mistake.

But if there is a mistake on the part of one party alone, and the other does not, and cannot be deemed to know of the mistake, the contract is binding.

In *Van Praagh v. Everidge* (1902 2 Ch. 266), at a sale of landed properties by auction, E purchased one lot in mistake for another. The price was not extravagant and the mistake was solely due to his own carelessness. Held, the contract was binding on E.

### c) **Bilateral Mistake**

A bilateral mistake, as observed earlier, arises when both parties to a contract are mistaken as regards a fact essential to the contract. They may have made a common or identical mistake; or a mutual or non-identical mistake.

Following may be cases of bilateral mistakes-

- (i) Common mistake as to the existence of the subject.
  - (ii) Common mistake as to the fact fundamental to the agreement.
  - (iii) Mutual or non-identical mistake as to the identity of the subject matter.
  - (iv) Mistake as to quality of subject-matter or promise.
  - (v) Mistake as to non-disclosure in contracts of utmost good faith.
- (i) **Common mistake as to the existence of the subject-matter.** Where both parties believe the subject-matter of the contract to be in existence at the time of the contract but in fact it is not in existence, there is operative mistake and the contract is void.

- (a) From promoters or directors who made such misrepresentation in a prospectus under Company Law;
- (b) Against an agent who commits a breach of warranty of authority;
- (c) From a person who (at the Court's discretion) is stopped from denying a statement he has made where (i) he made a positive statement intending that it should be relied on, and (ii) the innocent party did rely on it, and thereby suffered damage.

### **What to be proved?**

It should be remembered that in order to avoid a contract on the ground of misrepresentation, it is necessary to prove that (i) there was a representation or assertion, (ii) such representation induced the party aggrieved to enter into contract, (iii) the assertion was of fact (and not of law, as ignorance of law is no excuse); (iv) the statement was not a mere opinion, or hearsay, or commendation (i.e. reasonable praise) or tradesman's price, (v) the statement, which has become or turned out to be untrue, was made with an honest belief in its truth.

**Effect**

In an innocent misrepresentation, the party aggrieved may avoid the agreement, even though the statement was true at the time it was made but became untrue later by reason of change of circumstances.

### **11.6 FRAUD OR WILFUL MISREPRESENTATION**

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

To discharge the onus that he did not employ undue influence, the party must show that the other party to whom he owed the duty in fact acted voluntarily, in the sense that he was free to make an independent and informed estimate of the expediency of the contract or other transaction. The other party received independent advice before he completed the contract.

A few examples will illustrate undue influence.

- (i) A, having advanced money to his son B during his minority, upon B's becoming major obtained, by misuse of parental influence, a bond from B for a greater amount than the sum due in respect of the advance. A employed undue influence.
- (ii) 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 service. B employs undue influence.
- (iii) A Hindu, well advanced in years, with the object of securing benefits to his soul in the next world, gave his whole property to his Guru or spiritual adviser. There was undue influence. Similarly, where a cestui que trust (beneficiary) had no independent advice it was held a gift by him to the trustee of certain shares forming part of the trust fund was void.
- (iv) In *Debi Prasad v. Chhotey Lal*, All. 438, D was the grandson of C's own brother, and attended to the comforts of C in his illness, as he was also old, infirm and weak. C executed a deed of gift at the behest of D. The deed was vitiated by undue influence as it was clearly an unconscionable transaction. D was held to have had dominant influence over C, a sick, infirm and old man. Undue influence was presumed because of fiduciary relation.

## Unconscionable Transactions

When a person, without being fraudulent forces another to enter into an agreement by making an unconscionable use of his superior power he is said to make an unconscionable bargain. Such a bargain is voidable. The test is that between two parties on unequal footing one has sought to make an exorbitant profit of the other's distress. Where a person is heavily indebted to another and for a fresh loan is made to agree to pay exorbitant rate of interest, it will be an unconscionable transaction.

Similarly, where an heir to an estate borrowed Rs. 3,700 to enable him to prosecute his claim when he was without even the means of subsistence and gave the lender a decree only for Rs. 3,700 with interest at 50% per annum.

Also, where a spendthrift and a drunkard 18 years of age executed a bond in favour of his creditor agreeing to pay compound interest at 2 percent per annum with monthly rests, it was held the bargain was unconscionable.

