BOOK II

THE LAW RELATING TO SALE OF GOODS

1 DEFINITIONS

APPLICATION

The law relating to the sale of movable goods is contained in the Sale of Goods Act (Act III of 1930). The Act came into force on 1st July, 1930. It closely follows the English Act on the subject.

BUYER, SELLER AND GOODS

Buyer : Buyer means a person who buys or agrees to buy goods.—Sec. 2(1).

Seller : Seller means a person who sells or agrees to sell goods.—Sec. 2(13).

Goods

The term "Goods" includes every kind of movable property except (i) actionable claims and (ii) money.—Sec. 2(7)

An actionable claim means a debt or a claim for money which a person may have against another and which he may recover by suit. (see p. 109) Money means legal tender money.

These two types of movable property are not included in the definition of the term goods as used in the Sale of Goods Act. All other types of movable property are "goods" under the Act.

Movable articles like furniture, clothing etc. and shares and debentures are goods. Things attached to the earth are not movable. But growing crops and grass, which can be easily separated from the earth before sale, and fruits which can be severed from trees, are included within the definition of movable goods.

Goods may be classified into three types : Existing Goods, Future Goods and Contingent Goods.

Existing Goods

Existing goods are goods which are already in existence and which are physically present in some person's possession and ownership.—Sec. 6(1).

Existing goods may be either (*i*) *Specific and Ascertained* or (*ii*) *Generic and Unascertained*. Specific Goods are goods which can be clearly identified and recognised as separate things *e.g.*, a particular picture by a painter; a ring with distinctive features; goods identified and agreed upon at the time of the contract of sale etc. The term Ascertained Goods is used in the same sense as Specific Goods.

Generic Goods or Unascertained Goods are goods indicated by description and not separately identified. If a merchant agrees to supply one bag of wheat from his godown to a buyer, it is a sale of unascertained goods because it is not known which bag will be delivered. As soon as a particular bag is separated out and marked or identified for delivery it becomes specific goods.

Future Goods

Future Goods are goods which will be manufactured or produced or acquired by the seller after the making of the contract of sale.—Sec. 2(6).

Example :

P agrees to sell to *Q* all the mangoes which will be produced in his garden next year. This is an agreement for the sale of future goods.

Contingent Goods

There may be a contract for the sale of goods the acquisition of which by the seller depends upon a contingency which may or may not happen. [Sec. 6(2)] In such cases the goods sold are called Contingent Goods. Contingent goods come within the class of future goods.

Example :

X agrees to sell to *Y* a certain ring provided he is able to purchase it from its present owner. This is an agreement for the sale of contingent goods.

SALE AND AGREEMENT TO SELL

Sale

A contract for the sale of goods may be either a sale or an agreement to sell (Sec. 4). Where under a contract of sale the property in the goods (*i.e.,the ownership*) is transferred from the seller to the buyer the contract is called a sale. The transaction is a sale even though the price is payable at a later date or

delivery is to be given in the future, provided the ownership of the goods is transferred from the seller to the buyer.

Agreement to sell

When the transfer of ownership is to take place at a future time or subject to some condition to be fulfilled later, the contract is called an agreement to sell.

When an agreement to sell becomes a sale ? An agreement to sell becomes a sale when the prescribed time elapses or the conditions, subject to which the property in the goods is to be transferred, are fulfilled.

Where by a contract of sale the seller purports to effect a present sale of future goods, the contract operates as an agreement to sell the goods.

Examples :

(*i*) *P* agrees to buy from *B* a haystack on *B*'s land, with liberty to come on *B*'s land to take it away. This is a sale because the property in the goods has passed to the buyer.

(*ii*) *P* agrees to buy a quantity of soda to arrive by a certain ship. This is an agreement to sell because the property in the goods will pass to the buyer when the goods come and the agreement is naturally subject to the condition that the ship arrives in port with the goods.

DIFFERENCES BETWEEN A SALE AND AN AGREEMENT TO SELL

1. Transfer of ownership

In an agreement to sell, the property in the goods remains with the seller until the agreement to sell becomes a sale by the expiry of the agreed time or the fulfilment of the agreed conditions. Till this happens the goods can be resold by the seller or attached in execution of a decree against him. In case of a sale the property passes to the buyer and the goods cannot be seized in execution of a decree against the seller.

2. Transfer of Risk

Where the transaction amounts to a sale, the goods belong to the buyer and he has to bear the loss if the goods are subsequently damaged or destroyed.—Sec. 26.

3. Remedial measures

In the case of a sale, the unpaid seller has certain reliefs available, *e.g.*, lien, stoppage in transit, resale etc. In case of

an agreement to sell, the seller's remedy for breach of contract by the buyers, is a suit for damages.

4. Nature of contract

'Sale' is an 'executed contract' because in a sale, consideration moves simultaneous with the promises of both parties. Also, in a sale the property of specific goods is transferred to the buyer immediately. But an 'agreement to sell' is an 'executory contract' because the consideration is to move at a future date. Also the property of specific goods pass to the buyer later. (See. p. 36 and ch. 2 'Transfer of Ownership').

THE ESSENTIAL ELEMENTS

The essential elements of a contract for the sale of goods are enumerated below :

1. *Movable Goods* : The Sale of Goods Act deals only with movable goods, excepting actionable claims and money.—Sec. 2(7). This Act does not apply to immovable properties.

2. *Movable Goods for Money* : There must be a contract for the exchange of movable goods for money. Therefore in a sale there must be money-consideration. (See 'Price', p. 204-205) An exchange of goods for goods is not a sale. But it has been held that if an exchange is made partly for goods and partly for money, the contract is one of sale. *Aldridge* v. *Johnson*.[1]

3. *Two Parties* : Since a contract of sale involves a change of Ownership, it follows that the *buyer and the seller must be different persons*. A sale is a bilateral contract. A man cannot buy from or sell goods to himself. To this rule there is one exception provided for in section 4(1) of the Sale of Goods Act. A *part-owner* can sell goods to another part-owner. Therefore a partner may sell goods to his firm and the firm may sell goods to a partner. *Re Maclaren*.[2]

Examples :

(*i*) *P* & *Q* are each of them $\frac{1}{4}$ owners of a certain stock of movable goods. *P* can sell his rights to *Q*. After the sale *Q* becomes owner of $\frac{1}{2}$ share.

(*ii*) A club supplies food to the members. Any member taking it has to pay its cost to the club. Thus a member of the club pays to the members jointly (i.e., to the club). This transaction is a release of joint interest of the other members of the club. "Members of

[1] (1857) 7 E&B 885 [2] (1879) 11 Ch. Div. 68

a club or voluntary society are undivided joint owners, not part—owners.". Therefore it is not a sale. *Graff v. Evans.*[1]

4. *Formation of the contract of sale* : A contract of sale is made by an offer to buy or sell goods for a price and the acceptance of such offer. The contract may provide for the immediate delivery of the goods or immediate payment of the price or both, or for the delivery and payment by instalments, or that the delivery or payment or both shall be postponed.—Sec. 5(1).

5. *Method of forming the contract* : Subject to the provision of any law for the time being in force, a contract of sale may be *in writing*, or by *word of mouth*, or may be *implied* from the conduct of the parties.—Sec. 5(2)

6. *The terms of contract* : The parties may agree upon any term concerning the *time, place, and mode of delivery.* The terms may be of two types : essential and non-essential. Essential terms are called Conditions, non-essential terms are called Warranties. The Sale of Goods Act provides that in the absence of a contract to the contrary, certain conditions and warranties are to be implied in all contracts of sale.

7. *Other essential elements* : A contract for the sale of goods must satisfy all the essential elements necessary for the formation of a valid contract, *e.g.*, the parties must be competent to contract, there must be free consent, there must be consideration, the object must be lawful etc. (See. p. 13)

PRICE

Definition

"Price" means the money consideration for a sale of goods.—Sec. 2(10)

Ascertaining of price

The price in a contract of sale may be fixed by the contract of sale or may be left to be fixed in a manner agreed between the parties. It may also be determined by the course of dealing between the parties. Where there is no provision made in the contract regarding price, the buyer must pay a reasonable price. What is a reasonable price is a question of fact depending upon the circumstances of the case.—Sec. 9.

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[1] (1882) 8 Q. B. D. 373

Goods may be sold on a condition that the valuation is to be made by a third party. In such cases if the third party cannot or does not make the valuation, the agreement to sell becomes void. But if the goods or any part thereof had been delivered to and appropriated by the buyer, he shall pay a reasonable price therefor.—Sec. 10(1)

Where such third party is prevented from making the valuation by the fault of the seller or buyer, the party not in fault is entitled to damages.—Sec. 10(2).

DESTRUCTION OF GOODS

Goods perishing before making a contract

"Where there is a contract for the sale of specific goods, the contract is void if the goods without the knowledge of the seller have, at the time when the contract was made, perished or become so damaged as no longer to answer to their description in the contract."—Sec. 7.

Example :

There was a sale of cargo of corn. Without the knowledge of the seller, the cargo had before the sale become heated and was therefore landed at another port and sold. The sale is void. *Couturier* v. *Hastie*.[1]

Goods perishing before sale but after agreement to sell

"Where there is an agreement to sell specific goods, and subsequently the goods without any fault on the part of the seller of buyer perish or become so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided."—Sec. 8.

Example :

There was a contract for the sale of a horse. The buyer would use it for eight days for trial and it was not suitable, it would be returned. Three days before the delivery of the horse, it died, without any fault on the either party. The contract was avoided. *Elphick* v. *Barnes*.[2]

EARNEST MONEY

The payment of earnest money to mark the formation of an agreement for sale is a long standing custom in India as well

[1] (1856) 5 H. L. C. 673 [2] (1880) 5 C.P.D. 321

as in England. There is usually an understanding that if the contract is broken by the buyer, the seller is to retain the earnest money as compensation ; whereas if the contract is fulfilled the amount is credited to the purchase price payable. Earnest money is security for the fulfilment of agreement. A provision for the forfeiture of earnest money is not consideration to be penalty clause.—Sec. 74.

In *Shree Hanuman Cotton Mills and Anr.* v. *Tata Aircraft Ltd.*[1], the purchaser deposited Rs. 2,50,000 as earnest money, being the 25 per cent of the value of goods. He agreed that the full value of goods will be paid, before taking delivery but he failed to pay it. Held, the seller was entitled to forfeit the earnest money.

Sale-amount paid whether advance or earnest money : Money may be paid by the buyer to the seller at the time of the formation of an agreement of sale. If usually expressly stipulated whether the money is an 'advance' or an 'earnest money'. In the absence of any stipulation, the payment is interpreted as advance if it is a large part of the contract price. If the money paid is a small part of the contract price, it can be interpreted as earnest money. *Marimuthu Gounder* v. *Ramaswamy Gounder and others.*[2]

HIRE-PURCHASE AGREEMENTS

Definition

A hire-purchase agreement is one under which a person takes delivery of goods promising to pay the price by a certain number of instalments and, until full payment is made, to pay hire charges for using the goods. From this definition it can be said that a hire-purchase agreement is *a bailment plus an agreement to sell.*

Formerly, hire purchase agreements were frequently worded ambiguously and it was difficult to determine whether a particular transaction was a sale or a hire-purchase agreement. The law regarding this subject has been codified by the Parliament in 1972, viz.. the *Hire-Purchase Act* (No. 25 of 1972), but the Act has not been applied yet.

Summary

The main provisions of the Hire-Purchase Act are summarised on the next pages :

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[1] (1970) 2 S.G.A. 482 (Supreme Court) [2] AIR (1979) Mad. 189

1. Hire-Purchase Agreement means an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes a agreement under which,

(*i*) possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments, and

(*ii*) the property in the goods is to pass to such person on the payment of the last of such instalment, and

(*iii*) such person has a right to terminate the agreement at any time before the property so passes.—Sec. 2(e).

2. Hire-Purchase agreement must be in *writing* and *signed* by parties. A surety, if any, must sign the hire-purchase agreements.

The agreement shall be void if the above requirements have not been complied with.—Sec. 3.

3. Contents of hire-purchase agreement must include the following.—Sec. 4 :

(*i*) the hire-purchase price of the goods to which the agreement relates ;

(*ii*) the cash price of the goods i.e., the price at which the goods may be purchased by the hirer for cash ;

(iii) the date on which the agreement shall be deemed to have commenced ;

(*iv*) the number of instalments by which the hire-purchase price is to be paid, the amount of each of those instalments and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable ;

(*v*) the goods to which the agreement relates, in a manner sufficient to identify them ;

(*vi*) where any part of the hire-purchase price is, or is to be, paid otherwise than in cash or by cheque, the hire-purchase agreement shall contain, a description of that part of the hire-purchase price ; and

(*vii*) where any of the above requirements has not been complied with, the hirer may institute a suit for getting the hire-purchase agreement rescinded ; and the court may, if it is satisfied that the failure to comply with any such requirement has prejudiced the hirer, rescind the agreement on

such terms as it thinks just, or pass such other order as it thinks fit in the circumstances of the case.

4. The purchaser has the option of paying the full price before it was due. In that case the purchaser is entitled to get a rebate.—Secs. 9, 10.

5. In every instalment of the full price, it includes the hire of the goods and the purchasing price.—Sec. 7.

6. The seller can recover the possession of the goods, if the purchaser fails to pay any of the instalment price.—Sec. 17.

7. The Act provides that there will be certain warranties and conditions to be implied in the hire-purchase agreement. The words and expressions are defined in Contract Act and the Sale of Goods Act.—Sec. 6.

8. The Act shall not apply in relation to any hire-purchase agreement made before the commencement of this Act.—Sec. 31.

SALE AND OTHER CONTRACTS

Sale and Hire-purchase

In a sale, the property is transferred to the buyer; he can deal with the property as he likes and the transferee of the purchase gets a good title even if the price is unpaid. But in a hire-purchase agreement, the purchaser does not become owner till the full price is paid and therefore, the transferee from a person who has not paid the full price, gets no title.

In a Bombay case it has been laid down that (*i*) if the purchaser has no option of terminating the agreement by returning the goods, the transaction is a sale and not hire-purchase agreement and (*ii*) the transaction is hire-purchase agreement only if the buyer has the option of returning the goods. *Bhimji* v. *Bombay Trust Corporation.*[1]

Hire-purchase and Instalment Sale

There are differences between a hire-purchase agreement and an instalment sale, In the former, a sale is concluded after the total price and the hire charges are completely paid. The purchaser is not entitled to transfer the goods until the terms of the agreement are fully carried out. In the latter, (instalment

[1] 32 Bom. L.R. 64.

sale) the purchaser becomes the owner of specific goods immediately, although the total price is to be paid in a number of instalments.

Sale and Bailment

Bailment does not change ownership of the goods. A sale involves transfer of ownership.

In a bailment, the party delivering the goods is entitled to get back what he has delivered. In a sale the seller gets the price and there is no question of returning of goods.

Sale and Contract for Work and Labour

A contract of sale may be distinguished from a contract for work and labour. A contract of sale of goods contemplates the delivery of movable goods ; but if in substance the contract is one for the exercise of skill, it is a contract for work and labour.

"A contract of sale is a contract whose main object is the transfer of the property in and the delivery of the possession of, a chattel as a chattel to the buyer. Where the main object of work undertaken by the payee of the price is not the transfer of a chattel qua chattel, the contract is one for work and labour." *Union of India* v. *The Central India Machinery Manufacturing Co. Ltd. and others.*[1]

The distinction between the two types of contracts is of importance in England but not in India, except for taxation purposes.

Examples :

(*i*) A dentist agreed to make a set of artificial teeth to fit the mouth of a customer. Held, it is contract for the sale of goods. *Lee* v. *Griffin.*[2]

(*ii*) *G* engaged an artist to paint a portrait and supplied the canvas and paint. Held, it is a contract for work and labour and not one for the sale of goods. *Robinson* v. *Graves.*[3]

(*iii*) *V* entered into three contracts with Western Railway for construction of railway coaches on the under-frames supplied by the Railway. Labour and materials were supplied by *V*. Held, under the Bombay Sales Tax Act of 1953, the contracts were works contracts and not a sale. *State of Gujarat* v. *M/s Variety Body Builders.*[4]

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[1] AIR (1977) Supreme Court, 1537 [2] (1861) 30 L.J.K.B. 252
[3] (1935) 1 K.B. 579 [4] AIR (1976) Supreme Court, 2108

(*iv*) The Railway Board entered into a contract with a company for the manufacture and sale of wagons to the Union of India by the company. Even though some advance was taken from the Railway Board, the bulk of the material used in the construction belonged to the manufacturer who sold the end product for a price. Held, the contract was not one for work and labour but one for sale. *Union of India* v. *The Central India Machinery Manufacturing Co. Ltd. and others.* (see p. 209)

CONDITIONS AND WARRANTIES

Section 12 of the Sale of Goods Act states that a stipulation (or term) in a contract of sale with reference to goods may be a condition or a warranty.

Condition

A condition is a stipulation essential to the main purpose of contract, the breach of which gives rise to a right to treat the contract as repudiated.—Sec. 12(2).

Warranty

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

Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract.—Sec. 12(4).

Conditions and Warranties may be expressly stated in a written document or may be implied from the circumstances under which the contract was entered into.

It is for the court to find out whether a particular term was intended by the parties to be a condition or whether it was intended to be a warranty only. The intention of the parties is always to be given effect to.

Stipulation as to time

Unless a different intention appears from the terms of the contract, stipulations 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.—Sec. 11. (See pp. 110-111).

Example :

There was a contract for sale of goods, c.i.f. Antwerp. Delivery was to be given on October. Owing to a strike in the port of loading the goods were not shipped until November. Held, buyer were entitled to reject. *J. Aron & Co.* v. *Comptoir Wegimont.*[1]

Reasonable time a question of fact : Where in this Act any reference is made to a reasonable time, the question what is a reasonable time is a question of fact.—Sec. 63.

When a Condition can be treated as a Warranty—

1. *Voluntary waiver of a condition* : The buyer may elect to treat a breach of condition as a breach of warranty, i.e. instead of repudiating the contract he may accept performance and sue for damages, if he has suffered any.—Sec. 13(1).

Where a contract of sale is subject to a condition to be fulfilled by the seller, the buyer may waive the condition.

2. *Compulsory waiver of a condition* : Where a contract of sale is not severable and the buyer has accepted the goods or a part thereof, he cannot repudiate the contract but can only sue for damages. In such a case, the breach of condition can only be treated as a breach of warranty, unless there is a contract to the contrary.—Sec. 13(2).

If a buyer prevents the fulfilment of a condition contained in the contract, the condition becomes invalid.

Example :

Certain goods were promised to be delivered on 1st June, time being made the essence of the contract. The goods were delivered on the 2nd June. The buyer *may* accept the goods.

Distinction between Condition and Warranty

1. Condition is a term which is essential to the *main purpose* of the contract. Warranty is only a collateral term. It is *subsidiary* to the main purpose of the contract.

2. Breach of a condition gives the aggrieved party a right to repudiate the contract. It also creates a right to get damages. Breach of warranty entitles the aggrieved party to claim damages only.

3. A breach of condition may under certain circumstances, be treated as a warranty. But a warranty cannot become a condition.

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[1] (1921) 3 K.B. 435

Consequences of Breach of Conditions

1. If a condition is broken there arises a right to treat the contract repudiated.—Sec. 12(2).

2. *Repudiation of Contract before due date* : Where either party to a contract of sale repudiates the contract before the date of delivery, the other may either treat the contract as subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach.—Sec. 60.

Consequences of Breach of Warranty

1. A breach of warranty gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.—Sec. 12(3).

2. Under certain circumstances a 'condition' is to be treated as 'warranty'.—Sec. 13(1) and 13(2).—See above.

3. Nothing in Section 13 shall affect the case of any condition or warranty fulfilment of which is excused by law by reason of impossibility or otherwise.—Sec. 13(3). "It merely saves the rights of the seller, in appropriate cases, to rely upon the impossibility as an excuse to himself, if sued by the buyer."[1]

4. *Remedy for breach of warranty* : (1) Where there is a breach of warranty by the seller, or where the buyer elects or is compelled to treat any breach of a condition on the part of the seller as a breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods, but he may—

(*a*) set up against the seller the breach of warranty in diminution or extinction of the price ; or

(*b*) sue the seller for damages for breach of warranty.