In the following two cases the bargain was held unconscionable :

Where a poor Hindu widow borrowed Rs. 1,500 from a moneylender at 100% per annum for the purpose of enabling her to establish her claim for maintenance; and where an illiterate agriculturist heavily indebted to a moneylender sold his land worth thrice the amount of the debt under pressure of payment.

It must be remembered that in such cases the moneylender must be "in a position to dominate the will" of the borrower, and the bargain must be unconscionable within the meaning of clause 3 of Section 16. The mere fact that the rate of interest is exorbitant is no ground for relief under this section unless it be shown that the creditor was in a position to dominate the will of the borrower. Nowadays, however, drastic legislation in most of the States has provided greater protection to debtors.

## **Purda Nishin Woman**

The law throws around a Purda Nishin woman a special cloak of protection, and demands that person who deals with her must show affirmatively and conclusively that the deed was not only executed by, but was explained to, and was really understood by the lady. It must also be proved that no coercion or undue influence was exercised on her, either by the party to the transaction or by a third party, and that she had executed the document of her free will. The reason is that the ordinary presumption that a person understands the document to which he has affixed his name does not apply in the case of Purda Nishin Woman. But a lady, whether Hindu or Muslim, who is claiming to be Purda Nishin must prove complete seclusion; and some degree of seclusion is not sufficient to entitle her to get special protection.

## **Difference between coercion and undue influence**

- (i) Moral and Physical Force. In undue influence the influence is due to moral pressure whereas in coercion it is due to physical force. Undue influence is sometimes marked as 'moral coercion' which is distinct from 'physical coercion' or coercion in true sense.
- (ii) Relationship between Parties. In the case of undue influence there must be certain relationship between the parties which places one party in a position to dominate the will of the other i.e. undue influence is between the parties to the transaction, the promise procures the promisor's constant by undue influence. Coercion need not proceed from the promisee nor need it be directly against the promisor, that is, existence of certain relationship is not necessary in case of coercion.

## 11.10 KEYWORDS

**Mistake:** Mistake may be defined as incorrect belief about something.

**Bilateral Mistake:** It is a mistake in which both the parties to an agreement are confused about the facts which are essential to the agreement.

**Misrepresentation:** Misrepresentation is a false representation which is made innocently.

**Fraud:** Fraud may be defined as an intentional, deliberate or wilful misstatement of facts, which are material for the formation of a contract.

**Free Consent:** Free consent is the consent which is obtained by the free will of the parties, and neither party was forced or induced to give his consent.

**Coercion:** It means forcibly compelling a person to enter into a contract.

**Undue Influence:** It means the unfair use of one's superior power in order to obtain the consent of a person who is in a weaker position.

## 11.11 SELF-ASSESSMENT QUESTIONS

1. State when a consent is not said to be free. What is effect of such consent on the formation of a contract?
2. A contract caused by mistake is void. Explain with illustrations.
3. Explain and illustrate the effect of mistake of fact on contracts.
4. Explain with illustration, the effect of mistake of facts on an agreement with reference to (i) mistake relating to subject-matter. (ii) mistake relating to the identity of the parties and (iii) mistake relating to the nature of the transaction.
5. What is fraud? Distinguish it with misrepresentation.
6. What remedies are available to a person induced to enter into a contract by (a) misrepresentation which is not fraudulent, (b) fraud.

In *Satyabrat Ghose V. Mugneeram Bangur & Co.*, who were the owners of a large tract of land started a scheme for its development for residential purposes and accordingly divided it into a large number of plots for the sale of which they invited offers from intending buyers. The company's plan was to accept a small portion of the price by way of earnest money from the buyers at the time of agreement, construct the roads and drains itself and within one month after their completion call upon the buyers to complete the construction by paying one-third of the price at the time of the registration and the balance within 6 years bearing interest 6 percent per annum, time being deemed the essence of the contract.

B entered into a contract on those terms with M & Co., in 5-8-1919 and later on assigned the contract to S. Shortly prior to that assignment a portion of the land covered by the scheme was requisitioned for military purposes by the Government under the Defence of India Rules, and later the rest of the land was also requisitioned. M & Co., thereupon informed B that the land pertaining to the scheme was taken possession of by the Government and there was no knowing how long the government would retain possession and that the company could not, therefore, take up the construction of roads and drains during the continuance of the war and possible for many years after its termination. The company also wrote to B to treat the contract as cancelled and take back the earnest money. This letter was handed over by B to his assignee S, who asserted that the company was bound by the contract and could not rescind. S filed a suit for declaration that the contract date 5-8-19 was subsisting and that S, as assignee of B, was entitled to get the conveyance executed and registered by the company on payment of consideration mentioned in the agreement and in the manner and under the conditions specified therein. The company contended that the contract of sale became discharged by frustration as it became impossible of performance by reason of supervening events. On appeal the Supreme Court held that it could not be said the requisition order vitally affected the contract or made its performance impossible and accordingly the appeal was allowed and the suit was decreed.

In applying this rule the Court has to examine the nature and terms of the contract before it and the circumstances under which it was made and to determine whether or not the disturbing element which is alleged to have happened in the particular case has substantially prevented the performance of the contract as a whole. If the answer be in the affirmative, the contract will stand dissolved or discharged by virtue of Sec.

### **Effects of Subvening Impossibility or Frustration**

Sections 56 and 65 of the Indian Contract Act expressly provide for the consequences of the impossibility of performance as follows.

1. When the performance of a contract becomes subsequently impossible or illegal, the contract becomes void. Section 56, para 2.
2. When a contract becomes void, any person who has received an advantage under it must restore it, or make compensation for it to the person from whom he received it.
3. When one person has promised to do something which he knew or with reasonable diligence, might have known, and which the promisee did not know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise-Section 566, para 3.

A contracts to marry B being already married to C and being forbidden by the law to which he is subject to practice polygamy. A must take compensation to B for any loss caused to her by the non-performance of his promise.

### **12.6 DISCHARGE BY LAPSE OF TIME**

The Limitation Act., in some circumstances, affords a good defence to suits for breach of contract, and in fact terminates the contracts by depriving the party of his remedy at law. For example, where a debtor has failed to repay the loan on the stipulated date the creditor must file the suit against him within

**Example:** A contracted to sell his plot of 500 sq. yards to B for s. 100,000. The sale deed was executed which was in possession of A. Before the registration of the sale deed, A altered the deed and made it a deed for the sale of 300 sq. yards plot for Rs. 100,000. In this case, the contract is discharged and B is not bound to purchase the plot.

**(d) By insolvency**

The Insolvency Act provides for discharge of a contract contracts under particular circumstances. So where the Insolvency Court passes an order discharging the insolvent, this order exonerates or discharges him from liabilities on all debts incurred previous to his adjudication.

**(e) Right and liability vesting in the same person**

Where rights and liabilities under a contract vest in same person the contract is terminated and other parties to contract are discharged. For example, when a bill of exchange passes in the hand of the acceptor, the parties are discharged.

**12.3 DISCHARGE BY BREACH OF CONTRACT**

We have seen contract must strictly perform according to its terms, But where the promisor has neither performed his contract nor tendered performance and where the performance is not excused by consent express or implied, or where the performance is defective, there is a breach of the contract by him. Which entitles the other party to file a suit. If the contract is unilateral the only remedy for the other party is to claim relief for beach can claim relief for breach and also in certain circumstances is exonerated from liability to perform his part of the contract.

The breach of contract may be (I) actual (ii) constructive or anticipatory. The actual breach may take place (a) at the time when performance is due, or (b) when actually performing the contract. The constructive or anticipatory breach

specific performance. Sec.75 further entitles him to compensation for any damage he may have sustained through the non-fulfillment of the contract.

For instance, A singer, contracts with B 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 willfully absents herself from the theatre, and B in consequence, rescinds the contract. B is entitled to claim compensation for the damage which he has sustained through the non-fulfillment of the contract.

## 2. Damages

Where a contract has been broken, the party who suffers by such breach is entitled, under Sec.73 to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when make the contract, to be likely to result from the breach of it.

But compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach. Compensation is also available against a party for breach of a quasi-contract. Sec73 is based on the leading case of Hadley V. Baxendale (1854) 9 Ex. 34 the facts the which are as follows:

The plaintiff, an owner of a mill, delivered a broken shaft to the defendant common carrier to take to a manufacturer to copy it and make a new one. The carrier delayed delivery of the shaft beyond a reasonable time, as a result of which the mill was idle for a longer period than should have been necessary. The plaintiff did not make known to the defendant carrier that delay would result in a loss of profits. Held, the carrier was not liable for loss of profits during the period of delay.