(2) The fact that a buyer has set up a breach of warranty in diminution or extinction of the price does not prevent him from suing for the same breach of warranty if he has suffered further damages.—Sec. 59.

Implied condition and warranties

A stipulation (or term) in a contract of sale of goods may be *express* or *implied*. Express terms are those which have been expressly agreed upon by the parties. Implied terms are those which have been enacted in the Sale of Goods Act. Sections 14

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[1] Pollock and Mulla, *Indian Sale of Goods Act*.

to 17 of the Act contain a list of conditions and warranties which are implied in a contract for the sale of goods, *unless the circumstances of the contract are such as to show a different intention.* The implied conditions and warrants are stated below.

IMPLIED CONDITIONS

1. Condition as to title

There is an implied condition on the part of the seller that, in the case of a sale he has the right to sell the goods, and in the case of an agreement to sell, he will have the right to sell the goods at the time when the property is to pass.—Sec.14(a).

Examples :

(*i*) *R* bought a motor car from *D* and used it for four months. *D* had no title to the car. *R* was forced to return the car to the true owner. Held, there is a breach of the implied condition as to title and *R* is entitled to get back the purchase money paid notwithstanding the fact that he had used the car for 4 months. *Rowland* v. *Divell.*[1]

(*ii*) If the goods delivered can be sold only by infringing a trade mark, the implied condition of title is violated and the buyer can recover damages. *Niblett Ltd.* v. *Confectioner's Materials Co.*[2]

(*iii*) In a contract for the sale of shares there is an implied condition that there is no encumbrance of charge on the shares in favour of a third party. *Kissenchand* v. *Ramprotap.*[3]

2. Sale by description

Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description.—Sec. 15.

Goods are to be sold by description when the contract contains a description of the goods to be supplied. Such description may be in terms of the physical characteristics of the goods or may simply mention the trade mark, trade name, brand or label under which they are usually sold. A sale of 50 boxes of X brand soap or of 10 tons of Y brand mustard oil, is a sale of goods by description. In such cases the goods supplied must be the same as the goods described.

Example :

(*i*) A certain quantity of copra cake was sold "not warranted free from defect." The copra cake was adulterated with castor beans to such

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[1] (1923) 2 K.B 500 [2] (1921) 3. K. B. 387
[3] 44 C.W.N. 505

an extent that it could not be described as copra cake. Held, there was a violation of the implied condition and the buyer was awarded damages. *Pinnock Bros. v. Lewis & Peat Ltd.*[1]

(*ii*) *M* sold to *L*, 3000 cases of canned fruits, each case to contain 30 tins. *M* delivered 3000 cases, but about half the cases contained 24 tins each. Although the market value of the 24 tin cases were the same as the 30 tin cases, it was held that the buyer was entitled to reject the goods. *Re Moore & Co., and Landauer & Co.*[2]

3. Sale by sample

When goods are to be supplied according to a sample agreed upon, the following conditions are implied.—Sec. 17.

(*a*) The bulk shall correspond with the sample in quality.

(*b*) The buyer shall have a reasonable opportunity of comparing the goods with the sample.

(*c*) The goods shall be free from any defect rendering them *unmerchantable*, which would not be apparent on reasonable examination of the sample. If the defect is easily discoverable on inspection and the buyer takes delivery after inspection, he has no remedy.

Merchantable

This term was defined as follows : "The article in such quality and in such condition that a reasonable man, acting reasonably, would after a full examination accept it under the circumstances of the case in performance of his offer to buy that article, whether he buys for his own use or to sell again." *Bristol Tramways Co.* v. *Fiat Motors Ltd.*[3]

Example :

Some mixed worsted coatings were sold by sample. It was found that owing to a hidden defect of the cloth which could not be detected on reasonable examination, coats made out of it could not stand ordinary wear and were therefore unsalable. The buyer was held to be entitled to damage. *James Drummond and Sons* v. *E. H. Van Ingen & Co.*[4]

4. Sale by sample as well as by description

When goods are sold by sample as well as by description, the goods shall correspond both with the sample and with the description.—Sec. 15.

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[1] (1923) 1 K. B. 690
[2] (1921) 2 K.B. 519
[3] (1910) 2 K. B. 831, C.A.
[4] (1887) 12 A.C. 284

Example :

N agreed to sell to *G* some oil described as "foreign refined rape on warranted only equal to sample." The samples contained an admixture of hemp oil and the oil delivered was adulterated in the same way. Held, the oil supplied was not rape oil and therefore the buyer was entitled to reject the goods. *Nichol* v. *Godts.*[1]

5. Condition as to fitness or quality (Sec. 16)

There is an implied condition as to *quality* or *fitness for the purpose of the buyer* under the following circumstances only :

A. Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill, or judgment, and the goods are of a description which it is in the course of the seller's business to supply (whether he is the manufacturer or not).

Examples :

(*i*) *W* supplied *J* with tinned salmon which was poisonous. *J* fell ill and his wife died as a result of eating the salmon. Held, there was an implied condition of fitness because the seller obviously knew that the salmon was being purchased for consumption. The condition was violated by the grocer and damages were recoverable. *Jackson* v. *Watson & Sons.*[2]

(*ii*) *M*, a milk dealer supplied *F* with milk which was consumed by *F* and his family. The milk contained germs of typhoid. *F*'s wife was infected and died. Held, there was a breach of an implied condition of fitness and *M* was liable to pay damages. *Frost* v. *Aylesbury Dairy Co. Ltd.*[3]

(*iii*) There was a contract to supply 500 tons of coal for the S.S. "Manchester Importer". The coal supplied was found to be unfit for this ship. It was held that the buyer was entitled to get damages. *Manchester Lines* v. *Rea Ltd.*[4] In this case it was held that a buyer relies on the skill of the seller when he makes known to him the purpose for which the goods are required and the circumstances are such that any reasonable seller would take it that his judgment is being relied upon.

(*iv*) The plaintiff who was a draper and had no special knowledge of hot water bottles, went to a chemist and asked for a "hot water bottle". Held, that the bottle supplied must be fit for use as a hot water bottle. *Preist* v. *Last.*[5]

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[1] (1854) 10 Ex 191
[2] (1909) 2 K. B. 193
[3] (1905) 1 K.B. 608
[4] (1922) 2 A.C. 74
[5] (1903) 2 K.B. 148

B. An implied condition of fitness may be annexed to a contract of sale by usage of trade or custom of the locality.

C. When goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not) there is an implied condition that the goods are of merchantable quality, that is, fit to sell.

There is one exception to rule C.—If the buyer has examined the goods, there shall be no implied condition as regards defects which that examination ought to have revealed.

Examples of rule C :

(*i*) Some motor-horns were to be delivered by instalments. The first instalment was accepted but the second contained a substantial quantity of horns which were damaged owing to bad packing. Held, the buyer was entitled to reject the whole instalment as the goods were not saleable quality. *Jackson* v. *Rotax Motor etc.*[1]

(*ii*) *M* asked for a bottle of Stone's ginger wine in a restaurant. When he was drawing the cork the bottle broke and *M* was injured. Held, the sale was one by description and since the bottle was unmerchantable, *M* was entitled to recover damages. *Morelli* v. *Fitch Gibbons.*[2]

(*iii*) *B* wanted to purchase some glue. The seller showed him the glue which was stored in his warehouse in casks. *B* did not have the casks opened, which he could have done easily, but merely looked at the outside of the casks. The glue was found to have defects which would have been found out if *B* had inspected the contents of the casks. Held, there was no implied condition as to merchantable quality. *Thornett & Fehr* v. *Beer & Sons.*[3]

THE DOCTRINE OF CAVEAT EMPTOR

Definition

Caveat Emptor is a Latin expression which means, "buyers beware". The doctrine of caveat emptor means that, ordinarily, a buyer must buy goods after satisfying himself of their quality and fitness. If he makes a bad choice he cannot blame the seller or recover damages from him. "The rule probably originated at a time when goods were mostly sold in market overt, and the buyer therefore had every opportunity to satisfy himself as to the quality of the goods or their fitness for a particular purpose,

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[1] (1910) 2 K. B. 937
[2] (1928) 1 K.B. 636
[3] (1919) 1 K.B. 436

and at common law it was presumed that where the buyer could examine the goods even though he did not, he relied upon his own skill and judgment."[1]

Exceptions

Subject to certain exceptions, the doctrine of caveat emptor applies to India. Section 16 of the Sale of Goods Act lays down that in a contract for the sale of goods there shall be no implied condition as to quality or fitness for particular purpose *except* under the circumstances mentioned under that section. The exception are as follows :

(*a*) Where the buyer relies upon the skill and judgment of the seller. (See examples given under rule A above p. 215)

(*b*) Where by custom an implied condition of fitness is annexed to a contract of sale. (Rule B above p. 216)

(*c*) Where there is a sale of goods by description, there is an implied condition that the goods are fit for sale. (See examples under rule C above p. 216)

(*d*) Where the seller is guilty of fraud. A contract of sale of goods must satisfy all the essential elements of a contract and therefore if the consent of the buyer was obtained by fraud, the seller is not protected by the doctrine of caveat emptor.

In cases not falling under any of the four exceptions noted above, the seller is not liable to any penalty if the goods purchased are found to be unfit by the buyer for the purposes he had in mind.

The case of patented articles

Para 2 of Section 16(1) of the Sale of Goods Act provides that "in the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied condition as to its fitness for any particular purpose." Thus if a machine is patented as a "cotton cleaning machine" and is sold as such in the market there is *no* implied undertaking by the seller that the machine would clean cotton. If a buyer writes to a manufacturer, "send me one of your patented cotton cleaning machines", he cannot claim damages if he finds the machine useless. But if the buyer asks the manufacturer to supply a

[1] Pollock & Mulla, *Indian Sales of Goods Act.*

machine which will clean cotton, he relies on the judgment of the manufacturer and if the machine supplied is found to be unsuitable, he can claim damages.

Example :

B told a motor car dealer that he wanted a comfortable car for touring purposes. The dealer recommended a car which was being sold under the trade name of *X*. The car was found to be unsuitable and *B* sued the dealer for damages. It was held that *B* had relied on the skill and judgment of the dealer and was entitled to get damages. *Baldry* v. *Marshall*.[1]

IMPLIED WARRANTIES

In the absence of an agreement to the contrary, the following warranties are implied in every contract of sale :

1. *The buyer must get quiet possession* : The buyer shall have and enjoy quiet possession of the goods. [Sec. 14(b)]. Since disturbance to quiet possession is likely to arise only where the vendor does not possess the right to transfer the goods, this clause may be regarded as an extension of the implied condition of title provided for by Section 14(a).[2]

2. *The goods must be free from encumbrance* : There is an implied warranty that the goods shall be free from any charge or encumbrance in favour of a third party not declared or known to the buyer before or at the time when the contract is made.—Sec. 14(c).

The effect of this clause is that if the buyer pays off the charge or encumbrance, he will be entitled to recover the money from the seller.

3. *Fitness of goods, required for a purpose, may be warranted by usage of trade* : A warranty as to fitness for a particular purpose may be annexed to a contract of sale by a custom or usage of trade.—Sec. 16(3).

Exclusion of implied terms and conditions

Where any right, duty or liability would arise under a contract of sale by implication of law, it may be negatived or varied by express agreement or by the course of dealing between the parties, or by usage, if the usage is such as to bind both parties to the contract.—Sec. 62.

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[1] (1925) 1 K.B. 260 [2] Pollock & Mulla, *Indian Sale of Goods Act*

Comment : Section 62 of the Act provides that the liability for implied warranties under a contract of sale, can be excluded (i.e., negatived) by three methods, namely : (*i*) express contract, (*ii*) by the course of dealing between the parties, and (*iii*) by usage.

LIABILITIES OF THE SELLER APART FROM THE CONTRACT OF SALE

The Sale of Goods Act deals only with the contractual liabilities of the seller. But the seller may also be liable to pay damages under the law of torts if he causes injury by a wrongful act. Such damages may sometimes be recovered by a third party, *i.e.*, one with whom the seller never entered into any contract. Some example are given below.

Examples :

(*i*) *N* sold to *C* a tin of disinfectant powder knowing that it would be dangerous to open the tin without special care. *C* without knowledge of the danger, opened the tin, whereupon the powder flew into her eyes and injured them. *C* sued for damages. Held, *N* should have warned *C* of the possible danger and having failed to do so, was liable to pay damages. *Clarke* v. *Army Navy Co-operative Society Ltd.*[1]

(*ii*) The plaintiff went to a restaurant with a friend and ordered a bottle of ginger beer manufactured by the defendant. She drank a part of the bottle. When the remainder was poured into the glass a decomposed snail appeared with the liquid. For the resulting mental and bodily shock, she filed a suit for damages against the manufacturers. Damages were granted. The House of Lords held that a manufacturer of goods intended for consumption, is under a duty to take reasonable care that the goods are free from defects which render them noxious or dangerous. *Donoghue* v. *Stevenson*.[2]

EXERCISES

1. Define 'goods' and state the different types of 'goods'. (Pages 200-201)
2. Explain the difference between a condition and warranty. Under what circumstances can a breach of condition be treated as a breach of warranty ? (Pages 210-211)

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[1] (1903) 1 K.B. 155 [2] (1932) A.C. 562

3. Distinguish a 'condition' from a 'warranty' as used in the Indian Sale of Goods Act, and state the consequences for breach of condition and warranty. (Pages 211-216)
4. What do you understand by 'Caveat Emptor' ? Are there any exceptions to its application to sale of goods ? (Pages 216-217)
5. Explain the condition of fitness or quality and the exceptions to it. (Pages 215-216)
6. What are the implied conditions in a contract of sale of goods by sample ? (Pages 213-218)
7. Explain the following terms : Buyer ; Seller ; Earnest money ; Price of goods. (Pages 200, 204, 206)
8. What is a contract of Sale of Goods ? What are the distinctions between sale and agreement to sell ? When are agreement to sell ? When an agreement to sell becomes sale ? Illustrate. (Pages 201-203)
9. When stipulation in a contract of sale will amount to conditions and warranties ? State the conditions which may be termed as implied conditions in relation to goods. (Pages 210-216)
10 Explain the terms 'Condition' and 'Warranty'. Distinguish between the two. When can a condition be treated as warranty ? State the implied conditions in a contract of sale of goods. (Pages 210-216)
11. State the differences between the following :
    (*a*) Sale and hire-purchase. (Page 208)
    (*b*) Sale and agreement to sell. (Pages 201-202)
    (*c*) Hire-purchase and instalment sale. (Page 208)
    (*d*) Condition and Warranty. (Page 210)
12. Objective questions. Give short answers :
    (*i*) "Goods may be classified into three types". What are they ?
    (*ii*) Give one example of implied condition in a contract of sale of goods by sample. (Pages 200-201, 213)

2 TRANSFER OF OWNERSHIP

WHEN DOES PROPERTY PASS FROM THE SELLER TO THE BUYER?

Rules, Sections 18 to 25 of the Sale of Goods Act lay down the rules which determine when ownership of property passes from the seller to the buyer. These rules may be summarised as follows :

1. Unascertained Goods

When there is a contract for the sale of unascertained goods, property in the goods is not transferred to the buyer unless and until the goods are ascertained.—Sec.18.

An agreement to sell 50 maunds out of a large quantity of rice in a godown does not make the buyer the owner of anything. He can become owner of 50 maunds of rice only after this quantity of rice has been separated out from the other rice in the godown. "The individuality of the thing to be delivered" must be established before property in it can pass from the seller to the buyer. (Lord Ellenborough in, *Busk* v. *Davis.*[1])

2. The Intention of the Parties

In a contract for the sale of specific or ascertained goods, the property passes at such time as the parties to the contract intend it to pass. For the purpose of ascertaining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case. If the intention of the parties cannot be otherwise determined, the rules mentioned below are to be applied.—Sec.19.

3. Specific goods

Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of the goods, or both, is postponed.—Sec. 20.

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[1] (1814) 2 M & S 397

Property passes at the time of entering into the contract of sale if the following conditions are fulfilled :

(*i*) The goods are specific goods.
(*ii*) The goods can be immediately delivered.
(*iii*) The contract of sale is without any condition.
(*iv*) The parties themselves have not fixed a different time for the passing of property.

Deliverable State

Goods are said to be in a 'Deliverable state', when they are in such state that the buyer would under the contract be bound to take delivery of them.—Sec. 2(3).

Example :

On the 4th January, a haystack lying on the seller's land was sold. It was agreed that the price was to be paid on 4th February, The haystack will remain on the seller's land till 1st May and no hay was to be cut till the price was paid. The haystack was destroyed by fire. Held, the property in the haystack had passed on the making of the contract and the buyer must bear the loss. *Tarling* v. *Baxter*.[1]

4. When seller has something to do

Where there is a contract for the sale of specific goods and the seller is bound to do something to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof.—Sec. 21.

Example :

The contents of a cistern of oil was sold, the oil was to be filled into casks by the seller and then taken away by the buyer. Some of the casks were filled in the presence of the buyer but, before the remainder could be filled, a fire broke out and the entire quantity of oil was destroyed. Held, the buyer must bear the loss of the oil which was put into casks and the seller must bear the loss of the remainder. *Rugg* v. *Minnet*.[2]

5. When goods are to be measured, tested, etc.

Where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not

[1] (1827) 6 B & C 360 [2] 11 East 210

pass until such act or thing is done and the buyer has notice thereof.—Sec. 22.

Example :

A certain quantity of bark was sold at a fixed price per ton. It was agreed that for determining the money payable by the buyer, the bark would be weighed by the agents of the parties. After a certain quantity was weighed taken away, the re . was carried away by flood. Held, the buyer is liable to pay for ne part taken away by him and the loss of the remainder must be borne by the seller. *Simmons* v. *Swift*.[1]

6. Unconditional appropriation

Unconditional appropriation means doing something which identifies and determines the actual goods to be delivered. Property passes when such unconditional appropriation is made by one party with the consent of the other.

Where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either, by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after appropriation is made.—Sec. 23(1).

Example :

G sold to *P*, 140 bags of rice out of his stock (sale of unascertained goods). After the price was paid *G* sent a delivery order for 125 bags and wrote a letter saying that the remaining 15 bags were ready for delivery at his warehouse. *P* sent for the 15 bags after about a month, when it was discovered that the bags were stolen. Held, there was unconditional appropriation of the 15 bags by the seller, there was implied consent of the buyer to the appropriation (because he did not object) and therefore property in the 15 bags has passed to the buyer. He must therefore bear the loss and is not entitled to get back the price paid by him for them. *Pignataro* v. *Gilroy*.[2]

7. Delivery to the carrier

Where in pursuance of the contract, the seller delivers the goods to the buyer or to a carrier or other bailee (whether named by the buyer or not) for the purpose of transmission to the buyer,

[1] (1826) 5 B & C 857 [2] (1919) 1 K.B. 549

and does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract.—Sec. 23(2).

The general rule is that when the seller delivers the goods to a carrier for being taken to the buyer, there is unconditional appropriation on his part and the property passes to the buyer. To this rule there is one exception : property does not pass if the seller reserves the "right of disposal" of the goods.

Reservation of the Right of Disposal

(Sec. 25) Reservation of the right of disposal means any action by the seller which expresses an intention on his part not to part with control over the goods until certain conditions are fulfilled. In such cases, the property, passes when the conditions are fulfilled.

An intention to reserve the right of disposal may be presumed when a Bill of Lading or a Railway Receipt makes the goods deliverable to the order of the seller.

When the Bill of Lading or the Railway Receipt for the goods, and the Bill of Exchange for the price are sent together and the Bill of Lading or the Railway Receipt is deliverable to the buyer only when the Bill of Exchange is accepted or paid, the buyer is bound to return the Bill of Lading or the Railway Receipt if he does not honour the bill of exchange. If he wrongfully retains the Bill of Lading or the Railway Receipt, the property in the goods does not pass to him.