Alderson, B observed in this case, "When two parties have made a contract, which one of them has broken, the damage which the other party ought to receive in respect of such breach should be either such as may fairly be considered as

The suit may be for liquidated damages or un-liquidated damages.

Liquidated damages are damages agreed upon by the parties in the contract itself to be paid by the party breaking the contract in case of breach. The plaintiff has only to prove the breach of contract, and no proof of loss is required. But liquidated damages must appear to be a genuine pre-estimate of the loss that will be caused to one party if the contract is broken by the other. Where no damages are fixed by the contract, but the amount of compensation claim for a breach of contract is left to be assessed by the court, damages claimed are called unliquidated damages.

Unliquidated damages may be classified as follows:

**a) Ordinary Or Compensatory Damages**

In deciding a suit for damages, the court has to answer two questions: (I) Proximity and remoteness of damage, (ii) Measure of damages. The judge has to first decide whether or not the damage has resulted from proximate consequences of the breach, for remote consequences are not regarded. Once the court has decided that the damage is sufficiently proximate, it will turn to the measure of damages, that is the amount of money that will compensate the plaintiff. The question of remoteness of damage is governed by the maxim recognised in *Hadley v. Baxendale* and Sec. 73 of the Contract Act. *in jure unon remota causa, sed proxima spectatur*- "In law not the remote cause, but the proximate cause is taken notice of."

Thus, if the damage or loss suffered by reason of the breach of the contract is remote or indirect no compensation would be allowed. The aggrieved party however, would in case of breach of contract, be entitled to recover compensation for damage or loss caused to him thereby, if such loss or damage arose naturally and directly in the usual course of things from such breach, of which the parties to the contract knew, at the time of making the contract, to be likely to result from breach of contract. The first part of this rule states the case for ordinary damages and the latter concerns with special damages.

In *Hadley v. Baxendale*, the common negligence delayed delivery of the broken shaft to the manufacturer who has to copy it and make a new one. On account of the delay by the common carrier the mill remained idle for a longer period than should have been necessary. The plaintiff did not make known to the defendant, the common carrier, that for want of the shaft the mill would remain idle which would result in a loss of profit. The plaintiff was held entitled to recover damages for delay in delivery but not for loss of profits occasioned by the closure of the mill since there was no way the common carrier could have been foreseen that the mere absence of a shaft would cause the closure for the mill. The mill-owner could have recovered damages for loss of profit if he had informed the carrier of the likely result of delayed delivery.

### **Measure of damages**

The measure of damages is the estimated loss directly and naturally resulting in the ordinary course of events, from the breach of contract. The injured party is to be put in the same financial position as he would have been if the contract had been performed according to its terms.

In the case of sale and purchase, the damages, payable would be the difference between the contract price and the market price at the date of the breach. The damages are calculated as on the date of breach and any subsequent change of circumstances tending to an increase or reduction of damage cannot be taken note of.

A cow was sold with condition that it was free from disease. The cow was suffering from foot and mouth disease at the time of sale. Not only the cow die but it also infected other cows of the buyer. Held damages could be recovered for the entire loss.

### **b) Special Damages**

Special damages are those resulting from a breach of contract under some special circumstances. If at the time of entering into a contract a person has

## **(vi) Right to Resale**

In a sale, the property is with the buyer and as such the seller (in possession of goods after sale) cannot resell the goods. If he does so, the subsequent buyer having knowledge of the previous sale does not acquire a title to the goods. The original buyer can sue and recover the goods from the third person on owner, and can also sue the seller for the breach of contract as well as for the tort conversion. The right to recover the goods from the third person is, however, lost if the subsequent buyer had bought them bonfire without notice of the previous sale (Section 30).

On the other hand, in an agreement to sell, the property in the goods remains with the seller and as such he can dispose of the goods as he likes and the original buyer can sue him for the breach of contract only. In this case, the subsequent buyer gets a good title to the goods, irrespective of his knowledge of previous sale. Further, goods forming the subject matter of an agreement to sell can also be attached in execution of a decree of a court of law against the seller.

## **13.6 DISTINCTION BETWEEN SALE AND HIRE-PURCHASE**

The difference between a contract of sale and hire-purchase agreement are given below:

### **1. Nature of Contract**

A sale is an executed contract in which the ownership is transferred from the seller to the buyer as soon as the contract entered into

In a hire-purchase agreement it becomes the property of the buyer only after a certain agreed number of installments is paid till then the hire purchaser stands in the position of the bailee and not the owner of the goods.

### **2. Termination of the Contract**

In a sale the buyer cannot terminate the contract and as such is bound to pay the price of the goods.

On the other hand, the hire-purchase has an option to terminate the contract at any stage, and cannot be forced to pay the further installments.

Actionable claim and money are not goods. An actionable claim is something which can only be enforced by action in a Court of law. A debt due from one person to another is an actionable claim and cannot be bought or sold as goods. It can only be assigned. Money here means current money and not old rare coins.

The definition of the term 'goods' also suggests that it includes stocks and shares, growing crops, grass and things attached to or forming part of land which are agreed to be severed from land before sale. Growing crops and grass are included in the definition of the term 'goods' because they are to be severed from land. Trees which are agreed to be severed before sale or under the contract of sale are goods [Badri Prasad v State of MP, AIR (1970) SC 706]

Goods may be classified into various types as shown below:

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

#### **1. Existing goods**

Goods earned and possessed by the seller at the time of the making of the contract of sale are called existing goods. Sometimes the seller may be in possession but may not be the owner of the goods e.g. sale of goods by a mercantile agent. Existing goods may again be either specific, or ascertained or unascertained.

##### **a) Specific Goods**

These are the goods which are identified and agreed upon at the time a contract of sale is made. To be specific the goods must be actually identified; it is not sufficient that they are capable of identification e.g. If X who owns a number of horses, promises to sell one of them, the contract is for unspecified goods.

##### **b) Ascertained Goods**

These are the goods which are identified in accordance with the agreement after the contract of sale is made. Though commonly used as similar in meaning to specific goods, these are not always the same.

The above definition of unpaid seller states the following :

- (i) The seller shall be called an unpaid seller even when only a small portion of the price remains to be paid.
- (ii) It is for the non-payment of the price and not for other expenses, that a seller is termed as an unpaid seller.
- (iii) Where the goods have been sold on credit, the seller cannot be called as an unpaid seller during the credit period unless the buyer becomes insolvent. On the expiry of credit period if the price remains unpaid, then only the seller will become an unpaid seller.
- (iv) Where the full price has been tendered by the buyer and the seller has refused to accept it, the seller cannot be called as unpaid seller.

**Example :** State whether the seller is an unpaid seller or not in each of the following alternative cases :

- (a) X sold some goods to Y for Rs. 10,000. Y paid Rs. 9000 but failed to pay the balance.
- (b) X sold some goods to Y for Rs. 10,000 and received a cheque for the full price as conditional payment. On presentment, the cheque was dishonoured by the Bank.
- (c) X sold some goods to Y for Rs. 10,000 on a credit of one month. One month has not yet expired.
- (d) X sold some goods to Y for Rs. 10,000 on a credit of one month and one month has expired and the price remains unpaid,
- (e) X sold some goods to Y for Rs. 10,000 on a credit of one month. Y became insolvent during the period of credit.

**Solution :**

- (a) : X is an unpaid seller because the full price has not been paid.
- (b) : X is an unpaid seller because the cheque received as conditional payment has been dishonoured.

credit. By the insolvency of the buyer during the period of credit the right of lien which may have been suspended earlier for the period of credit is revived and the credit granted earlier comes to an end.

The term 'insolvent' here does not mean a person who has been adjudged insolvent under the Insolvency Law. In Sale of Goods Act "a person is said to be insolvent who has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not". [Section 2 (8)]

The right of lien is linked with possession and not with title. It is essentially a right over the property of another person. The unpaid seller's lien can be exercised only so long as the goods are in the actual possession of the seller or his agent. Once the possession is lost, the lien is also lost. The right of lien cannot be exercised during the currency of a credit term. When the term expires, the unpaid seller may exercise the right of lien. The lien of the unpaid seller is for the price only, so when the price has been paid or tendered, he cannot retain possession of the goods any longer. Again the right of lien does not extend to other charges which the seller may have to incur for storing the goods during the exercise of the lien.