Examples :

(*i*) *X* sends certain goods by lorry for delivery to *W*, without reservation of the right of disposal. The property passes to *W* as soon as the goods are handed over to the carrier.

(*ii*) *X* sends certain goods by lorry to *Y* and instructs the lorry driver not to deliver the goods until the price is paid by *Y* to the lorry driver. The property passes only when the price is paid.

8. Goods sent on approval or "on sale or return"

(Sec. 24) When goods are delivered to the buyer on approval or "on sale or return" or other similar terms, the property therein passes to the buyer—

(*a*) when he signifies his approval or acceptance to the seller or does any other act adopting the transaction :

(*b*) If he does not signify his approval or acceptance to the seller but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and if no time has been fixed, on the expiration of a reasonable time.

Examples :

(*i*) *K* delivered some jewellery to *X* on sale or return. *X* pawned the jewellery with *A*. Held, *X*'s act amounts to an acceptance of the sale transaction and hence *A*'s rights are protected. *Kirkham* v. *Attenborough*.[1]

(*ii*) Certain goods were delivered to *A* on sale or return. *A* delivered the goods to *B* on similar terms, *B* to *C*, and *C* to *D*. *D* lost the goods. Held, since *A* was unable to return the goods to the seller, the sale was complete and must pay the price. *Genn* v. *Winkel*.[2]

(*iii*) *P* sends certain books to *Q* on approval. *Q* does not return them or ask the seller to take them away, for six months. He is deemed to have approved the sale and must pay the price.

TRANSFER OF OWNERSHIP : TIME OF

Sale of goods involves transfer of ownership of property from the seller to the buyer. It is necessary to determine the precise moment of time at which the ownership of the goods passes from the seller to the buyer, because of the following reasons :

1. *Risk passes with property* : The general rule is that risk passes with the property. If the goods are lost or damaged by accident or otherwise, then, subject to certain exceptions, the loss falls on the person who is the owner at the time when the goods are lost or damaged.

2. *Who can take action* ? : When there is danger of the goods being damaged by the action of third parties it is the owner who can take action.

3. *What is the effect of insolvency* ? : In case of insolvency of either the buyer or the seller it is necessary to know whether the goods will be taken over by the official Assignee. The answer depends upon whether the ownership of the goods is with the party who has become insolvent.

Passing of risk

Section 26 lays down the rules regarding the passing of risk.

[1] (1897) 1 Q.B. 201 [2] (1912) 107 L.T. 434

The general rule is that goods remain at the seller's risk until the ownership is transferred to the buyer. After the ownership has passed to the buyer, the goods are at the buyer's risk whether delivery has been made or not. "Risk follows ownership." (See examples given in pages 224-225).

There are two exceptions to the rule stated above.

1. Where delivery has been delayed through the fault of either the buyer or the seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

2. The parties may agree that the risk will pass at a time different from the time when ownership passed. For example, the seller may, in a particular case, agree to be responsible for the goods even after the ownership has passed to the buyer.

Destruction of part of goods sold

See examples in p. 204 , and paragraphs 4, 5 and 6, pp. 222-223.

TRANSFER OF TITLE BY NON-OWNER

General Rule

The general rule is that only the owner of goods can sell the goods. No one can convey to a transferee a better title than he himself has. If a person transfers articles not belonging him, the transferee gets no title. This principle is expressed by the Latin phrase,"*Nemo quod qui non habet*", which means "none can give who does not himself possess". This rule applies to both movable and immovable property. But as regards movable goods it is subject to certain exception noted below. In each of the following cases, a person who is not an owner, can give to the transferee a valid title to the goods :

1. Estoppel

Under certain circumstances the true owner may be prevented, by his conduct, from denying the seller's authority to sell. Suppose that *X* is the owner of certain goods. *X* acts in such a manner that *Y* is induced to believe that the goods belong to *Z*. On that belief *Y* buys the goods from *Z*. Under these circumstances, the court will not allow *X* to prove his ownership. Thus *Y* gets a good title to the goods even though he has purchased them from *Z* who is not their owner.

Example :

P, the owner of certain machinery, left them in the possession of *Q*. A person named *R* who had obtained a decree against *Q*, seized the goods in execution of the decree. *P* took no steps for several months to claim the goods. He also conversed with *R*'s solicitor regarding the execution without mentioning his title to the machinery. *R* then had the machinery sold in execution. It was held that *P* was estopped from denying that the machinery was *Q*'s. *Pickard* v. *Sears*.[1]

2. Sale by a mercantile agent

Sale of goods by a mercantile agent gives a good title to the purchaser even in cases where the agent acts beyond his authority, provided the following conditions are satisfied.—Sec. 27 :

(*i*) The agent is in possession of the goods or of a document of title to the goods.

(*ii*) Such possession in with the consent of the owner.

(*iii*) The agent sells the goods in the ordinary course of business.

(*iv*) The purchaser acts in good faith and has no notice that the agent had no authority to sell.

["*Mercantile Agent*"—'Mercantile agent' means an agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods.—Sec. 2(9)]

3. Sale by one of several joint owners

If one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in the goods is transferred to any person who buys them from such joint owner provided the buyer acts in good faith and without notice that the seller had no authority to sell.—Sec. 28.

4. Sale of goods obtained under a voidable agreement

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

[1] (1937) 6 A. & E. 469

Example :

X, buys a ring from *Y* at a low price by undue influence and sells it to *Z* who is an innocent purchaser without notice of *X*'s defective title. *Z* has a good title and *Y* cannot recover the ring from him even if the agreement with *X* is subsequently rescinded.

It is to be noted that the above section applies when the goods have been obtained under a *voidable* agreement, not when the goods have been obtained under a *void* or *illegal* agreement. If the original agreement is of no legal effect (*void ab initio*) the title to the goods remain with the true owner and cannot be passed on to anybody else.

Example :

In *Cundy* v. *Lindsay* (see p. 74) goods were obtained by an agreement which was found to be void. It was held that no title passed to the buyer though he was a bona fide purchaser for value and without notice of any defect in the seller's title.

5. Sale by the seller in possession of goods after sale

Where a person, having sold goods, continues to be in possession of the goods or of the documents of title to the goods, a transfer of title by him or his agent by way of sale of pledge, gives a good title to the transferee provided the transferee was acting in good faith and had no knowledge of the seller's want of title.—Sec. 30(1). The original buyers in such cases can obtain damages from the seller but cannot recover the goods from the second buyer.

Example :

M has 50 barrels of tobacco at a warehouse on the dock. The dock warrant was issued to him. *M* sells the tobacco to *J* who leaves the dock warrant to *M* but takes no step to have the tobacco transferred to *J*'s name. *M* subsequently pledges the tobacco and delivers the dock warrant to *C*. Held, *C*, acting in good faith, will acquire good title against *J*. *Johnson* v. *Credit Lyannals*.[1]

["*Document of title to goods*" includes a bill of lading, dock-warrant, warehousekeeper's certificate, wharfingers' certificate, railway receipt, warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession on control of goods, or authorising or purporting to authorise, either by endorsement or by delivery,

[1] (1877) 3 G.P.D. 32

the possessor of the document to transfer or receive goods thereby prepresented.—Sec. 2(4)].

6. Buyer in possession of goods over which the seller has some rights

When goods are sold subject to some lien or right of the seller (for example for unpaid price) the buyer may sell, pledge, or otherwise dispose of the goods to a third party and give him a good title, provided the following conditions are satisfied.—Sec. 30(2).

(*i*) The first buyer is in possession of the goods or of the documents of title to the goods with the consent of the seller.

(*ii*) The transfer is by the buyer or by a mercantile agent acting for him.

(*iii*) The person receiving the same acts in good faith, and without notice of any lien or other right of the original seller.

Example :

Furniture was delivered to *X* under an agreement that the price was to be paid in two instalments, the furniture to become the property of *X* on payment of the second instalment of the price. *X* sold the furniture before the second instalment was paid. It was held that there was a binding agreement by *X* to buy the goods and therefore a transfer by him to a bona fide purchaser for value without notice conveyed a good title. *Lee* v. *Butler*[1]

7. An unpaid seller

An unpaid seller of goods can under certain circumstances, re-sell the goods. The purchaser of such goods gets a valid title of the goods.—Sec. 54. (See p. 242)

8. Sale under the Contract Act

(*a*) A pawnee may sell the goods of pawnor if the latter makes a default of his dues. The purchaser under such a sale gets a good title.—Sec. 176, Contract Act (See p. 172)

(*b*) A finder of goods can sell the goods under certain circumstances. The purchaser gets a good title.—Sec. 169, Contract Act. (See p. 169)

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[1] (1893) 2 Q. B. 318

Cases not coming within the exceptions

It is to be noted that apart from the cases mentioned above, the general rule applies, and no seller can give a better title that he himself has. Some examples are given below.

Examples :

(*i*) *X* found a ring. He made a reasonable search for the owner but did not find him. He then sold the ring to *Y*. It was held that the true owner can recover the ring from *Y*. *Farquaharson Bros.* v. *King & Co.*[1]

(*ii*) A horse was sold at a public auction. The horse was stolen property but this was not known to either the auctioneer or the buyer. Held, the true owner can recover the horse. *Lee* v. *Bayes.*[2]

(*iii*) *B* let out a motor car on hire to *M* at £ 15 per month. It was agreed between the parties that *M* could purchase the car by paying in all £ 424 at any time within 24 months. After a few months *M* pledged the car with *C*, *B* sued to recover the car from *C*. It was held that as *M* had only an option to purchase, the cannot give good title to *C* and hence *B* can recover the car. *Belsize Motor Supply Co.* v *Cox.*[3]

EXERCISES

1. State the rules of ascertaining the intention of the parties as to the time when the property in the specific and unascertained good is to pass the buyer. (Pages 221-225)
2. What are unascertained goods? When does property pass in a contract for the sale of such goods? (Pages 200, 221)
3. Enumerate the rules under which property in goods is transferred from the seller to the buyer. (Pages 221-225)
4. When does property in goods sold pass from the seller to the buyer? Discuss the exception, to the rule that 'no one can give better title to the goods than he has himself'. (Pages 221-225, 226-230
5. (*a*) The general law is that no seller of goods can give the buyer of goods a better title to the goods than he himself has. Explain. (Page 226)

   (*b*) Are there any exceptions to the above general law? If so, what are they? (Pages 226-230)
6. "No seller of goods can give the buyer of goods a better title to those goods than he himself has". Discuss. (Pages 226-230)

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[1] (1902) A.C. 325 [2] (1856) 18 C.B. 599
[3] (1914) 1 K.B. 244

7. When does property in goods pass from the seller to the buyer in a contract of sale of goods? (Pages 225-226)

8. Problem :

(*a*) *A*, buys, by sample 100 bales of "Fair Bengal Cotton" ; goods according to sample were delivered but the cotton was not "Fair Bengal Cotton". Is the buyer entitled to reject the goods? Give reason. (Pages 213-214)

(*b*) *A*, a shipbuilder, contracts to sell to *B* for a stated price, a vessel lying in *A*'s yard ; the vessel is to be rigged and fitted for a voyage, and the price is to be paid on delivery. Has the property in the vessel passed to *B*? (Para 4, page 222)

(*c*) *A* is the owner of a pen but he does not know that. *X* pretends to be the owner of that pen and sells it to *A*. Is it a valid sale? (Para 1, page 226)

(*d*) On 1st March, *A* agrees to sell one particular horse to *B* for Rs. 5,000. According to the terms of the agreement, the horse is to be delivered on 5th April when payment will be made. When does property in the horse pass from the seller to the buyer? (Para 3 & 6, pages 221 & 223)

(*e*) *X* handed over a motor car to a mercantile agent for sale on condition that the car would not be sold below a specified price. In spite of the agreement the agent sold it to *A* below the price and ran away with the money obtained. *A* then resold the car to *B* in good faith. Can *X* recover the car from *B*? (Para 2, pages 227)

9. Objective Questions.

(*a*) 'The general rule is that only the owner of goods can sell the goods". Mention two exceptions to the general rule. (Page 226)

(*b*) Who is a mercantile agent? (Page 227)

(*c*) Answer the best alternative : In a sale, if the goods are destroyed, the loss falls on (i) the buyer ; (ii) the seller. (Page 205)

3 PERFORMANCE OF THE CONTRACT OF SALE

DELIVERY

Delivery means a "voluntary transfer of possession from one person to another."—Sec. 2(2). Sir Frederick Pollock has defined "delivery" as "voluntary dispossession in favour of another."[1]

The mode of giving possession is to be determined by the parties. Delivery may be Actual, Symbolic or Constructive.

1. *Actual delivery* occurs when the goods themselves are delivered : the goods are physically handed over to the seller or to his agent.

2. *Symbolic delivery* occurs when the buyer gets the means of obtaining possession. *Example* : Certain specific goods were locked in the godown and the seller gives the key of the godown to the buyer. It transfers possession and gives it actual control of the place.

3. *Constructive delivery* occurs when a change in the possession of the goods without any change in the actual and visible custody, *e.g.*, the delivery of the bill of lading with which goods may be obtained. *Hurry v. Mangles.*[2]

RULES REGARDING DELIVERY

The Sale of Goods Act lays down the following rules regarding delivery and other matters concerning the performance of the contract of sale :

1. Possession of Buyer

Delivery of goods sold may be made by doing anything which the parties agree shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf.—Sec. 33.

2. Effect of part delivery

A delivery of part of goods, in progress of the delivery of the whole, has the same effect, for the purpose of passing the

[1] Pollock and Mulla, *Sale of goods Act*, p. 7.
[2] (1808) 1 Camp. 452.

property in such goods, as a delivery of the whole ; but a delivery of part of the goods, with an intention of severing it from the whole, does not operate as a delivery of the remainder.—Sec. 34.

Examples :

(*i*) Some goods lying at a wharf, were sold and the seller instructed the wharfinger to give delivery to the buyer. The buyer weighed the goods and took away a part of them. There is delivery of the whole. If the part remaining on the wharf is lost the loss will fall on the buyer. *Hammond* v. *Anderson.*[1]

(*ii*) *X* sold 5 bales of certain goods to *Y*. *Y* received and paid for one bale and refused to accept the others. The amounts to part delivery. *Mitchell Reid Co.* v. *Buldeo Doss.*[2]

3. Application for delivery

Apart from any express contract the seller of goods is not bound to deliver them until the buyer applies for delivery.—Sec. 35.

4. Place of delivery

Whether it is for the buyer to take possession of the goods or for the seller to send them to the buyer is a question depending in each case on the contract, express or implied, between the parties. Apart from any such contract, goods sold are to be delivered at the place at which they are at the time of the sale, and goods agreed to be sold to be delivered at the place at which they are at the time of the agreement to sell, or if not then in existence, at the place at which they are manufactured or produced.—Sec. 36(1).

5. Time of delivery

(1) Where under the contract of sale the seller is bound to send the goods to the buyer but no time for sending them is fixed, the seller is bound to send them within a reasonable time.—Sec. 36(2).

(2) Demand or tender of delivery may be treated as ineffectual unless made at a reasonable hour. What is a reasonable hour is a question of fact.—Sec. 36(4).

6. Possession of a third person

Where the goods at the time of sale are in the possession of a third person, there is no delivery by seller to buyer unless

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[1] 8 RR 763 [2] (1888) 15 Cal 1.

and until such third person acknowledges to the buyer that he holds the goods on his behalf.—Sec. 36(3). This is called Delivery by Attornment.

7. Expenses of delivery

Unless otherwise agreed, the expenses of and incidental to putting the goods into a deliverable state shall be borne by the seller.—Sec. 36(5).

8. Delivery of the Wrong Quantity

(1) Where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them, but if the buyer accepts the goods so delivered he shall pay for them at the contract rate.—Sec. 37(1).

(2) Where the seller delivers to the buyer a quantity of goods larger than he contracted to sell, the buyer may accept the goods included in the contract and reject the rest, or he may reject the whole. If the buyer accepts the whole of the goods to delivered, he shall pay for them at the contract rate.—Sec. 37(2).

Example :

The right to reject the goods is not equivalent to right to cancel the contract. If the buyer rejects the goods, the seller has a right to tender again the contract quantity subject to the terms and conditions of the contract and the buyer is bound to accept the same. *Borrowman Phillips & Co.* v. *Free and Hollis*[1] ; *Vilas Udyog Ltd* v. *Prag Vanaspati*.[2]

(3) Where the seller delivers to the buyer the goods he contracted to sell mixed with goods of a different description not included in the contract, the buyer may accept the goods which are in accordance with the contract and reject the rest or may reject the whole.—Sec. 37(3).

(4) The provisions of Section 37 are subject to any usage of trade, special agreement or course of dealing between the parties.—Sec. 37(4).

9. Instalment Delivery

(1) Unless otherwise agreed (1) the buyer of goods is not bound to accept delivery thereof by instalments.—Sec. 38(1).

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[1] (1878) 4 Q.B.D. 500 [2] AIR (1975) Guj. 112

(2) Section 38(2) provides that where instalment delivery and separate payment for each instalment has been agreed upon, and either party fails to perform his obligations about one of the instalments, the failure may amount to (*i*) a repudiation of the whole contract or (*ii*) a severable breach for which damages can be claimed but the contract cannot be repudiated. The question is to be decided on the basis of the terms of the contract and the circumstances of the case.

10. Delivery to the Carrier or Wharfinger

Section 39 provides that delivery of goods to a carrier for transmission to the buyer or to wharfinger for safe custody, is *Prima facie* deemed to be delivery to the buyer. The seller shall, unless otherwise authorised by the buyer, make a reasonable contract with the carrier or the wharfinger. If he does not do so and the goods are lost or damaged, the buyer may refuse to treat such delivery as delivery to himself or may hold the seller responsible for the damages. In cases of set transit, in circumstances where it is usual to insure, the seller shall notify the buyer so that he can insure. If the seller fails to do so, the goods remain at his risk during the transit.

11. Examining the goods

The buyer has the right to examine the goods for the purpose of ascertaining whether they are in conformity with the contract. —Sec. 41.

12. Acceptance

The buyer is deemed to have accepted the goods when he intimates to the seller that he has accepted them, or when the goods have been delivered to him and he does any act, in relation to them which is inconsistent with the ownership of the seller, or when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.—Sec. 42.

13. Buyer is not bound to return rejected goods

Unless otherwise agreed, where goods are delivered to the buyer and he refuses to accept them, having the right so to do, he is not bound to return them to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them.—Sec. 43.

14. Liability of Buyer

The buyer is liable to the seller for any loss occasioned by his neglect or refusal to take delivery, and also for a reasonable charge for the care and custody of the goods.—Sec. 44.

DUTIES OF SELLER OF GOODS

1. Delivery

(1) It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale.—Sec. 31.

(2) Unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange of the price, and the buyer shall be ready and willing to pay the price in exchange of possession of the goods.—Sec. 32.

The seller of goods has the duty of giving delivery according to the terms of the contract and according to the rules contained in the Sale of Goods Act. (See pp. 232-235)

2. Risk of deterioration in the goods

Where the seller of goods agrees to deliver them at his own risk at a place other than that where they are when sold, the buyer shall, nevertheless, unless otherwise agreed, take any risk of deterioration in the goods necessarily incident to the course of transit.—Sec. 40.

3. Damages for non-delivery

Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for a damages for non-delivery.—Sec. 57.

4. Specific Performance

Under certain circumstances in any suit for breach of contract to deliver specific or ascertained goods, the Court may, if it thinks fit, on the application of the plantiff, by its decree direct that the contract shall be performed specifically. The power of the court to order specific performance in such cases is to be used subject to rules contained in the Specific Relief Act regarding specific performance of contracts.—Sec. 58.

DUTIES OF BUYER OF GOODS

The buyer of goods has the following duties :

1. Payment of price

He must pay the price of goods according to the terms of the contract.—Sec. 31.

2. Compensation

If he wrongfully refuses to accept delivery, he must pay compensation to the seller.—Sec. 32, Sec. 42, and Sec. 56.

3. Delivery

Unless otherwise agreed, the seller is not bound to deliver the goods without the application of the buyer for delivery.—Sec. 35.

4. Liability of Buyer

When the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and the buyer does not within a reasonable time after such request take delivery of the goods, he is liable to the seller for any loss occasioned by his neglect or refusal to take delivery, and also for a reasonable charge for the care and custody of the goods.—Sec. 44.

5. Interest and Special Damages

The seller or the buyer may recover interest or special damages in any case where by law interest or special damages may be recoverable. He may also recover the money paid where the consideration for the payment of it has failed.

In the absence of a contract to the contrary, the Court may award interest at such rate as it thinks fit on the amount of the price—

(*a*) to the seller in a suit by him for the amount of the price—from the date of the tender of the goods or from the date on which the price was payable.

(*b*) to the buyer in a suit by him for the refund of the price in a case of a breach of contract on the part of the seller—from the date on which the payment was made.—Sec. 61.

RIGHTS OF BUYER OF GOODS

1. Delivery

The buyer has the right to have delivery of the goods according to the terms of the contract.—Sec. 37.

2. Repudiation

Unless otherwise agreed, the buyer of goods is not bound to accept delivery by instalments.—Sec. 38.

The buyer is not bound to accept the delivery of a wrong quantity (short delivery or extra-delivery).—Sec. 37.

3. Buyer's right of examining goods

(1) Where goods are delivered to the buyer which he has not previously examined, he is not deemed to have accepted them unless and until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract.—Sec. 41(1).

(2) Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he is bound, on request, to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract.—Sec. 41(2).

4. Buyer is not bound to return rejected goods.

Sec. 43. See p. 235, para 13.

5. Damages for non-delivery

Sec. 57. See p. 236, para 3.

6. Specific performance

Sec. 58. See p. 236, para 4.

7. Remedy for Breach of Warranty

Sec. 59. See p. 212, para 4.

8. Repudiation of Contract

Sec. 60. See p. 212, para 2.

9. Effects of Tax Changes

Where in a contract of sale there is no stipulation for the payment of taxes or there was no tax on the articles in question or where the contract is for the sale of goods tax paid, and, subsequently any customs or excise duty or any tax on the sale or

purchase of goods is imposed, increased, decreased or remitted,—

(*a*) the seller may add to the price the amount of duty imposed or increased, and

(*b*) the buyer may deduct from the price the amount of duty decreased or remitted.

The aforesaid provisions will not apply if a contrary intention appears from the terms of the contract.—Sec. 64A.

RIGHTS OF SELLER OF GOODS

1. Remedies

Unpaid, sellers have certain remedies *viz.*, Seller's Lien, Right of Stoppage in Transit, Right of Resale and Suit for the Price. (See pp. 240-241)

2. Enforcement of liabilities of buyer

The seller can enforce the liabilities of buyer for not taking delivery.—Sec. 44. (See para 14, p. 236)

3. Other rights

The seller has been given certain rights to the aggrieved party for the following reasons : Damages for Non-delivery (Sec. 57); Remedy for breach of warranty (Sec. 59); repudiation of contract (Sec. 60); interest and special damages (Sec. 61); increasing of the amount of duty imposed or increased (Sec. 64A). See pages 237-239.

RIGHTS OF THE UNPAID SELLER AND REMEDIAL MEASURES

Who is an unpaid seller ?

The seller of goods is deemed : to be an unpaid seller (*a*) when the whole of the price has not been paid or tendered or (*b*) when a bill of exchange or other negotiable instrument has been received as conditional payment, and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise.—Sec. 45(1).

The term 'seller' includes any person who is in the position of a seller, *e.g.*, agent of the seller.

Suppose that goods worth Rs. 500 are sold. The seller is deemed to be an unpaid seller under any of the following circumstances ;

(*a*) If the whole of the purchase price (Rs. 500) is not paid on the due date.

(*b*) If payment is made in the form of a negotiable instrument (bill of exchange or cheque) and the instrument is dishonoured.

Unpaid Seller's Rights

Rights of an unpaid seller can be listed as follows, (1) *against the goods*– Seller's Lien, Stoppage in Transit, and Resale, (2) *against the buyer personally*—Suits for Price, Damages and Interest. The right are explained below.

1. Sellers Lien or Vendor's Lien (Sections 47-49)

When can the right of lien be exercised ? The unpaid seller of goods, who is in possession of them, is entitled to *retain possession* until payment or tender of the price in the following cases :

(*a*) where the goods have been sold without any stipulation as credit ;

(*b*) where the goods have been sold on credit but the term of credit has expired ;

(*c*) where the buyer becomes insolvent.

Rules regarding seller's Lien : (1) The seller may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer.

(2) If the goods have been sold on credit, the seller cannot refuse to part with possession unless the term of credit has expired.

Example :

Goods are sold on 1st November on condition that the price is to be paid on 1st December. The seller must give delivery. But if the buyer does not take delivery and the seller is in possession on 1st December, the seller can refuse to part with possession till the price is paid.

(3) Lien can be exercised for non-payment of the price, not for any other charges.

Example :

The seller cannot claim lien for godown charges which he had to incure for storing the goods in exercise of his lien for the price.

(4) When an unpaid seller has made a part delivery of the goods he can exercise lien on the balance of the goods not

delivered unless the part delivery was made under such circumstances as to show an intention to waive the lien.

(5) The seller can abandon or waive the lien if he so desires.

(6) The unpaid seller does not lose his lien by reason only that he has obtained a decree for the price of the goods.

Loss of right of lien : The unpaid seller of goods loses his lien thereon in the following cases :

(*a*) Where he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods ;

(*b*) when the buyer or his agent lawfully obtains possession of the goods ; and

(*c*) by waiver thereof.

2. The Right of Stoppage in Transit (Sections 50-52)

Explanation : When the buyer of goods *becomes insolvent,* and the goods are *in course of transit* to the buyer, the seller can *resume possession* of the goods from the carrier. This is known as the right of stoppage in transit.

Rules regarding the course of transit : The following points are to be noted in connection with the right of stoppage in transit.

(*i*) The goods are deemed to be in course of transit from the time they are delivered to the carrier to the time they are delivered to the buyer or his agent.

(*ii*) The right of stoppage in transit comes to an end as soon as the goods are delivered to the buyer or his agent. The carrier may become the agent of the buyer under some circumstances, *e.g.*, if after the arrival of the goods at the appointed destination, the carrier acknowledge to the buyer that he holds the goods on his behalf. The seller's right to resume possession comes to an end in such a case. A shipowner carrying goods may be acting as the agent of the buyer if the circumstances so indicate.

(*iii*) If the carrier wrongfully refuses to deliver the goods to the buyer's the transit is at an end, and the seller's right is lost.

(*iv*) Where a part delivery has been made, the remainder of the goods may be stopped in transit unless it is shown that the part delivery was made under such circumstances as to show an agreement to give up possession of the whole of the goods.

Who is an insolvent? The term insolvent is used here to denote a person who is financially embarrassed.. It is not

necessary that the buyer should be declared insolvent by a court of law before the right of stoppage in transit can be exercised.

The method of taking possession: The right of stoppage in transit is to be exercised by the seller by taking actual possession or by *giving notice* to the carrier to redeliver the goods to the seller. The carrier, upon such notice being given, is bound to redeliver the goods to the seller or his agent. The expenses of redelivery must be borne by the seller.

3. The Right of Resale

(Sec. 54). The unpaid seller who has retained possession of the goods in exercise of his right of lien or who has resumed possession from the carrier upon insolvency of the buyer, can resell the goods.

(*a*) if the goods are of a *perishable nature*, without any notice to the buyer, and

(*b*) in other cases after *notice to the buyer*, calling upon him to pay or tender the price within reasonable time, and upon failure of the buyer to do so.

If the money realised upon such resale is not sufficient to compensate the seller, he can sue the buyer for the balance. But if he receives more than what is due to him, he can retain the excess.

A resale does not absolve the buyer from his liabilities to compensate the seller for damages he may have suffered.

The person who buys the goods upon such resale gets a good title even if the seller has failed to give notice to the first buyer. But if no notice is given and the goods are sold, the seller cannot sue the first buyer for damages for breach of contract and must pay back to the first buyer any profit which he has realised from the resale (*i.e.*, the amount received in excess of the original price).

4. Suit for the Price

(Sec. 55) Where under a contract of sale the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may sue him for the price of the goods.

Where under a contract of sale the price is payable on a certain day irrespective of delivery and the buyer wrongfully

neglects or refuses to pay such price, the seller may sue him for the price although the property in the goods has not passed and the goods have not been appropriated to the contract.

5. Suit for Damages

Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance.—Sec. 56.

6. Claim for Interest and Special Damages

The seller may recover interest or special damages in any case where by law interest or special damages may be recoverable. He may also recover the money paid where the consideration for the payment of it has failed.—Sec. 61 (See p. 237, para 5)

DISTINCTION BETWEEN LIEN AND STOPPAGE IN TRANSIT

1. The right of Stoppage in Transit is applicable to the *insolvent* buyer. But the right of Lien is applicable to all persons, *solvent or insolvent.*

2. The right of Lien is applicable to goods which are in the possession of *the seller.* The right of Stoppage in Transit is applicable to the goods which are in possession of *the carrier.*

3. The right of Stoppage in Transit is applied to the buyer through the carrier. Therefore stoppage means the seller's right to *'regain'* the goods. But Lien means the right to *'retain'* the goods. Of course both the rights are applicable to goods only.

SUB-SALE OR PLEDGE BY BUYER

1. The unpaid seller's right of lien or stoppage in transit is not affected by any sale or other disposition, of goods which the buyer may have made, unless the seller has assented thereto :

Provided where a document of title to goods has been issued or lawfully transferred to any person as buyer or owner of the goods, and that person transfers the document to a person who takes the document in good faith for consideration, then, if such last mentioned transfer was by way of sale, the unpaid seller's right of lien or stoppage in transit is defeated, and, if such last mentioned transfer was by way of pledge or other disposition for value, the unpaid seller's right of lien or stoppage in transit

can only be exercised subject to the rights of the transferee.—Sec. 53(1).

2. Where the transfer is by way of pledge, the unpaid seller may require the pledgee to have the amount secured by the pledge satisfied in the first instance, as far as possible, out of any other goods or securities of the buyer in the hands of the pledgee and available against the buyer.—Sec. 53(2).

CONSEQUENCES OF BREACH OF CONTRACT OF SALE

The Sale of Goods Act gives the following rights to the aggrieved parties when there is a breach of contract of sale of goods :

Seller's Remedies Against the Goods : (1) Seller's Lien, Sections 47-49. (2) Stoppage in Transit. Sections 50-52. (3) Resale. Sec. 54.

Remedies of the Seller Against Buyer Personally : (1) Suit for Price. Sec. 55. (2) Damages for Non-acceptance. Sec. 56. (3) Claim for Interest and Special Damages. Sec. 61.

Buyer's Remedies Against the Seller : (1) Damages for Non-delivery. Sec. 57. (2) Specific Performance. Sec. 58. (3) Remedy for Breach of Warranty. Sec. 59. (4) Repudiation of Contract. Sec. 60.

The rights stated above have been discussed in pages 236-237, 239-241

AUCTION SALES

The following rules are contained in the Sale of Goods Act regarding sale of goods by auction.—Sec. 64.

1. Where goods are put for sale in lots, each lot is *prima facie*, deemed to be the subject of a separate contract of sale.

2. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner, and until such announcement is made, any bidder may retract his bid.

Since an offer can be refused, and a bid is an offer, it follows that the auctioneer is not bound to accept the final or any other bid. A lot can be withdrawn after bidding had taken place for some time.

3. A right to bid may be reserved expressly by or on behalf of the seller. If such right is expressly reserved, the seller or any one person on his behalf may, bid at the auction.

4. Where the sale is not notified to be subject to a right

to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person ; and any sale contravening this rule may be treated as fraudulent by the buyer.

5. The sale may be notified to be subject to a reserved or upset price, *i.e.*, there may be a price below which the goods will not be sold. The reserve price may be kept secret.

6. If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

Case Law on Auction Sales

(1) A bid by an intending buyer is construed as an offer. As an offer, it can be withdrawn any time before acceptance, which in this case occurs by the fall of the hammer, or any other customary manner. It has been held that it is customary in this country to repeat the final offer three times. *Agra Bank* v. *Hamlin*.[1]

(2) A combination between intending buyers not to be bid against each other is known as a "knock out" agreement. Such agreements are not illegal. *Jyoti* v. *Jhowmull*.[2]

(3) Agreements which are likely to prevent the property put up from realising its fair value and to damp the sale, would certainly be against the public good, but an agreement between two or more persons not to bid against each other at an auction is not illegal or against public good. *Lachhman Das and others* v. *Hakim Sita Ram and others*.[3]

(4) Sec. 64(2) of the sale of goods Act does not deal with question of the passing of the property in the goods sold at auction sale but instead it deals with the completion of the contracts of sale. *Consolidated Coffee Ltd.* v. *Coffee Board, Bangalore*.[4]

(5) An auctioneer can set his own terms and conditions for holding an auction. If he does so those conditions would govern the rights of the parties. The seller is not bound to accept the highest bid, it necessarily implies that he can accept any lower bid. Lapses on the receipt of a higher bid, and if the highest bid was not to be accepted for any reason, the auction must be abandoned and fresh auction would be required to be held. *M. Lachia Setty and Sons Ltd.* v. *The Coffee Board, Bangalore*.[5]

EXERCISES

1. Does the Indian Sale of Goods Act provide for any rules as to delivery ? What are the rules ? (Pages 232-233)

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[1] (1890) 14 Mad 235
[2] (1909) 36 Cal 134
[3] AIR (1975) Delhi 159
[4] AIR (1980) Supreme Court 1468
[5] AIR (1981) Supreme Court 162

2. Enumerate the duties of the seller in respect of the sale of goods. (Page 236)
3. State the rights of a buyer in case of (*i*) short delivery, (*ii*) delivery in excess of contract goods and (*iii*) delivery of contract goods together with other goods. (Para 8, pages 234)
4. Who is an unpaid seller of goods and what are his rights against the goods ? Has he any remedy against the buyer personally ? (Pages 239-241)
5. What is the meaning of vendor's lien ? How does it arise and how is it lost ? Has a vendor any power over goods which have passed from his possession ? If so, when ? (Pages 240, 241)
6. Describe the rights of an unpaid seller against the buyer personally. When and under what circumstances can the seller exercise right of re-sale ? (Pages 239, 242)
7. Distinguish clearly between seller's right of lien and right of stoppage in transit. Add illustrations. (Pages 243)
8. Write a note upon the remedies of the buyer of good where there is a breach of warranty by the seller. (Page 244)
9. State the consequences of re-sale without giving notice to the original buyer. (Pages 242-243)
10. What are the rules regarding sub-sale or pledge by a buyer ? (Pages 243-244)
11. Under the Sale of Goods Act, what remedies are available in the event of a breach of contract ? (Page 244)
12. State the rules regarding Auction Sales. (Pages 244-245)
13. (*a*) Problems : *A* agreed to sell to *B* 1200 tons of coal to be delivered in monthly instalments of 100 ton each. After three instalments had been delivered *A* refused to deliver any further coal under the contract. Discuss the rights of *A* and *B* after this refusal. (Para 9, page 234))
    (*b*) *A* sells his horse to *B* for Rs. 500. *B* pays *A* Rs. 400. Is *A* an unpaid seller ? (Page 239)
    (*c*) *S* agrees to sell potatoes to *B* to be delivered on arrival of ship *X*. The ship arrives but no potatoes on ship. Discuss the liability of the seller. (Para 1 & 3, page 236)
    (*d*) *P* sells some quantity of goods to *Q* on credit. The goods have been delivered to *Q*. *Q* on due date refuses and/or neglects to pay the price. What is the remedy available to *P* ? (Para 4, page 242)
14. Objective questions. Give short answers.
    (*i*) Mention two rights of the unpaid seller. (Page 240)
    (*ii*) Who is an unpaid seller ? (Page 239)

BOOK III

THE LAW OF PARTNERSHIP

1 NATURE OF PARTNERSHIP

APPLICATION

The Indian Partnership Act of 1932 (Act IX of 1932) applies to partnerships created by agreement between parties. The Act is not retrospective; it does not affect any right, title interest, obligation or liability acquired or incurred before the act came into operation in 1932. (Sec. 74). The Act is not exhaustive. It does not apply to Joint Hindu Family firms.

THE ESSENTIAL ELEMENTS OF A PARTNERSHIP

Definition and characteristics

Section 4 of the Partnership Act defines a partnership as follows : "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all." A partnership, as defined in the Act, must have three essential elements :

1. There must be an agreement entered into by two or more persons.
2. The agreement must be to share the profits of a business.
3. The business must be carried on by all or any of them acting for all.

1. Voluntary Agreement

The *first element* shows the voluntary contractual nature of partnership. A partnership can only arise as a result of an agreement, express or implied, between two or more persons. Where there is no agreement there is no partnership. But a partnership cannot be formed with more than ten persons in banking and twenty persons in other types of business. A partnership with persons exceeding the above limits must be registered under a Companies Act.

"Person"—See p. 251

Partnership is not created by status : Section 5 states that, "The relation of partnership arises from contract and not from status." In particular the members of a Hindu undivided family

carrying on a family business, as such, are not partners in such business.

Example :

The sole proprietor of a business dies leaving a number of heirs. The heirs inherit the stock in trade of the business including the goodwill of the business but do not become partners until there in an agreement, express or implied, to carry on the business as partners. *Habib Bux* v. *Samuel Fitz Co.*[1]

2. Sharing of Profits of a Business

The *second element* states the motive underlying the information of a partnership. It also lays down that the existence of a business is essential to a partnership. Business includes any trade, occupation or profession. If two or more persons join together to form a music club it is not a partnership because there is no business in this case. But if two or more persons join together to give musical performances to the public with a view to earning profit, there is a business and a partnership is formed.

3. Mutual Agency

The *third element* is the most important feature of partnership. It states that persons carrying on business in partnership are agents as well as principals. The business of a firm is carried on by all or by any one or more of them on behalf of all. Every partner has the authority to act on behalf of all and can, by his actions, bind all the partners of the firm, Each partner is the agent of the others in all matters connected with the business of the partnership. The law of partnership has therefore been called a branch of the law of agency.

The Tests of a True Partnership

In a true partnership, all the essential elements mentioned above must be present. Section 6 of the Partnership Act lays down that in determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all relevant facts taken together.

If all the relevant facts taken together show that all the three

[1] (1925) 23 All. L. J. 961

essential elements are present, the group of persons doing business together will be called a partnership.

Of the three elements, the second element, viz., sharing of profits, is important but *not* conclusive. Sharing of profits may exist under circumstances where there is no question of partnership. As examples the following cases may be cited :

(*i*) A creditor taking a share of profits in lieu of interest and part-payment of principal.

(*ii*) A creditor who supervises the conduct of a debtor's trade with an agreement that he will be paid out of the profits of the business. The creditor does not thereby become his partner. *Mollow March & Co.* v. *Court of Wards.*[1]

(*iii*) An employee getting a share of profits as remuneration.

(*iv*) Share of profits given to workers as bonus.

(*v*) Share of profits given to the widow or children of deceased partners as annuity.

In all the above cases the third essential element of partnership, (*viz.*, agency) is absent. A creditor or an employee, or the widow and children of deceased partners cannot bind the firm by any act done on behalf of the firm. Only those who have authority to bind the firm by their actions can be called partners. Thus, the most important test of partnership is agency and authority.

The tests of a true partnership were first laid down by the House of Lords in the case of *Cox* v. *Hickman.*[2] In that case, a debtor transferred his business to trustees with instructions to carry on the business and use the profits for paying his creditors. It was held that the creditors were not partners of the business. Section 6 of the Partnership Act is a comprehensive restatement of the rule laid down in this case.

Circumstances which the court must take into consideration in determining the existence of partnership : The court must take into account all the relevant circumstances, e.g., the terms of the agreement, if any ; the conduct of the parties ; the mode of doing business ; who controls the property ; the mode of keeping accounts ; the manner of distribution of profits etc.