**Example :** A sold certain shares to B. The relative share certificates and transfer forms duly signed were handed over by the seller to the buyer against payment of price by cheque. The buyer became insolvent. It was held by the Privy Council that the seller had no lien on shares because his lien ceased when he parted with the possession. *Bharucha v. Wadihah*, 28 Bom. L.R. 777 (P.C.).

The right of lien is indivisible in nature, and so the buyer is not entitled to claim delivery of a portion of the goods on payment of a proportionate price. Further this right is available even after part delivery of the goods has been

### **Effect of Sub-Sale or Pledge By Buyer (Section 53)**

The general rule is that the unpaid seller's right of lien or stoppage in transit is not affected by any sale or other disposition of the goods which the buyer may have made. However, there are two exceptions to this general rule. They are stated below :

1. When the seller has assented to the sale or other disposition with the buyer may have made.

**Example :** A sold to B 80 maunds of grain out of a grainary. B then sold (out of these 80 maunds) 60 maunds to C. C after receiving from B the delivery order presented it to A. A told C that the grains would be delivered in due course, B then became insolvent. A's right against the 60 maunds is not lost since A recognised the title of C the sub-buyer (Knights v. Wiffen)

2. When a document of title to goods (e.g., a bill of lading or railway receipt) has been issued or transferred to a buyer, and the buyer transfers the document to a person who takes the document in good faith and for consideration, then

- (a) If such last mentioned transfer was by way of sale, the unpaid seller's right of lien or stoppage in transit is defeated, and
- (b) If such last mentioned transfer was by way of pledge, the unpaid seller's right of lien or stoppage in transit can only be exercised, subject to the rights of the pledge. But in this case the unpaid seller may require the pledgee to satisfy his claim against the buyer first out of any other goods or securities of the buyer in the hands of the pledge.

- (c) **Right of Resale**

An unpaid seller can resale the goods under the following three circumstances :

- (i) Where the goods are of a perishable nature.
- (ii) Where the seller expressly reserves right of resale if the buyer commits a default in making the payment.

As a result of this resale, the original contract will be terminated but the seller will have a right to claim damages [Section 54 (4)].

- (iii) Where the unpaid seller who has exercised his right of lien or stoppage in transit gives a notice to the buyer about his intention to resell and buyer does not pay or tender within a reasonable time.

**Effects of resale with or without Notice (Sections 54 (2) and (3)) :** The effects of resale with or without notice are summarized as under :

Rights	In case of resale after notice	In case of resale without notice
I Unpaid seller's right to recover the loss on resale	available	not available
II Original buyer's right to recover the profit on resale	not available	available
III New buyer's (who buys in resale) right to acquire a good title	available	available

**Example :** X sold 10 tons of rice to Y at a rate of Rs. 40,000 per ton on a credit of one month. One month expired but Y did not pay. State the legal position in each of the following alternative cases :

- d) Where the fulfillment of any condition or warranty is excused by law by reason of impossibility or otherwise.

## 15.6 STIPULATION AS TO TIME

The stipulations as to time may be of two types :

- i) As to time of payment;
- ii) Other stipulations as to time e.g., with regard to the performance of the contract.

Regarding the importance of various stipulations as to time Section 11 of the Act provides as under :

Unless a different intention appears from the terms of the contract, stipulation as to time of payment are not deemed to be of the essence of a contract of sale. Whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract.

It may be noted that the general rule stated in Section 11 is that the time of payment of the price is not deemed to be of the essence of the contract. Therefore, in case of delay in the payment of the price by the buyer, the seller cannot avoid the contract for that reason but he can only claim compensation for the same. The parties are, however, free to express a different intention in their contract. They may make the time of the payment of the price as of the essence of the contract.

Stipulations as to time, except as regards time of payment are usually of the essence of the contract. Where the parties to the contract stipulate that time as regards delivery of goods, payment or any other factor shall form the essential terms of the contract, time shall than be regarded as a condition in construction of a contract for sale of the goods, breach of which shall provide right to the aggrieved party to cancel the contract. Example (a) : A sold certain goods to B. The payment was to be made on delivery of goods. B failed to pay after the goods had been in part delivered. A did not

1. where they infringe a trade mark, or
2. the use of them is dangerous or injurious in a way not to be expected from goods of the kind, or
3. they are unfit for use.