Sharing of losses : Sharing of losses is a consequence of partnership rather than a test of partnership. Losses are not

[1] (1872) L.R. 4 P.C. 419 [2] (1860) 8 H.L.C. 268

mentioned in the definition of partnership as given in Section 4. But in determining whether a partnership exists or not, the court must take into account how losses are shared. In *Raghunandan* v. *Hormasji*[1] it was held that partners may agree that one or more of them shall not be liable for losses. But such an agreement will be binding only among themselves. All the partners will be liable to third parties for the debts of the firm.

Who can be a partner ?

1. *Person* : Under the [redacted] Partnership Act, a person may be partner if he has the capacity to enter into a contract ("Capacity of parties" see p. 49)

Who is a 'person' ? For the purposes of the Partnership Act, the term 'person' does not include a partnership or a limited company. Thus a Company *P* cannot form a partnership with a Company *Q*. *G. M. Refining Co.* v. *Commr. of I-Tax.*[2] 1949

Similarly, a firm *X* cannot form a partnership with firm *Y*. But all the partners of firm *X* and all the partners of firm *Y* can form a single partnership, subject to the rules regarding the number of partners. (See, Section 11, p. 254 and para 5 below).

2. *Minor* : A minor cannot be a partner. But in an existing partnership, a minor can be admitted into a firm if all the partners of the firm agree. (See p. 271) Such a minor gets all the benefits of the partnership.

3. *Person of unsound mind* : A person who is of unsound mind cannot become a partner.

4. *Woman* : A woman can be a partner, married or unmarried. Of course a woman cannot be a partner if she is a minor or she is of unsound mind.

5. *Company* : In a Company the capacity to enter into contract is determined by the Memorandum and Articles of the Association of the company. The liability of the members of a firm under the Partnership Act, for the debts of the firm, is unlimited. But a company cannot incur unlimited liability. Therefore a company cannot become a partner of a firm.

6. An *alien enemy* cannot enter into a contract of partnership with a citizen of India. (See p. 55)

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[1] (1949) 51 Bom. 342 [2] AIR (1967), Cal. 429

PARTNERSHIP AND CERTAIN SIMILAR ORGANISATIONS

Partnership and Co-ownership

Co-ownership means joint ownership. A and B jointly purchase a horse. They are co-owners but not necessarily partners. The distinction between co-ownership and partnership can be described as follows :

1. In a partnership each partner is the agent of the others but *a co-owner is not the agent* of the other owners. The rights of a co-owner cannot be affected by any act done by the other owners.

2. Partnership always arises out of agreement. Co-ownership *may arise by agreement or by operation of law. A* and *B* inherit a house from their father. They become co-owners by operation of the law of inheritance. *Habib Bux* v. *Samuel Fitz & Co.* (See p. 249)

3. *A co-owner can transfer his interest* to a third party without the consent of the other co-owners. A partner can transfer his interest, under certain circumstances, but the transferee can never become a partner of the business without the consent of the other partners.

4. A partnership always implies a business. Co-ownership may *exist without any business, e.g.*, joint ownership of a residential house.

5. Since co-ownership may exist without a business, the question of *sharing profits or losses is immaterial* in a co-ownership. In a partnership there must be sharing of profits.

6. A partner has a lien on the partnership assets for moneys spent by him for the partnership. A co-owner has *no lien* under similar circumstances.

Partnership and a Club

A club is an 'association of persons' formed for social purposes. It differs from a partnership in the following respects—it is not a business ; there is no motive of earning profits and sharing them ; a member of a club is not the agent of the other members ; a member is not responsible for the debts of the club unless he participated in the transaction ; and, the death or resignation of a member does not affect the existence of the club.

Partnership and a Company

See Company Law, Book XI.

Partnership and a Joint Hindu Family Firm

A Hindu joint family which carries on a trade inherited from its ancestors is called a Hindu Joint Family Firm. Such firms are very common in India, particularly among Hindus governed by the Mitakhsara school. The points of difference between such a firm and a contractual partnership can be enumerated as follows :

1. *Method of creation* : A partnership is created by agreement ; a joint family firm is created by operation of law. Membership of a joint family firm is the result of status, *i.e.*, position of the person concerned as member of a joint family or coparcenary.

2. *Authority of members* : In a joint family firm the manager or *Karta* has authority to bind the members by all acts coming within the scope of the joint family business but no other members has any such authority. In a partnership every partner has authority to bind the firm by his actions and can participate in the business of the firm.

3. *Liability of members* : In a partnership every partner is liable to an unlimited extent for the debts of the firm. In a joint family firm only the Karta has unlimited liability ; the other members are liable only to the extent of their share in the joint family business.

4. *Position of minors* : The minor members of a joint family are members of the firm from the date of their birth. In a partnership a minor cannot be a member, except in one special case. (See p. 271) The reason is that a partnership is the result of an agreement and a minor does not have capacity to enter into an agreement.

5. *Position of women* : A woman can be a partner under the Act, but not in a Joint Hindu Family firm.

6. *Number of members* : In a contractual partnership, the number of members must not exceed 10 in a banking firm and 20 in other kind of firms. There is no limit on the number of members in joint family firms.

7. *Death of members* : The death of a member of a joint family firm has no effect on the firm. The firm continues with

the other members. In a partnership, death of a partner dissolves the firm, unless otherwise agreed by the partner's.

8. *Registration* : In a partnership registration is optional. A joint family firm does not require registration.

9. *Dissolution and accounts* : A member of a joint family firm when severing his connection with the firm cannot ask for accounts of past profits and losses, but a partner of a firm under similar circumstances can.

10. *Law* : A partnership is governed by the Partnership Act; a joint family firm is governed by Hindu law.

11. *Partnership* : The karta of a joint Hindu family and an undivided member of that family can join a partnership. But the Hindu undivided family cannot as such enter into a contract of partnership with another person or persons. *Commissioner of Income Tax, W. B.* v. *Kalu Babu.*[1]

12. *A floating body* : A Hindu undivided family is a floating body. Its composition changes by births, deaths, marriages and divorce.

13. *Unity of ownership* : In a joint Hindu family business no member of the family can say that he is the owner of one-half, one-third or one-fourth. The essence of joint Hindu family property is unity of ownership and community of interest, and the shares of the members are not defined. *Nanchand Ganguram Shetji* v. *Mallappa Mahalingappa Sadalge and other.*[2]

14. *A precarious existence* : A partnership is likely to have a precarious existence, because a partnership can be ended at any time. *Aggarwal & Co.* v. *Commissioners of Income Tax.*[3]

PARTNERSHIP FORBIDDEN BY LAW

1 *Number of partners* : Section 11 of the Companies Act, 1956 prohibits the formation of the partnership for the purpose of carrying on the business of banking with more than ten persons and for any other purpose with more than twenty persons. If it is desired to carry on business with more than 10 or more than 20 persons for banking and non-banking business respectively, a company must be formed.

2. An agreement to form a partnership, for the purpose of carrying on an illegal trade or a prohibited trade, is void.

[1] AIR (1959) Supreme Court 1289 [2] AIR (1976) Supreme Court 835
[3] AIR (1970) Supreme Court 1343

SOME DEFINITIONS

Firm, Firm-name, Partner

Persons who have entered into partnership with one another are called individually "partners" and collectively "a firm" and the name under which their business is carried on is called the "firm-name."—Sec. 4, para 2.

The Legal Status of a Firm

A firm is not an artificial person like a company. It is merely a collective name for the individual who are trading in partnership. Therefore, a firm is not a legal person or a legal entity. A partnership firm cannot be distinguished from its partners. The rights, duties and obligation of a firm are actually the rights, duties and obligations of the persons who own the firm.

Classes of Partners

Partners can be classified as below :

1. *Active Partner* : An active partner is one who actually participates in the business of the firm. A person becomes a partner only by agreement.

2. *Dormant, Sleeping or Nominal Partner* : These partners join the firm by agreement but do not take any active part in the business. Their liabilities are same as of Active Partners.

3. *Sub-Partner* : The transferee of a share of a partner's interest in a firm is called a Sub-Partner. Suppose *P*, the owner of $\frac{1}{4}$ of firm, transfers $\frac{1}{2}$ of his share to *Q*. *Q* will be called a sub-partner. His rights and liabilities are limited.

Name of a Partnership

The partners may select any firm-name they please, subject to the following restrictions :

(*a*) They must not select a name which will fraudulently imply that their business is the same as some other competing concern.

(*b*) They cannot use words like 'President', 'Royal', etc. which will imply that the firm is enjoying the patronage of the state.

The names of all the partners may be used together as the firm-name or the name of any particular partner may be so used. It may happen that the name of a partner is used as the firm-name but that name is identical with the firm-name of a rival

trade. This is not illegal. A man is entitled to use his own name for carrying on business even though it is identical with the name of another person carrying on a similar business. But if there is any fraudulent intention, he may be stopped from doing so. *Turton* v. *Turton*.[1]

Classes of Partnerships

Partnerships can be classified as below :

1. *Partnership-at-will* : A partnership is called a partnership-at-will (*i*) when the partnership is *not for* a fixed period of time and (*ii*) when no provision is made as to when and how the partnership will come to an end.—Sec. 7.

A partnership-at-will can be dissolved whenever any partner chooses to do so.

2 *Particular Partnership—Joint Venture* : A particular partnership is one which is formed for a particular adventure or a particular undertaking. (Sec. 8). Such a partnership is usually dissolved on the completion of the adventure or undertaking.

3. *Limited Partnership* : In Great Britain, according to the provisions of the Partnership Act of 1907, a partnership may be formed in which the liability of all partners (except one) is limited. There must be at least one partner with unlimited liability. In India there is no such provision. In India the liability of all the partners must be unlimited.

Partnership Property

The property of the firm includes all property and rights and interests in property originally brought into the stock of the firm or acquired by purchase or otherwise, by or for the firm, or for the purposes and in the course of the business of the firm, and includes also the goodwill of the business.—Sec.14.

Thus, property of the firm means (*i*) property originally brought in by the partners, (*ii*) property obtained while the firm was in business and (*iii*) the goodwill of the firm.

Goodwill of a firm is an asset of the firm. In the absence of any provision expressly made or clearly implied, the normal rule is that the share of a decreased partner, including goodwill, devolves upon his legal representatives. *Khurshal Khengar Shah & Ors.* v. *Khorshedbanu Dadiba Boatwalla & Ors.*[2]

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[1] (1889) 42 Ch. D. 128 [2] (1971) S.C.A. 16 (Supreme Court)

Unless the contrary impression appears, property and rights and interests in property acquired with money belonging to the firm are deemed to have been acquired for the firm.

Application of the property of the firm : Subject to contract between partners the property of the firm shall be held and used by the partners exclusively for the purpose of the business.—Sec. 15.

Examples of Partnership Property : A partnership is formed with *X*, *Y* and *Z* as partners. *X* contributes to the stock of the firm a plot of land, *Y* a motor lorry and, *Z* the sum of Rs. 10,000. Subsequently the firm purchases, out of its earnings, a house. All these properties, and the goodwill of the business, are properties of the firm.

Goodwill

Goodwill is not defined in the Partnership Act. Goodwill may be described as the advantage which is acquired by a firm (over and above the value of the stock-in-trade and capital and funds) from the connections it has built up with its customers and the reputation it has gained.

"Goodwill, I apprehend, must mean every advantage....that has been acquired by the old firm in carrying on its business, whether connected with the premises in which the business was previously carried on, or with the name of the late firm, or with any other matter carrying with it the benefit of the business." *Churton* v. *Douglas.*[1]

"The goodwill of a business is the whole advantage of the reputation and connexion formed with customers together with the circumstances, whether of habit or otherwise, which tend to make such connexion permanent. It represents in connexion with any business or business product the value of the attraction to customers which the name and reputation possesses."—*Halsbury.*[2]

Goodwill is part of the property of the firm. Section 55 of the Partnership Act provides that in setting the accounts of a firm after dissolution, the goodwill shall, subject to contract between the partners, be included in the assets and it may be sold either separately or along with other property of the firm.

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[1] (1859) 28 L.J. Ch. 841, 845 [2] *Laws of England*, 3rd Edition, p. 360

At the time of valuation of goodwill it is necessary to consider the type of business and the type of customer which such a business is inherently likely to attract as well as all the surrounding circumstances. *Mehru Belgam Vala and another* v. *G. Bell & Co. and others.*[1]

The Partnership Agreement

The agreement to carry on business in partnership may be oral or in writing. If it is in writing, the document in which the terms are incorporated is called the Deed of Partnership or the Articles of Partnership.

Written documents of partnership usually contain exhaustive provisions regarding matters concerning the business and the relationship between the partners. The following matters are generally included : name and address of the partners ; firm-name ; nature of business ; place of business and the business address ; duration of the partnership and the mode of dissolution ; the amount of capital to be contributed by each partner ; the share of profits to be taken by each partner ; the mode of management ; the powers of the partners ; terms on which a partner can retire ; expulsion of partners ; introduction of new partners etc.

REGISTRATION OF FIRMS

The registration of a partnership is not compulsory. Therefore an unregistered firm is not an illegal association. But an unregistered firm suffers from certain disabilities and therefore registration is necessary for carrying on business.

The Formalities of Registration

(Sections 56-71). The registration of a firm may be effected at any time by sending by post or delivering to the Registrar of Firms of the locality, a statement in the prescribed form and accompanied by the prescribed fee, stating the following particulars ; (*a*) the firm-name (*b*) the place or principal place of business of the firm, (*c*) the names of any other places where the firm carries on business, (*d*) the date when each partner joined the firm, (*e*) the names in full and permanent addresses of the partners and (*f*) the duration of the firm.

[1] AIR (1983) Mad 351

The statement shall be signed and verified by all the partners, or their agents specially authorised on this behalf. On receipt of the statement and the fees, the Registrar records an entry of the statement in the Register of Firm and the firm is thereupon considered to be registered.

Alterations in any of the above particulars have to be recorded.

The Register of Firms can be inspected and copies of entries taken by any person on payment of the necessary fees.

Under Section 56 of the Act, the Government of any State may, by notification, declare that the provisions relating to the registration of firms shall not apply to the State or any part thereof.

Time for Registration

A firm may be registered at anytime. But an unregistered firm cannot file certain suits. (See below). A firm must be registered before it can file suits or claim set-off. A firm can be registered even after the partners have agreed to dissolve the firm.

Consequences of Non-registration (Sec. 69)

An unregistered firm and the partners thereof suffer from certain disabilities :

1. A partner of an unregistered firm cannot file a suit (against the firm or any partner thereof) for the purpose of enforcing a right arising from contract or a right conferred by the Partnership Act.

2. No suit can be filed on behalf of an unregistered firm against any third party for the purpose of enforcing a right arising from a contract.

3. An unregistered firm cannot claim a set-off in a suit. ['Set-off' means a claim by the defendant which would reduce the amount of money payable by him to the plaintiff].

The effect of Section 69 is (*i*) to bar all suits by an unregistered firm against third parties for the enforcement of rights arising from contracts, and (*ii*) to bar all suits between partners *inter se* for the enforcement of partnership rights. The section does not bar suits in respect of torts, *i.e.*, civil suits for damages for the violation of a right.

Exceptions : There are certain exceptions to the rules stated above.

1. A partner of an unregistered firm can file a suit for the dissolution of the firm and for accounts.

2. Suits can be filed for the realisation of the properties of a dissolved firm even though it was unregistered.

3. The Official Assignee or Receiver can realise the properties of an insolvent partner of an unregistered firm.

4. There is no bar to suits by unregistered firms and by the partners thereof in areas where the provisions relating to the registration of firms do not apply by notification of a State Government under Section 56.

5. An unregistered firm can file a suit (or claim a set off) for a sum not exceeding Rs. 100 in value, provided the suit is of such a nature that it has to be filed in the Small Causes Court. Proceedings incidental to such suits, *e.g.*, execution of decrees, are also allowed.

6. An unregistered firm suffers from certain disabilities but it is not an illegal association. Therefore registration of a firm is optional.

EXERCISES

1. What are the essentials of a partnership ? (Pages 248-249)
2. What is the test of determining whether a partnership between *A* and *B* does not exist ? (Pages 249-250)
3. "Sharing of profits is only *prima facie* evidence of partnership." Discuss. (Pages 248-249)
4. What is partnership property ? For what purposes can it be used ? (Page 256)
5. How far can a partner of a firm be considered as an agent of the other partners ? (Pages 249, 264)
6. Explain the following terms : Firm ; Partner ; Dormant ; Sleeping or Nominal Partner ; Partnership at will ; Partnership property ; Partnership agreement ; Goodwill. (Pages 254-258)
7. Must a firm be registered ? What are the effects of non-registration of a firm ? (Pages 258-260)
8. Although registration of firms is not compulsory, firms are usually registered. What are the disadvantages of non-registration of a firm under the law of partnership ? (Pages 258-260)
9. Distinguish between the following :
   (*a*) Partnership firm and a Hindu joint family firm. (Page 253)

(*b*) Partnership and co-ownership. (Page 252)
(*c*) Partnership and a club. (Page 252)
(*d*) Active partner and Sleeping partner. (Page 255)

10. *Problems* :
(*a*) *X* is the sole owner of a firm. He admits *Y* as a partner on the following terms ; (*i*) *Y* is not to bring any capital ; (*ii*) *Y* is not to be responsible for any loss ; (*iii*) *Y* is to receive Rs. 200 p.m. in lieu of profits ; and (*iv*) *Y* is to have all the powers of a partner. Discuss the legal position of *Y* in the firm. (Pages 249-250)
(*b*) A and B agree to share profits of the business carried on by them but do not state anything in the Deed about sharing of losses. Is it a valid partnership ? (Pages 250-251)
(*c*) A person wants to join a firm as a partner on the following conditions : he will devote himself entirely to business of the firm, but he will not bring in any capital and will not be responsible for any loss of the firm. Discuss. (Pages 249-250)

11. Objective questions.
(*a*) Define Partnership. (Page 248)
(*b*) What do you understand by partnership-at-will ? (Page 256)

2 RIGHTS AND LIABILITIES OF PARTNERS

RELATIONS OF PARTNERS TO ONE ANOTHER

Determination of rights and duties of partners by contract between the partners : The mutual rights and duties of the partners of a firm may be determined by contract between the partners. Such contract may be expressed or may be implied from the course of dealings of the firm. The mutual rights and duties may be altered any time with the consent of all the partners.—Sec. 11(1).

The Partnership Act lays down *two general rules* regarding the conduct of the partners to one another.

1. *General duties of partners* : "Partners are bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm to any partner or his legal representative."—Sec. 9.

This section lays down that the relationship between partners is one of *utmost good faith*. Though partners are not trustees for one another, it has been held in some cases that the relationship between them is of a fiduciary character.

2. *Indemnity* : "Every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm."—Sec. 10.

This rule follows logically from the rule laid down in the previous section. Since partnership implies utmost good faith, a partner must not act fraudulently against the firm. If he does, he must make up the loss.

Subject to the general principles stated above the following rules are laid down in the Act regarding the relationship between the partners as regards the management of the business and their mutual rights and duties.

1. Rules regarding the conduct of the business (Sec. 12)

Subject to any agreement to the contrary, the following rules apply as regards the management of a firm :

(*a*) every partner has a right to take part in the conduct of the business ;

(*b*) every partner is bound to attend diligently to his duties in the conduct of the business;

(*c*) and difference arising as to ordinary matters connected with the business may be decided by a majority of the partners, and every partner shall have the right to express his opinion before the matter is decided but no change may be made in the nature of the business without the consent of all the partners; and

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

Subject to contract between the partners, the property, of the firm shall be held and used by the partners exclusively for the purposes of the business.—Sec. 15.

The partners may distribute the work of management among themselves in any way they like. There may be a partner who takes no active part in the business.

The partnership contract may provide that a partner shall not carry on any business other than that of the firm while he is a partner. Such an agreement is *not* void on the ground of restraint of trade.—Sec. 11(2).