**Examples:** (a) P asked for a bottle of Stone's Ginger Wine at D's restaurant. While P was drawing the cork, with a cork screw, the bottle broke at the neck and injured him. It was held that the sale was by description and since the bottle was not of merchantable quality. P was entitled to recover damages. [Morelli v Fitch and Gibbons (1928), 2 KB 636]

(b) A manufacturer supplied 600 horns under contract. The horns were found to be dented, scratched and otherwise of faulty manufacturer. Held, they were not of merchantable quality and therefore, the seller's suit for price was dismissed. Jackson v Rotax Motor & Cycle Co. (1910) 2 k.b. 397).

(c) A radio set was sold to a layman. The set was defective from the beginning and it did not work in spite of repairs. Held, the purchaser could return the set and claim a refund. [R.S. Thakur v H.C. & Corp, AIR (1971) Bom. 971]

All such defects as make the goods unmerchantable are of two kinds, called patent defects and latent defects. Patent defects are those which can be found on examination by a person of ordinary intelligence with the exercise of due care. Latent defects are those which cannot be discovered on such examination. There is an implied condition on the seller's part that the goods are free from latent defects.

In case of patent defects where an opportunity is afforded to the buyer to examine the goods, but the buyer makes only a casual examination of the goods, this will amount to an examination within the meaning of this section, and the seller would not be liable to for the defects which such an examination ought to have revealed.

10sh., for getting it overhauled and putting in order. Unknown to the parties the typewriter had been stolen and the plaintiff was compelled to return the same to its true owner. In an action by the plaintiff against the defendant it was held that the defendant had made a breach of warranty implied in a contract of sale of goods that the buyer shall have and enjoy quiet possession of the goods. The plaintiff was entitled to recover not only the sum of pound 11-10sh, the amount spent on overhauling, as the same was the loss arising naturally in the usual course of things.

## **2. Implied Warranty of Freedom from Encumbrances**

There is an implied warranty on the part of the seller that the goods are free from any charge or encumbrance. A breach of this warranty will occur when the buyer discharges the amount of encumbrance. This warranty will not apply where such Encumbrances are declared to the buyer when the contract is made or he has notice of them. Where there is a breach of this implied warranty, the remedy of the buyer is to sue for damages.

**Example:** A, the owner of the watch pledges it with B. After a week, A obtains possession of the watch from B for some limited purpose and sells it to C. B approaches C and tells him about the pledge affair. C has to make payment of the pledge amount to B. There is breach of this warranty and C is entitled to claim compensation A.

## **Disclosure of Dangerous Nature of Goods**

There is another implied warranty on the part of the seller that in case the goods are inherently dangerous or they are likely to be dangerous to the buyer and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger. If there is a breach of this warranty, the seller will be liable in damages.

In *Clarke v Army and navy Co-operative Society Ltd.* (1903) 1 K.B. 155, C purchased a tin of disinfectant powder from A. A knew that the tin was to be opened with special care otherwise it might prove dangerous. He also knew that C was ignorant

### 15.11 SELF ASSESSMENT QUESTIONS

1. Define the term 'condition' and 'Warranty'. Explain the difference between the two.
2. Discuss the provision of the sales of Goods Act relating to the implied conditions in a contract of sale by sample.
3. "Let the buyer beware" - Comment.
4. State the conditions in a contract for the sale of goods (i) by description (ii) required for a particular purpose.

### 15.12 SUGGESTED READINGS

P.P.S. Gogna, Mercantile Law, S.Chand & Company, New Delhi.

N.D. Kapoor, Company Law, Sultan Chand & Sons, New Delhi.

S.C. Aggarwal, Company Law, Dhanpat Rai Publications, New Delhi.

S.K. Aggarwal, Business Law, Gargota Publishing Company, New Delhi.

G.E. Murthy, Elements of Business Law, S Chand & Co., New Delhi.

K.R. Balchandari, Business Law for Management, Himalaya Publication House, New Delhi.

S.S. Gulshan & G.K. Kapoor, Business Law, New Age International Publishers, New Delhi.

S.C. Kuchhal, Mercantile Law, Vikas Publishing House, New Delhi.

Avtar Singh, The Principles of Mercantile Law, Eastern Book Co., Lucknow.

M.C. Shukla, A Manual of Mercantile Law, S. Chand & Co., New Delhi.

R.S.N. Pillai and Bagavathi, Business Law, S. Chand & Co., New Delhi.