2. Mutual rights and duties (Sec. 13)

Subject to any contract to the contrary, the mutual rights and duties of partners are as follows :

(*a*) a partner is not entitled to receive remuneration for taking part in the conduct of business;

(*b*) the partners are entitled to share equally in the profits earned and shall contribute equally to the losses sustained by the firm;

(*c*) where a partner is entitled to interest on the capital subscribed by him such interest shall be payable only out of profits;

(*d*) a partner making, for the purposes of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, is entitled to interest thereon at the rate of six per cent per annum;

(*e*) the firm shall indemnify a partner in respect to payments made and liabilities incurred by him—(*i*) in the ordinary and proper conduct of the business, and (*ii*) in doing such act, in any emergency, for the purpose of protecting

the firm from loss, as would be done by a person of ordinary prudence, in his own case, under similar circumstances; and

(*f*) a partner shall indemnify the firm for any loss caused to it by his wilful neglect in the conduct of the business of the firm.

3. Personal profits earned by partners (Secret Profits—Sec. 16)

Subject to contract between the partners,

(*a*) if a partner derives any profit, for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm;

(*b*) if a partner carries on any business of the same nature as and competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business.

Examples :

(*i*) A partner without the knowledge of his other partners obtained for his own benefit the renewal of the lease of the business premises of the firm. Held, the renewed lease was partnership property. *Featherstonehaugh* v. *Fenwick*.[1]

(*ii*) *P* and *Q* were partners of a firm. *Q* was appointed to buy sugar for the firm. Without the knowledge of *P*, he supplied his own sugar to the firm at the market price and made large profits. Held, he must make over the profits to the firm. *Bentley* v. *Craven*.[2]

4. Continuance of pre-existing terms (Sec. 17)

Subject to contract between the partners, the relationship between them is presumed to remain the same if the constitution of the firm changes for any reason, or if the firm was for a fixed period and continues to exist after the expiry of the term, or when business not included in the original contract is undertaken.

THE AUTHORITY OF A PARTNER

Agency

Partner to be agent of the firm : "Subject to the provisions of this Act, a partner is the agent of the firm for the purposes

[1] (1810) 17 Ves. 298 [2] (1853) 18 Beav. 75

of the business of the firm." (Sec. 18) When two or more persons agree that they would carry on a business jointly and share the profits earned thereby, each is a principal and each is an agent for the others. Each is bound by any of the other's *contracts entered into with third parties* in course of the business of the partnership. The principle of agency governs the relationship between the partners. It has therefore been said that the law of partnership is a branch of the law of agency.

The authority of a partner to act on behalf of the firm can be divided into two categories : Express Authority and Implied Authority.

Express Authority

Any authority which is expressly given to a partner by the agreement of partnership called Express Authority. The firm is bound by all acts done by a partner by virtue of any express authority given to him.

Implied Authority

Implied Authority means the authority to bind the firm which arises by implication of law from the facts of partnership.

Section 19 of the Act lays down that the act of a partner which is done to carry on, *in the usual way, business of the kind carried on by the firm,* binds the firm.

Mode of doing act to bind firm : Section 22 provides that in order to bind a firm, an act or instrument done or executed by a partner (or other person on behalf of the firm) shall be done or executed *in the firm name,* or in any other manner expressing or implying an *intention to bind the firm.*

Examples :

(*i*) *X*, the partner of a firm of confectioners, purchases sugar on credit in the firm's name. The firm is bound to pay for the sugar.

(*ii*) *P*, the partner of a firm of confectioners, purchases a horse on credit in the firm's name. The firm is not bound in the absence of any express authority from the other partners because this act does not come within the scope of a confectioner's business.

(*iii*) *Y*, the partner of a firm borrows money in his personal name. The firm is not bound because it is not an act of the firm.

Limitations of a partner's Implied Authority [Sec. 19(2)]

In the absence of any usage of custom of trade to the

contrary, the implied authority of a partner does not empower him to—

(*a*) submit a dispute relating to the business of the firm to arbitration,
(*b*) open a banking account on behalf of the firm in his own name,
(*c*) compromise or relinquish any claim or portion of a claim by the firm,
(*d*) withdraw a suit or proceeding filed on behalf of the firm,
(*e*) admit any liability in a suit or proceeding against the firm,
(*f*) acquire immovable property on behalf of the firm,
(*g*) transfer immovable property belonging to the firm, or
(*h*) enter into partnership on behalf of the firm.

Alteration of Authority (Sec. 20)

The express or implied authority of a partner may be altered, extended, or restricted by agreement between the partners at any time. But notwithstanding any such restrictions, any act done by a partner which falls within the implied authority of a partner, binds the firm unless the person with whom he is dealing knows of restriction or does not know or believes that partner to be a partner.

Authority in an Emergency (Sec. 21)

A partner has authority in an emergency, to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm.

ADMISSION BY A PARTNER

An admission or representation made by a partner concerning the affairs of the firm is evidence against the firm, if it is made in the ordinary course of business.—Sec. 23.

NOTICE TO A PARTNER

Notice to a partner who habitually acts in the business of the firm of any matter relating to the affairs of the firm operates as notice of the firm, except in the case of a fraud on the firm committed by or with the consent of that partner.—Sec. 24.

From the above it follows that a notice to a dormant partner is not notice to the firm.

LIABILITY OF PARTNERS TO OUTSIDERS

The partner's liabilities can be discussed in three categories.

I. Liability of a Partner for Acts of the Firm

Every partner is liable, jointly with all the other partners and also severally for all acts of the firm done while he is a partner.—Sec. 25.

This section lays down the rule that every partner is liable, to an unlimited extent, for all debts due to third parties from the firm incurred while he was a partner.

As between the partners, the liability is adjustable according to the terms of the partnership agreement. Thus if a partner is entitled to receive $\frac{1}{4}$ th share of profits he is liable to pay $\frac{1}{4}$ th share of the losses. The accounts between the partners will be adjusted on this basis. But a third party, who is a creditor of the firm, is entitled to realise the whole of his claim from any one of the partners.

There is no difference between working partners and dormant partners as regards liability to third parties. A dormant partner also is liable to an unlimited extent for all debts of the firm.

II. Liability of the Firm for wrongful acts of a Partner

Where, by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred the firm is liable therefore to the same extent as the partner.—Sec. 26.

III. Liability of Firm for misapplication by Partners

Where—

(*a*) a partner acting within his apparent authority receives money or property from a third party and misapplies it, or

(*b*) a firm in the course of its business receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss.—Sec. 27.

Example :

X, a member of a firm of solicitors, obtained a loan for *M*, from some other clients of the firm. *X* said to *M* that the mortgagee required collateral security for the loan and *M* deposited certain share warrant payable to bearer. The security was actually not necessary. The other partners of the firm and the mortgagee had no knowledge of this deposit. *X* then misappropriated the share and absconded. Held, the transaction was within the apparent authority of the other partners, and was an act of firm. Therefore the act was binding on the firm. The firm had to pay the loss. *M. Rhodes* v. *Moules*.[1]

RIGHTS OF PARTNERS

The rights of partners, and the relations of partners to one another, are determined by the agreement of the partners. Where there is *no express or implied terms in the agreement*, the rules stated in the Partnership Act will be applied. Subject to any contract to the contrary, the important rights of partners are summarised below :

1. *Conduct of business* : Every partner has a right to take part in the conduct of the business.—Sec. 12(a).

2. *Can express opinion* : Every partner shall have the right to express his opinion.—Sec. 12(c).

3. *Access, inspection, copy* : Every partner has a right to have access to and to inspect and copy any of the books of the firm.—Sec. 12(d).

4. *Equality of profits* : The partners are entitled to share equally in the profits earned.—Sec. 13(b).

5. *Interest on capital* : A partner is entitled to get interest on the capital out of profits only.—Sec. 13(c).

6. *Interest on advance* : A partner, paid or advanced to the firm beyond the amount of capital, is entitled to interest thereon at the rate of six per cent per annum.—Sec. 13(d).

7. *To get indemnity* : The firm shall indemnify a partner in respect of payment's made and liabilities incurred by him, in the ordinary and proper conduct of the business and in doing such act, in any emergency.—Sec. 13(e).

8. *Application of property of firm* : The property of the firm shall be held and used by the partners exclusively for the purposes of the business.—Sec. 15.

9. *Partner's authority* : Every partner has right to act on behalf of the firm. He has express and implied authority.—Secs. 18 and 19.

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[1] (1895) ch. 236

10. *Powers in an emergency* : He has certain powers in an emergency.—Sec. 21.

11. *Reconstitution* : The constitution of a firm may be changed by the introduction of a new partner, death, retirement, insolvency, expulsion or by the transfer of a partner's share to an outsider. The rights and liabilities of the incoming and outgoing partners have been stated in the sections 29 & 31 to 38. (See under "Reconstitution", p. 273).

12. *Dissolution* : A partner has the right to get the firm dissolved under appropriate circumstances. Upon dissolution, the partners have the right to get accounts of the firm and surplus assets according to their shares. (See p. 278)

13. *Right to carrying on a competing business* : By a special agreement, an outgoing partner can be prevented from carrying on a similar business within a specified period or local limits. But if there is no restraining agreement, an outgoing partner can carry on a competing business and may advertise such business. But, subject to contract to the contrary, he cannot use the firm-name, represent himself as carrying on the firm business or solicit the custom of the former buyers of the firm.—Sec. 36. (See p. 276)

14. *Right to share profits after retirement* : If after retirement (or death) and the continuing partners carry on the business of the firm with the property of the firm (without any final settlement of accounts) the outgoing partner (or the legal representative of the deceased partner) is entitled to get share of profits or 6% per annum of his share of the property of the firm, at their option.—Sec. 37. (See p. 276)

DUTIES OF PARTNERS

The important duties of partners are summarised below :

1. *Justice, Faithfulness, True Accounts, Full Information* : Partners are bound to carry on the business of the firm to the greatest common advantages, to be just and faithful to each other, and to render true accounts and full information of all things affecting the firm to any partner or his legal representative.—Sec. 9.

2. *To pay indemnity* : Every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm.—Sec. 10.

3. *To attend diligently* : Every partner is bound to attend diligently to his duties.—Sec. 12(b).

4. *No remuneration* : Subject to any contract to the contrary, a partner is not entitled to receive remuneration for taking part in the contract of the business.—Sec. 13(a).

5. *Equality of losses* : Subject to any contract to the contrary, partners are bound to pay the losses of the firm equally.—Sec. 13(b). *Nowell* v. *Nowell.* (See p. 283)

6. *To pay indemnity for wilful neglect* : A partner shall indemnify the firm for any loss caused to it by his wilful neglect in the conduct of the business of the firm.—Sec. 13(f).

7. *No private benefit* : A partner cannot use the partnership properties, directly or indirectly, for his own benefit.—Sec. 15

8. *To account for secret profit* : If a partner derives any profits for himself from any transaction of the firm, or from the use of the property or business connection of the firm or the firm name, he shall account for that profit and pay it to the firm.—Sec. 16(a).

9. *No secret profit* : If a partner carries on any competing business of the firm, he shall account for and pay to the firm all profits made by him in that business.—Sec. 16(b).

10. *Unlimited liability.* Every partner is liable for the acts of the firm done while he is a partner. The liability is joint and several.—Sec. 25. (See p. 267).

PARTNERSHIP BY HOLDING OUT OR ESTOPPEL

A person may, under certain circumstances, be liable for the debts of a firm although he is not a partner. If a person, by words spoken or written, or by conduct, represents himself or knowingly permits himself to be represented, to be a partner in a firm, he is liable as a partner in that firm to any one who has on the faith of any such representation given credit to the firm.—Sec. 28.

If *X* induces *Y* to believe that *X* is a partner of a firm *AB* and *Y*, believing that *X* is a partner, gives credit to *AB*, *X* will be responsible for compensating *Y*. He will not be heard to say that he is not a partner of *AB*. This is known as partnership by Holding Out or Estoppel. ("Estoppel"—See p. 52)

Examples :

(*i*) Two brothers *A* and *B* carry on a business in the family name. Another brother *C*, having the same name attends the place of

business and behaves with outsiders as if he was a partner. *C* is liable as a partner by holding out.

(*ii*) *X* carried on business as *R. S. & Co.* and employed a person named *R. S.* to act as manager of the business. It was held that *R. S.* is a partner by the principle of estoppel. *Bevan* v. *The National Bank Ltd.*[1]

To hold a person liable as a partner by holding out, it is necessary to establish the following :

1. He represented himself, or knowingly permitted himself to be represented as partner.

2. Such representation occurred by words spoken or written or by conduct.

3. The other party on the faith of that representation gave credit to the firm.

It is not necessary that there should be any fraudulent intention on the part of the person holding himself out as partner. Nor is it necessary that he should be aware of the fact that a person is giving credit on the faith of the representation.

A partner by holding out is liable to make good the loss which the person giving credit, may suffer. But thereby he acquires no claim upon the firm.

A retired partner : A partner who has retired from the firm but allows the use of his name in connection with the firm may become liable to third parties by the principle of holding out.

The deceased partner : The legal representatives of a deceased partner do not become liable for the debts of the firm merely because the name of the deceased is used as a part of the firm name.

MINOR ADMITTED AS A PARTNER

A minor cannot enter into a contract of partnership because an agreement by a minor is void. But if all the partners agree, a minor may be admitted to the benefits of an existing firm. The rights and liabilities of such a minor partner are governed by the following rules. (Sec. 30) :

1. The minor has a right to such share of the property and of the profits of the firm as may be agreed upon by the partners.

2. The minor may have access to and inspect and copy any of the accounts of the firm.

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[1] (1906) 27 T.L.R. 65

3. The share of the minor in the profits and in the assets of the firm are liable for the acts of the firm but the minor is not personally liable for any such act. (His personal properties are not liable).

4. So long as the minor continues to be a member of the firm, he cannot file a suit against the other partners for an account or for the payment of his share of the property or profits of the firm. He can file such a suit only when he wants to sever his connection with the firm. [If the minor files such a suit, the minor's share shall be determined by valuation in accordance, as far as possible, with the procedure laid down in Sec. 48 of the Act for taking accounts of a dissolved partnership].

5. At any time within six months of his attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, the minor may give public notice that he has elected *to become* or that he has elected *not to become* a partner in the firm. Such notice shall determine his position as regards the firm. If he *gives no* notice, he shall become a partner of the firm on the expiry of the said six months.

["**Public Notice**"—The mode of giving public notice is laid down in Section 72 of the Act. In the case of a registered firm : (i) a copy of the notice is to be sent to the Registrar of Firms, and (ii) a copy must be published in the local official Gazette and in at least one vernacular newspaper circulating in the district where the firm has its place or principle place of business. In the case of unregistered firms, only (ii) is necessary.]

[If the minor wants to take advantage of the fact that he had no knowledge of being admitted into the benefits of a partnership, the burden of proving such lack of knowledge is upon him.]

6. The following rules apply when a minor elects to become a partner or becomes a partner by failing to notify otherwise :

(*a*) His rights and liabilities as a minor continue up to the date on which he becomes a partner, but he also becomes *personally liable* to third parties for all acts of the firm done since he was admitted to the benefits of partnership.

(*b*) His share in the property and profits of the firm shall be the share to which he was entitled as a minor.

7. The following rules apply when the minor elects not to become a partner :

(*a*) His rights and liabilities continue to be those of a minor up to the date on which he gives public notice.

(*b*) His share is not liable for any acts of the firm done after the date of the notice.

(*c*) He is entitled to use the partners for his share of the property and profits of the firm.

RECONSTITUTION OF A FIRM

Incoming and Outgoing Partners

The constitution of a firm may be changed by the introduction of a new partner ; death, retirement, insolvency and expulsion of a partner ; or by the transfer of a partner's share to an outsider. All these are included within the term Reconstitution of a firm. Upon reconstitution, the rights and liabilities of the incoming and outgoing partners have to be determined. The provisions of the Partnership Act regarding such cases are stated below.

Introduction of a New Partner (Sec. 31)

A new partner can be introduced only with the consent of all the partners. The share of profits which a new partner is entitled to get is fixed at the time he becomes a partner. He is liable for all the debts of the firm after the date of his admission but he is not responsible for any act of the firm done before he became a partner, unless otherwise agreed. These rules do not apply to a minor becoming a partner under Section 30.

Retirement of a Partner (Sec. 32)

A new partner may retire (*a*) with the consent of all the other partners, (*b*) in accordance with the terms of the agreement of partnership, or (*c*) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

A retire partner may be discharged from any liability to any third party for acts of the firm done before his retirement if it is *so agreed with the third party* and the *partners of the reconstituted firm.* Such agreement may be implied from the course of dealing between the firm and the third party after he had knowledge of the retirement.

The retired partner continues to remain liable to third parties for all acts of the firm until public notice is given of the retirement. Such notice may be given either by the retired partner or by any member of the reconstituted firm.

[The mode of giving Public Notice is laid down in Sec. 72 of the Act. See p. 272]

A retired partner is not liable for the debts of the firm incurred after public notice of his retirement.

Expulsion of a Partner (Sec. 33)

A partner can be expelled only when the following conditions are fulfilled :

(*a*) When the contract of partnership contains a provision for expulsion under stated circumstances.

(*b*) The power to expel is exercised in good faith by the majority of the partners.

(*c*) The expelled partner has been given notice of the charges against him and has been given an opportunity to answer the charges. *Carmichael* v. *Evans.*[1]

The liabilities of an expelled partner for the debts of the firm are the same as those of a retired partner.

Insolvency of a Partner (Sec. 34)

When the partner of a firm is adjudicated an insolvent, he ceases to be a partner from the date on which the order of adjudication was passed by the court. Whether the firm is thereby dissolved or not depends on the terms of the agreement between the partners.

If the firm is dissolved, the usual procedure in case of dissolution is adopted (*i.e.*, the assets are collected and the debts and charges are paid). If any balance remains due to the insolvent out of the assets, the same is handed over to the Official Assignee or the Official Receiver.

If the firm is not dissolved by the insolvency the share of the insolvent partner vests in the Official Assignee or the Official Receiver. Thereafter the estate of the insolvent partner is not liable for any act of the firm and the firm is not liable for any act of the insolvent done after the date of the order of adjudication.

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[1] (1904) 1 Ch. 486

Death of Partner (Sec. 35)

Ordinarily the death of a partner has the effect of dissolving the firm. But it is competent for the partners to agree that the firm will continue to exist even after the death of partner.

Where the firm is not dissolved by the death of a partner, the estate of the deceased partner is not liable for any act of the firm done after his death.

Transfer of a Partner's Interest (Sec. 29)

A partner may transfer his interest in a firm to an outsider. The transfer may be absolute or partial. The interest may also be sold to a third party in execution of a decree of a court. The transferee in such cases gets very limited rights over the firm. His rights can be described as follows :

1. The transferee does not become a partner of the firm. He cannot interfere in the conduct of the business or require accounts or inspect the books of the firm.

2. The transferee is entitled to receive the share of profits of the transferring partner. But he has to accept the account of profits agreed to by the partners.

3. If the firm is dissolved or if the transferring partner ceases to be a partner, the transferee is entitled, as against the remaining partners, to receive the share of the assets of the firm to which the transferring partner is entitled. For the purpose of ascertaining that share, the transferee is entitled to an account as *from the date of dissolution.*

Sub-Partnership

The transferee of a share of a partner's interest in a firm is sometimes called a Sub-partner and the relationship a Sub-partnership. Suppose that X, the owner of $\frac{1}{4}$ share of a firm, transfers $\frac{1}{2}$ of his share to Y. The transferee Y becomes a sub-partner. The position of a sub-partner is the same as that of a transferee of a partner's interest. (See above)

RIGHTS OF AN OUTGOING PARTNER

1. Restraint of trade

By a special agreement among the partners, an outgoing partner may be prevented from carrying on a similar business within a specified period or within specified local limits. Such

an agreement is valid and is an exception to the general rule that agreements in restraint of trade are void.—Sec. 36(2).

2. To carry on competing business

If there is no restraining agreement, an outgoing partner may carry on a business competing with that of the firm and he may advertise such business. But, subject to contract to the contrary, he may not (*a*) use the firm name, (*b*) represent himself as carrying on the business of the firm, or (*c*) solicit the custom of persons who were dealing with the firm before he ceased to be a partner.—Sec. 36(1).

3. To share subsequent profits

Where any member of a firm has died or otherwise ceased to be a partner, and the surviving or continuing partners carry on the business of the firm with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, the share of the profit of the outgoing partner or his representatives is to be decided in the following way :

(*i*) he or his estate is entitled *at the option of himself or his representatives* to such share of the profits made since he ceased to be a partner (as may be attributable to the use of his share of the property of the firm) or,

(*ii*) to interest at the rate of six per cent per annum on the amount of his share capital in the property of the firm.

But this rule will be followed only if by contract between the partners an option is given to surviving or continuing partners to purchase the interest of a deceased or outgoing partner. And, if the option is duly exercised, the estate of the deceased partner, or the outgoing partner or his estate, as the case may be, will not be entitled to any further or other share of profits. But, if any partner assuming to act in exercise of the option does not abide in all material respects by the terms thereof, he is liable to account under the foregoing provisions of this section.—Sec. 37.

4. Revocation of continuing guarantee by change in firm

A continuing guarantee given to a firm or to a third party in respect of the transactions of a firm is, in the absence of agreement to the contrary ; revoked as to future transactions from the date of any change in the constitution of the firm.—Sec. 38.

EXERCISES

1. Can a partner of a firm be considered agent of other partners ? (Pages 264-266)
2. What are rights and liabilities of a minor who has been admitted to the benefits of a partnership ? (Pages 271-273)
3. Can a minor become a member of a partnership firm? If so, discuss his rights and liabilities. (Pages 271-273)
4. What are the laws regarding personal profits earned by partners ? (Page 264)
5. State the rights regarding an outgoing partner (*i*) to carry on competing business and (*ii*) to share in the subsequent profits. (Pages 275-277)
6. What liabilities, If any, has a person who holds out as a partner in regard to his relations with the public ? (Pages 270-271)
7. Discuss the rights and liabilities of partners of a firm. (Pages 267-269)
8. Define partnership. What do you understand by implied authority of a partner ? Are there any limitations on implied authority ? (Pages 248, 264-266)
9. What are the consequences of insolvency of a partner ? (Pages 274-275)
10. State the law of relations of partners to one another. (Pages 262-263)
11. What are the rights and duties of partners as between themselves ? (Page 263)
12. What are the duties of a partner ? (Page 269)
13. What are the rights of a partner as against the other partners of a firm ? (Pages 268-269)
14. Objective questions. Give short answers.
    (*i*) "A partner may transfer his interest in a firm by sale, mortgage or charge". True or False ? (Page 275)
    (*ii*) State the procedure to be followed by a minor in a partnership firm in order to give public notice on attaining his majority (Pages 271-272)
    (*iii*) Mention the authority to whom intimation will be sent in case a minor partner wants to continue as a partner on attaining majority. (Pages 271-272)

3 DISSOLUTION OF FIRMS

☆ What is Dissolution ?

Dissolution of a firm means the end of a firm by the break up of the relation of partnership between *all* the partners. Dissolution is to be distinguished from reconstitution of a firm. In the latter case, the partnership continues but there is a change in the number of partners. In the former case there is complete severance of jural relations between all the partners.

THE GROUNDS OF DISSOLUTION

A firm may be dissolved on any of the following grounds :

1. By Agreement (Sec. 40)

A firm may be dissolved any time with the consent of all the partners of the firm. Partnership is created by contract, it can also be terminated by contract.

2. Compulsory Dissolution (Sec. 41)

A firm is dissolved—

(*a*) by the adjudication of all the partners or of all the partners but one as insolvent, or

(*b*) by the happening of any event which makes the business of the firm unlawful.

But if a firm has more than one undertaking, some of which become unlawful and some remain lawful, the firm may continue to carry on the lawful undertakings.

3. On the happening of Certain Contingencies (Sec. 42)

Subject to contract between the partners, a firm is dissolved—

(*a*) if constituted for a fixed term, by the expiry of that term ;

(*b*) if constituted to carry out one or more adventures or undertakings, by the completion thereof :

(*c*) by the death of a partner ; and

(*d*) by the adjudication of a partner as an insolvent.

The partnership agreement may provide that the firm will not be dissolved in any of the aforementioned cases. Such a provision is valid.

4. By notice (Sec. 43)

Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all other partners of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution, or, if no date is mentioned, as from the date of communication of the notice.

5. Dissolution by the Court (Sec. 44)

At the suit of a partner, the court may dissolve a firm on any one of the following grounds :

(*a*) Insanity

If a partner *has become of unsound mind.* The suit for dissolution in this case can be filed by the next friend of the insane partner or by any other partner.

(*b*) Permanent Incapacity

If a partner becomes permanently incapable of performing his duties as a partner. *Permanent incapacity* may arise from an incurable illness like paralysis. In *Whitwell* v. *Arthur*[1] a partner was attacked with paralysis which on medical evidence was found to be curable. Dissolution was not granted.

The suit for dissolution in this case must be brought by a partner other than the person who has become incapable.

(*c*) Guilty Conduct

If a partner is *guilty of conduct* which is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business. To justify dissolution under this clause the misconduct must be of such a nature as to affect adversely the particular business concerned. Misconduct which affects one business may not affect another business. Therefore the court must take into account the nature of business that the partnership carries on. The test generally applied is whether the act complained of is likely to affect the *credit* and *custom* of the particular business.

The suit for dissolution on the ground mentioned in this clause must be brought by a partner other than the partner who is guilty of misconduct.

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[1] (1865) 35 Beav. 140

Examples :

(*i*) The partner of a firm of solicitors was convicted of travelling on the railway without a ticket and with intent to defraud. It was held that since the conviction was for dishonesty, it was likely to be detrimental to the partnership business and dissolution was granted. *Carmichael* v. *Evans*.[1]

(*ii*) In English cases dissolution has been granted for the following acts—conviction for an offence involving moral turpitude; misapplication of the monies of a client by a solicitor; adultery by a doctor; speculation in shares by the partner of a regular mercantile business.[2]

(*d*) Persistent Breach of Agreement

If a partner wilfully and persistently commits *breach of the partnership agreement* regarding management or otherwise conducts himself in such a way that it is not reasonably practicable for the other partners to carry on business in partnership with him.

The suit for dissolution in cases coming under this clause is to be brought by a partner other than the partner guilty of the acts complained of.

Example :

In English cases the following acts have been held to be sufficient ground for directing dissolution; refusing to account for monies received; taking away the books of account; the application of monies belonging to the firm in payment of his private debts : continued quarrelling, and such a state of animosity as precludes reasonable hopes of reconciliation and friendly co-operation.[3]

(*e*) Transfer of whole Interest

If a partner has transferred the *whole of his interest* in the firm to an outsider or has allowed his interest to be sold in execution of a decree.

Transfer of a partner's interest does not by itself dissolve the firm. But the other partners may ask the court to dissolve the firm if such a transfer occurs. Only the transfer of the entire interest of the partner gives ground for action. The transfer of a part of the partner's interest does not provide any ground for dissolution. The formation of a sub-partnership is, therefore, not a ground for dissolution.

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[1] (1904) 1 Ch. 486

[2] Lindley, (9th edition), p. 690

[3] Lindley, p. 691

The suit for dissolution on the ground mentioned in this clause must be brought by a partner other than the partner whose interest has been transferred or sold.

(*f*) Loss

If the business of the firm cannot be carried on except at a *loss*. Since the motive, with which partnerships are formed, is acquisition of gain, the courts have been given discretion to dissolve a firm in cases where it is impossible to make profits.

(*g*) Just and Equitable clause

If the court considers it *just and equitable* to dissolve the firm. This clause gives a discretionary power to the court to dissolve a firm in cases which do not come within any of the foregoing clauses but which are considered to be fit and proper cases for dissolution.

Example :

Dissolution has been granted under the clause in the following cases—deadlock in the management ; partners not on speaking terms ; disappearance of the substratum of the business.

THE CONSEQUENCES OF DISSOLUTION

1. Acts done after dissolution

Until public notice is given of the dissolution, the partners continue to be liable to third parties for all acts done in connection with the affairs of the firm.—Sec. 45.

2. Winding up

Upon dissolution, the firm comes to an end and its affairs must be wound up according to the rules laid down in the Act. The assets of the firm must be collected and applied in payment of the debts and liabilities. The surplus, if any, is to be distributed among the partners according to their rights. The deficit, if any, is to be paid by the partners according to the terms of the agreement of partnership.—Sec. 46.

3. Continuing Authority of Partners for Purpose of Winding up

Notwithstanding the dissolution, the authority of each partner to bind the firm (and the other mutual rights and obligations of the partners) continue (*i*) so far as may be necessary to wind

up the affairs of the firm, and (*ii*) to complete transactions begun but unfinished at the time of the dissolution.

After dissolution, a partner cannot bind the firm in any case other than the two cases mentioned above. A partner who has been adjudicated insolvent cannot bind the firm in any case after the order of adjudication has been passed.—Sec. 47.

4. Personal Profits earned after Dissolution

If any partner earns any profit from any transaction connected with the firm after its dissolution, he must share it with the other partners and the legal representatives of the deceased partners.—Sec. 50.

5. Return of Premium

Where a partner has paid a premium on entering into partnership for a fixed term, and the firm is dissolved before the expiration of that term otherwise than by the death of a partner, he shall be entitled to repayment of the premium or of such part thereof as may be reasonable, regard being had to the terms upon which he became a partner and to the length of time during which he was a partner, unless—

(*a*) the dissolution is mainly due to his own misconduct, or

(*b*) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.—Sec. 51.

6. Rescission for Fraud or Misrepresentation

Where a contract creating partnership is rescinded on the ground of the fraud or misrepresentation of any of the parties thereto, the party entitled to rescind is, without prejudice to any other right entitled—

(*a*) to a lien on the assets of the firm remaining after the debts of the firm have been paid, for any sum paid by him for the purchase of a share in the firm and for any capital contributed by him;

(*b*) to rank as creditor of the firm in respect of any payment made by him towards the debts of the firm; and

(*c*) to be indemnified by the partner or partners guilty of the fraud or misrepresentation against all the debts for the firm.—Sec. 52.

7. Right to Restrain from use of Firm-name or Firm Property

After a firm is dissolved, every partner of his representative may, in the absence of a contract between the partners to the contrary, restrain any other partner or his representative from carrying on a similar business in the firm name or from using any of the property of the firm for his own benefit, until the affairs of the firm have been completely wound up. But a partner who has purchased the goodwill of the firm, cannot be restrained from using the firm name.—Sec. 53.

8. Agreements in Restraint of Trade

Partners may, upon or in anticipation of the dissolution of a firm, make as agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such an agreement will not be void on the ground of restraint of trade.—Sec. 54.

MODE OF SETTLING ACCOUNTS UPON DISSOLUTION

The settlement of accounts between partners upon dissolution is to take place in the manner provided for in the partnership agreement. Subject to such agreement, the Partnership Act lays down the following rules regarding the matter :

1. Losses are to be paid first out of profits, next out of capital, and, lastly if necessary by the partners individually in the proportions in which they were entitled to share profits. Capital deficiency is to be treated as loss and is to be borne by the partners in proportion to the profit sharing ratio.—Sec. 48 (*a*).

Examples :

(*i*) *P* and *Q* were partners. *P* contributed £1929 and *Q* £29 to the capital. It was agreed that the profits and losses of the business were to be shared equally. Upon dissolution the losses amounted £14,000. Held, whatever may be the capital contributions of the partners, the losses must be shared equally. *Nowell* v. *Nowell*.[1]

(*ii*) *A, B & C* are three partners in a firm. Their capital contributions are, *A*—Rs. 10,000, *B*—Rs. 5,000, *C*—Rs. 1,000. They share profits equally. Upon dissolution it is found that realisable assets are—Rs. 20,000 and debts payable are—Rs. 13,000.

From the above it follows that available assets are Rs. 7,000.

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[1] (1869) 7 Eq. 538

Therefore capital deficiency is Rs. 9,000. Each partner must contribute Rs. 3,000 towards capital deficiency, because they have equal shares in profits.

The final position is that *A* is to pay Rs. 3,000 and receive Rs. 10,000 ; *B* is to pay Rs. 3,000 and receive Rs. 5,000 ; *C* is to pay Rs. 3,000 and receive Rs. 1,000.

C therefore contributes Rs. 2,000. This contribution together with the available assets Rs. 7,000, amounts to Rs. 9,000. Out of this *A* gets Rs. 7,000 and *B* gets Rs. 2,000.

2. The assets of the firm including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order :

(*a*) in paying the debts of the firm to third parties ;

(*b*) in paying to each partner ratably what is due to him from the firm for advances as distinguished from capital ;

(*c*) in paying to each partner ratably what is due to him on account of capital ; and

(*d*) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.—Sec. 48(b).

3. If a partner becomes insolvent or otherwise cannot pay his share of the contribution, the capital of the solvent partners cannot be returned in full. In this case, the solvent partners must share ratably the available assets (including their own contribution to the capital deficiency), *i.e.*, the available assets will be distributed in proportion to their original capital. This result follows from the language of sub-section (ii) of Section 48(b). In the English case, *Garner* v. *Murray*.[1] a similar rule is laid down.

Example :

In the example given above if *C* is insolvent, he will pay nothing. The available assets will be Rs. 7,000 *plus* Rs. 6,000 (the contributions of *A* and *B*) *i.e.*, in all Rs. 13,000. The amount will be shared between *A* and *B* in the ratio of 2 : 1 which is the ratio between their capital.

4. Payment of the Firm Debts and of Separate Debts

Where there are joint debts from the firm, and also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of debt of the firm, and

[1] (1904) 73 L. J. Ch. 66

if there is any surplus, then the share of each partner shall be applied in payment of his separate debts or paid to him. The separate property of any partner shall be applied first in the payment of his separate debts, and the surplus (if any) in the payment of the debts of the firm.—Sec. 49.

SALE OF GOODWILL AFTER DISSOLUTION

Goodwill is a part of the property of the firm. (See p. 257). Section 55 of the Partnership Act provides that in settling the accounts of a firm after dissolution, the goodwill shall, subject to contract between the partners, be included in the assets and it may be sold either separately or along with other property of the firm.

Rights of Buyer and Seller of Goodwill

The purchaser of the goodwill gets the exclusive rights to represent himself as carrying on the old business. He also gets the exclusive right to use the name of the old firm.

But the sellers of the goodwill (*i.e.*, the partners of the firm) or any one or more of them may carry on a business competing with that of the buyer and may advertise the business. This right is given by Section 55(2) of the Partnership Act because of the general principle that a man may adopt any trade, occupation, or profession that he chooses.

To protect the buyer of the goodwill in case of competition with the partners of the old firm. Section 55(2) provides that such a partner or partners cannot (*a*) use the firm name, (*b*) represent himself as carrying on the business of the firm, or (*c*) solicit the custom of persons who were dealing with the firm before its dissolution (unless there is an agreement with the buyer of goodwill permitting any of these).

Agreements in Restraint of Trade

The buyer of the goodwill may further protect himself from the competition of the old partners by entering into an agreement with any partner prohibiting such partner from carrying on any business similar to that of the firm within a specified period or within specified local limits. Such an agreement shall be valid if the restrictions imposed are reasonable (notwithstanding the fact that the agreement may amount to restraint of trade).—Sec. 55(3).

EXERCISES

1. What is meant by "dissolution of a firm"? What are the rights and obligations of partners after the dissolution of partnership ? (Pages 278, 281-283)
2. What are the grounds of dissolution of a partnership firm ? (Pages 278-281)
3. What are the circumstances in which a firm may be dissolved by the court ? (Patges 279-281)
4. Define partnership. Discuss the different modes of dissolution of partnership. (Pages 248, 278-281)
5. If there are no rules in the absence of partnership agreement how is settlement of accounts by a firm done after its dissolution ? (Pages 283-285)
6. How are the assets of the firm and its partners liable for the debts of the firm on the dissolution of the firm ? (Pages 283-285)
7. State the mode of settlement of accounts between partners after dissolution of the firm. (Pages 283-285)
8. State the rights of the buyer and seller of Goodwill. (Pages 283-285)
9. Objective Questions.
   (*a*) A partner of a firm was attacked with paralysis, will the firm be dissolved ? (Para (*b*), page 279)
   (*b*) A partner of a firm was convicted of travelling without ticket. Will he be expelled from the firm ? (Para (*c*), page 279)
   (*c*) State the two grounds under which a firm may be compulsorily dissolved. (Para 2, page 278)

BOOK IV

THE LAW RELATING TO NEGOTIABLE INSTRUMENTS

1 DEFINITIONS

NEGOTIABLE INSTRUMENTS

Documents of a certain type, used in commercial transactions and monetary dealings, are called Negotiable Instruments.

"Negotiable" means transferable by delivery and "instrument" means a written document by which a right is created in favour of some person. The term negotiable instrument, literally means "a document transferable by delivery". In English mercantile law, the term is used in this wide sense. Thus a negotiable instrument is one in which, "the true owner could transfer, the contract or engagement contained therein by simple delivery of the instrument".

In India the term negotiable instrument is used in a *restricted sense*. The law relating to such instruments is contained in the Negotiable Instruments Act of 1881 which states that, "A Negotiable Instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer".—Sec. 13(1). Thus in India only three kinds of instruments are recognised as negotiable instruments *viz.*, promissory notes, bills of exchange and cheques.

Bills of lading, dividend warrants, *Hundis* and similar other documents are not covered by the Negotiable Instruments Act. But as these documents are, in various respects, analogous to notes and bills, the rules laid down in the Act relating to negotiable instruments are, under certain circumstances, applied to them.

The Negotiable Instruments Act is based on English law. It is more or less a codification of the English common law rules on the subject.

PROMISSORY NOTE (PRO-NOTE OR HAND NOTE)

Definition

"A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money

only to, or to order of a certain person, or to the bearer of the instrument."—Sec. 4.

The person who makes the promise to pay is called the *Maker*. He is the debtor and must sign the instrument. The person who will get the money (the creditor) is called *Payee*.

Essential Elements

From the definition given in the Act it is apparent that the following essential requirements must be fulfilled by an instrument intended to be a promissory note :

1. The instrument must be *in writing*.

2. The instrument *must be signed* by the maker of it. A signature in pencil or by a rubber stamp of facsimile is good. An illiterate person may use a mark or cross instead of writing out his name. The signature or mark may be placed anywhere on the instrument, not necessarily at the bottom. It may be at the top or at the back of the instrument. (Date.—See p. 304)

3. The instrument must contain a *promise to pay*. The promise to pay must be express. It cannot be implied or inferred. A mere acknowledgement of indebtedness is not enough.

Example :

"Mr. Sen I. O. U. Rs. 1000". Here I. O. U. stands for, "I owe you." This is only an admission of indebtedness. There is no promise to pay and therefore the instrument is not a promissory note. *Laxmibai* v. *Raghunath*.[1]

4. The promise to pay must be *unconditional*. If the promise to pay is coupled with a condition it is not a promissory note.

Examples :

(*i*) "I promise to pay *B* Rs. 300 first deducting thereout any money which he may owe me."

(*ii*) "I promise to pay *B* Rs. 500 on *D*'s death provided *D* leaves me enough to pay this sum."

(*iii*) "I promise to pay *B* Rs. 500, seven days after *D*'s marriage."

These instruments are not promissory notes because the promise to pay is coupled with a condition. "I promise to pay *B* Rs. 500 on demand" is a note with an unconditional promise.

Stipulations of the following type are *not* regarded as conditions : promise to pay at a specified time or at a specified place or after the occurrence of an event which is certain to occur, or payment after calculating interest at a certain rate.

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[1] 29 Bom. 373

Example :

"I promise to pay *B* Rs. 500 on 1st April, 1980." "I promise to pay *B* Rs. 500 on demand at Bombay." "I promise to pay *B* Rs. 500 seven days after the death of *C*." These are all valid promissory notes.

5. The *maker* of the instrument must be *certain and definite.*

6. A Promissory note must be *stamped* according to the Indian Stamp Act.

7. The sum of *money* to be paid must be *certain.*

Examples :

(*i*) "I promise to pay *B* Rs. 500 and all other sums which shall be due to him."

(*ii*) "I promise to pay some money on the occasion of his marriage." The above instruments are not promissory notes because the sum of money to be paid is uncertain.

8. The payment must be in the *legal tender money* of India. A promise to pay certain quantity of goods or a certain amount of foreign money is not a promissory note.

9. The money must be payable to a *definite person* or according to his order. A note is valid even if the payee is misnamed or is indicated by his official designation only. Evidence is admissible to show who the payee really is

Example :

A document, if it otherwise satisfies the definition of promissory note, will not cease to be so merely because the words "to order" are absent in the document. *K. A. Lona etc.* v. *M/s Dada Haji Ibrahim Hilari & Co. and others.*[1]

10. The promissory note may be payable *on demand* or after a certain *definite period* of time.

11. The Reserve Bank Act *prohibits* the creation of a promissory note payable on demand to the bearer of the note, except by the Reserve Bank and the Government of India. (See p. 305)

Specimens of Promissory Notes

An instrument is valid as a promissory note if it is so drafted as to satisfy the essential requirements of a promissory note. Subject to this condition the parties may use any form desired. Some typical forms are given below.

(*i*) "On demand I promise to pay *A, B.* of No. 37, College Street

[1] AIR (1981) Kerela 86

or order Rs. 1000 (Rupees one thousand only) with interest at 8 per cent per annum, for value received in cash." Sd/*X. Y.*

Date _____

Address_____

(*ii*) "One year after date I promise to pay *C.D.* or order Rs. 1000." Sd/*X. Y*

Date_____

(*iii*) "On demand I promise to pay *B* or order Rs. 500."—Sd/*X. Y.*

(*iv*) "I acknowledge myself to be indebted to *B* in Rs. 1000 to be paid on demand, for value received."—Sd/*X. Y.*

BILL OF EXCHANGE

Definition

"A Bill of Exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument."—Sec. 5.

The maker of a bill of exchange is called the *Drawer*. The person who is directed to pay is called the *Drawee*. The person who will receive the money is called the *Payee*. When the payee has custody of the bill, he is called the *Holder*. It is the holder's duty to present the bill to the drawee for his acceptance. The drawee signifies his acceptance by signing on the bill. After such signature the drawee becomes the *Acceptor*.

In a bill of exchange sometimes the name of another person is mentioned as the person who will accept the bill if the original drawee does not accept it. Such a person is called the *Drawee in case of Need*.

Essential Elements of a Bill of Exchange

A Bill of Exchange to be valid must fulfil the following requirements :

1. The instrument must be in *writing*.
2. The instrument must be *signed* by the drawer. (Date—See p. 304)
3. The instrument must contain an *order to pay*, which is express and *unconditional*.
4. The drawer, drawee and the payee must be *certain and definite individuals*.
5. The amount of money to be paid must be *certain*.

6. The payment must be in the *legal tender money* of India.
7. The money must be payable to a *definite person* or according *to his order.*
8. A bill of exchange must be properly *stamped.*
9. The bill may be made payable on demand or after a definite period of time. But no one except the Reserve Bank and the Government of India can draw a bill payable on demand to the bearer of the bill (See p. 305)

Comments : The requirements are more or less the same as in promissory notes and are subject to similar conditions as regards signature etc.

If any of the requirements mentioned above is not fulfilled, the document is not a bill of exchange.

Examples :

(*i*) " Please let the bearer have seven pounds and oblige." This is not a bill of exchange because it is a request and not an order. *Little* v. *Slackford.*[1]

(*ii*) "We hereby authorise you to pay on our account to the order of *X*, £600." This is not a bill of exchange because it is not an order to pay. *Hamilton* v. *Spottiswoode.*[2]

Specimens of Bills of Exchange

A bill of exchange may be drawn in any form, provided the requirements mentioned above are fulfilled.

Examples :

To *A. B.*

(*i*) Six months after date pay *P. Q.* or order Rs. 1000

Sd/ *X. Y.*
Date_____

Stamp—

(*ii*) One month after sight pay to *P. Q* or bearer (or order) Rs. 500.

Sd/ *X. Y.*
Date_____

Stamp—

Differences between a promissory note and a bill of exchange

1. Number of parties

In a promissory note there are two parties—the maker and the payee. In a bill of exchange there are three parties—the drawer, the drawee and the payee.

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[1] (1828) M & W 171 [2] (1849) 4 Ex. 200

2. Promise and order

In a promissory note there is a *promise* to pay. In a bill of exchange there is an *order* to pay.

3. Acceptance

A promissory note is signed by the person liable to pay; therefore, no acceptance is necessary. A bill of exchange except in certain cases, requires to be accepted by the drawee before it is binding upon him.

4. Liability

The maker of promissory note is primarily liable on the instrument. The drawer of a bill is liable only when the drawee does not accept the instrument or pay the money due.

5. Relationship

In a Promissory Note the maker stands in an immediate relationship to the payee. In a Bill of Exchange a drawee stands in immediate relationship with the acceptor and not to the payee.

"The drawer of a bill of exchange stands in immediate relation with the acceptor. The maker of a promissory note, bill of exchange or cheque stands in immediate relation with the payee and the indorser with his indorsee. Other signers may by agreement stand in immediate relation with a holder".—Sec 44, Explanation.

6. Notice

In case of non-payment or non-acceptance of a bill, notice must be given to all persons liable to pay. This is called the notice of dishonour. In the case of a promissory note, notice of dishonour to the maker is not necessary.

7. Protest

In case of dishonour, a foreign bill must be protested if such a protest is necessary according to law of the place where it is drawn. In case of dishonour of a promissory note, protest is not necessary.

CHEQUE

Definition

A cheque is a bill of exchange drawn upon a specified banker and payable on demand.—Sec. 6.

Essential features of Cheque

1. A cheque must fulfil all the essential requirements of a bill of exchange.

2. A cheque may be payable to bearer or to order but in either case it must be payable on demand.

3. The banker named must pay it when it is presented for payment to him at his office during the usual office hours, provided the cheque is validly drawn and the drawer has sufficient funds to his credit.

4. Bill and notes may be written entirely by hand. There is no legal bar to cheques being hand-written. Usually however, banks provide their customers with printed cheque forms which are filled up and signed by the drawer.

5. The signature must tally with the specimen signature of the drawer kept in the bank.

6. A cheque must be dated. A banker is entitled to refuse to pay a cheque which is not dated. A cheque becomes due for payment on the date specified on it.

7. A cheque drawn with a future date is valid but it is payable on and after the date specified. Such cheques are called post-dated cheques.

8. A cheque may be presented for payment after the due date but if there is too much delay the bank is entitled to consider the circumstance suspicious and refuse to honour the cheque. The period after which a cheque is considered too old or stale varies according to custom from place to place. It is usually six months in Indian cities.

9. In some certain circumstances the bank is not bound to pay the cheques. (See ch. 6)

The usual form of a cheque

Cheques are usually printed in the form shown below.

Example :

To *X. Y. Bank*

Date_____

Pay *A. B.* or order (or bearer) the sum of Rupees Five Hundred only. Rs. 500/-

Sd./ C. D.

Different types of cheques

There are two types of cheques : Open Cheques and Crossed Cheques. An open cheque is one which is payable in cash across the counter of the bank.

A crossed cheque is one which has two short parallel lines marked across its face. A cheque marked in this fashion can be paid only to another banker. Naturally it will not be paid across the counter. The system of crossing cheques arose by mercantile usage and was later on sanctioned by law. The advantage of crossing is that it reduces the danger of unauthorised persons getting possession of a cheque and cashing it. A crossed cheque can only be cashed through a bank of which the payee of the cheque is a customer.

There are different modes of crossing a cheque. The simplest mode of crossing is to put two parallel lines across the face of the cheque. This is called General Crossing. A cheque crossed generally will be paid to *any* bank through which it is presented. When the name of bank is written between the parallel lines, it is called Special Crossing. A cheque crossed specially will be paid only when it is presented for collection by the bank named between the parallel lines. Such crossing affords a greater measure of protection against loss.

In addition to general or special crossing, a cheque may contain various remarks written on it, the effect of which is to restrict payment in certain ways. The usual remarks are "Account Payee" and "Not Negotiable."

"Account Payee Only"

The words 'account payee' on a cheque is interpreted as a direction on the banker to credit the proceeds of the cheque to the account of the payee. The negotiation of such cheques is not prohibited, therefore such a cheque remains transferable. Regarding negotiable instruments, there is a general principle that if the cheque is negotiable in its origin, (that is payable to order or bearer), the words "Account Payee Only" prohibiting transfer or indicating an intention not to transfer will not defeat the transferability or negotiability of the cheque. *National Bank* v. *Silke.*[1]

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[1] (1891) 1 Q. B. 435

Comments : But although the payee is entitled to transfer the cheque to anyone, the transferee will face difficulty in getting the cheque collected for him. The words "account payee only" suggests that the collecting banker shall receive proceeds of the cheque only for the payee and shall credit only to his account. If the banker goes against this order, he will be guilty of negligence. Hence "account payee only" crossing is not negotiable practically, as banks will collect it on behalf of no person other than the payee.

"Not Negotiable"

A cheque marked with the words "not negotiable" can be transferred or assigned by the payee. The transferee will get the same rights, as regards payment, as the transferor had. But the transferee will not get the rights of a holder in due course.

"A person taking a cheque crossed generally or specially, bearing in either case the words not negotiable, shall not have, and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had."—Sec. 130.

From the language of the Sec. 130 it follows that the transferee of such a cheque takes it at his own risk. *Great Western Ry. Co.* v. *London and County Banking Co.*[1]

See also the 'comments' on "Account Payee Only", above.

Certification of Cheques by Banks

In some countries there is a custom of marking a cheque with the words 'good for payment" by the drawee bank (*e.g.*, in U.S.A.). The effect of this practice is that, it cannot be countermanded by the drawer, and the payee is certain of getting the money. It has been held in *Bank of Baroda* v. *Punjab National Bank*[2] that the practice of marking or certifying cheques has not been established in India, either by judicial decisions or by statutes. Therefore even if a particular cheque is market as good, the drawee bank in India may refuse to honour it if there are insufficient funds. By inter-bank agreement, the marking of cheques have been stopped.

Crossing after Issue

Section 125 of the Negotiable Instruments Act provides as follows :

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[1] (1901) A.C. 414 [2] AIR (1944) Privy Council 58

Where a cheque is uncrossed, the holder may cross it generally or specially.

Where a cheque is crossed generally, the holder may cross it specially.

Where a cheque is crossed generally or specially, the holder may add the words, "not negotiable".

Where a cheque is crossed specially, the banker to whom it is crossed specially may again cross it specially to another banker, his agent, for collection.

Who can Cross a Cheque ?

A cheque can be crossed by the Drawer, the Holder and Bank (for collection). The Holder and the Bank can cross the cheque under the circumstances described in Sec. 125. (See above). The Drawer can cross a cheque (generally or specially) *before* issuing it.

Distinction between Bill of Exchange and Cheque

1. A bill of exchange can be drawn upon any person, including a bank. A cheque can be drawn only upon a bank. Thus every cheque is a bill of exchange but every bill of exchange is not a cheque.

2. Except under certain specified circumstances, a bill of exchange requires acceptance. A cheque does not require any acceptance.

3. A cheque is always payable on demand. The acceptor of a bill of exchange is allowed a grace period of three days, after the maturity of the bill, to make the payment.

4. The drawer of a bill is discharged from liability if the bill is not presented to the acceptor for payment at the due time. But the drawer of a cheque is discharged from his liability only if he suffers damage owing to delay in presenting the cheque for payment.

Example :

The holder of a cheque retains it for two months after the due date without attempting to cash it. In the meantime the bank goes into liquidation. Had the cheque been presented for payment earlier it would have been paid. Owing to the undue delay in presentation the drawer has lost his money. He is therefore, not required to pay the holder again. What is undue delay is a question of fact depending on the circumstances of the case.

5. If a bank fails to pay a cheque, it is not necessary to give notice of dishonour to the drawer to make him liable to compensate the payee. In the case of bills of exchange, it is necessary to give notice of dishonour, except in certain special cases.

6. A cheque may be crossed ; there is no provision for crossing a bill.

7. The payment of a cheque may be countermanded by the drawer. The payment of a bill cannot be countermanded.

8. A cheque does not require any stamp. A bill of exchange (except in certain cases) must be stamped.

HOLDER AND HOLDER IN DUE COURSE

Holder

The holder of a negotiable instrument means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto.—Sec. 8.

The person legally entitled to receive the money due on the instrument, is called the Holder. Thus clerks or servants having the instrument in their custody are not holders except as agents of the holder. A person who obtains possession of the instrument by illegal means (e.g., theft) is not a holder.

The Holder in due Course

The holder in due course is a particular kind of holder. The holder of a negotiable instrument is called the holder in due course if he satisfies the following conditions.—Sec. 9.

1. He obtained the instrument for valuable consideration.

2. He became holder of the instrument before its maturity, *i.e.*, before the amount mentioned in it became payable.

3. He had no cause to believe that any defect existed in the title of the person from whom he derived his title.

Explanation : From the aforesaid conditions it is clear that a person cannot be a holder in due course if,

(*a*) he has obtained the instrument by gift or for an unlawful consideration or by illegal methods ;

(*b*) if he has obtained the instrument after its maturity ; and

(*c*) if the circumstances are such that a reasonable person would suspect that the title of the transferor is defective.

Examples :

(*i*) An instrument torn to pieces and pasted together is suspicious. *Baxendale* v. *Bennett*.[1]

(*ii*) An instrument containing erasures is suspicious.

(*iii*) A post dated cheque does not indicate any defective title and therefore the transferee of such a cheque may be a holder in due course if the other conditions are satisfied. *Hithcock* v. *Edwards*.[2]

(*iv*) If the hundi is payable to order, then, to be holder in due course, it is not necessary for endorsee or payee to show that they obtained hundi for consideration. But if the hundi is payable to bearer then the person possessing the bill will be holder in due course only if he has come in possession of the hundi for consideration. *Madhya Bharat Khadi Sangh* v. *Bal Kishen Kapoor and others*.[3]

Rights of a Holder in Due Course

The holder in due course is in a privileged position. Under the law he has the following rights ;

1 *Defects of instruments are eliminated* : The holder in due course *gets a good title* to the instrument even though the title of the transferor is defective. If *X* obtains an instrument by fraud, he cannot get payment. But if *X* transfers the instrument to *Y* under circumstances which make *Y* a holder in due course, *Y* can sue on the instrument and get the amount due on it. The party liable to pay can take, as against *X*, the defence of fraud but as against *Y* he will not be allowed to take such a defence.

2. *Unauthorised acts of an agents may be valid* : Negotiable instruments are sometimes handed over to *agents for a particular purpose ; e.g., for collection.* If the agent acts beyond his authority and transfers the instrument to a person who satisfies the conditions of a holder in due course, the latter can recover the amount mentioned in the instrument. The party liable to pay cannot plead that the agent acted without authority.

3. *Good title in an inchoate stamped instrument* : The holder in due course gets a good title even though the instrument was originally an inchoate stamped instrument and the transferor completed the instrument for a sum greater than what was intended by the maker.—Sec. 20 (See p. 306)

4. *Liability of prior parties to holder in due course* : Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.—Sec.36.

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[1] (1878) 3 Q.B.D. 525

[2] (1889) 60 L.T. 636

[3] AIR (1979) All 253

5. *Holder can file a suit in his own name* : The holder in due course can file a suit, against the parties liable to pay, in *his own name.*

6. *Acceptance of bill drawn in fictitious name* : The acceptor of a bill exchange drawn in a *fictitious name* and payable according to the drawer's order is liable to pay to the holder in due course, if there is an endorsement on the bill signed in the same hand as the drawer's signature and purporting to be made by the drawer. The acceptor cannot plead, by way of defence, that the bill is drawn in a fictitious name.—Sec. 42.

7. *Unlawful instruments* : Instrument obtained by unlawful means or for unlawful consideration is valid when the possessor or indorsee of the instrument is a holder in due course.—Sec. 58.

8. *Estoppel against denying original validity of instrument* : The maker of a promissory note, the drawer of a bill of exchange or cheque, and the acceptor of a bill of exchange for the honour of the drawer, in a suit thereon by the holder in due course, is not permitted to deny the validity of the instrument as originally made or drawn.—Sec. 120.

But section 120 does not prevent a minor from taking the defence of minority. Also, there is no liability if the signature is forged.

9. *Estoppel against denying capacity of payee to indorse* : No maker of a promissory note and no acceptor of a bill of exchange payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the date of the note or bill, to indorse the same.—Sec. 121.

10. *Estoppel against denying capacity of payee to indorse* : The indorser of a negotiable instrument, in a suit thereon by a subsequent holder, is not permitted to deny the signature or the capacity to contract of any prior party to the instrument.—Sec. 122.

11. *Transferee from a holder in due course* : A holder of a negotiable instrument who derives title from a holder in due course has the rights thereon of that holder in due course.—Sec. 53.

ESSENTIAL FEATURES OF NEGOTIABLE INSTRUMENTS

1. Writing and Signature

Negotiable Instruments must be written and signed by the

parties according to the rules relating to Promissory Notes, Bills of Exchange and Cheques.

2. Money

Negotiable Instruments are payable by legal tender money of India. The liabilities of the parties of Negotiable Instruments are fixed and determined in terms of legal tender money.

3. Negotiability

Negotiable Instruments can be transferred from one person to another by a simple process. In the case of bearer instruments, delivery to the transferee is sufficient. In the case of order instruments two things are required for a valid transfer : indorsement (*i.e.*, signature of the holder) and delivery. An instrument may be made non-transferable by using suitable words, *e.g.*, "Pay to *X* only."

4. Title

The transferee of a negotiable instrument, when he fulfils certain conditions, is called the holder in due course. The holder in due course gets a good title to the instrument even in cases where the title of the transferor is defective.

5. Notice

It is not necessary to give notice of transfer of a negotiable instrument to the party liable to pay. The transferee can sue in his own name.

6. Presumptions

Certain presumptions apply to all negotiable instruments. *Example* : it is presumed that there is consideration. It is not necessary to write in a promissory note the words "for value received" or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration. (See. p. 340)

7. Special Procedure

A special procedure is provided for suits on promissory notes and bills of exchange. (The procedure is prescribed in the Civil Procedure Code). A decree can be obtained much more quickly than it can be in ordinary suits.

8. Popularity

Negotiable instruments are popular in commercial transactions because of their easy negotiability and quick remedies.

9. Evidence

A document which fails to qualify a: a negotiable instrument may nevertheless be used as evidence of the fact of indebtedness.

Example :

P writes to *Q* "I. O. U. Rs. 500". This is not a promissory note but the document can be used as evidence to show that *P* is indebted to *Q* for Rs. 500.

BANKER'S DRAFT

A Bill of Exchange is sometimes called a Draft. A Bill of Exchange drawn by a bank is called a Banker's Draft.

Banker's Drafts are of two kinds : *(i)* from one office to another of the same bank and *(ii)* from one bank to another. The first type cannot be payable to a bearer on demand. (Section 31 of Reserve Bank of India Act). Section 131A of the Negotiable Instruments Act provides that a draft drawn by one branch of a bank upon another and payable to order, is governed by the same rules as a crossed cheque.

The characteristic features of Bank Drafts are stated below :

(*i*) It is drawn by a banker upon its branch or upon another bank.

(*ii*) It is payable on demand.

(*iii*) It cannot be payable to bearer.

(*iv*) It cannot be stopped or countermanded, except by order of the Court.

From the consideration of S. 85A and S. 10 it follows that :

(1) The relationship between the purchaser of a draft and the bank from which that draft has been purchased, it merely that of the debtor and creditor.

(2) The purchaser of the draft can, therefore, call upon the bank from which he has purchased it to cancel the draft and pay back the money to him at any time before the draft has been delivered to the payee.

(3) If, however, the sole object of the issue of the draft was to transmit the money to another person, a fiduciary relationship is created between the purchaser of the draft and the bank which

issued it, and the purchaser of the draft can countermand payment only if the bank has not actually parted with the money held by it as agent, thus terminating the relationship of principal and agent.

(4) Ordinarily, a bank issuing a draft cannot refuse to pay the amount thereof, unless there was some doubt as to the identity of the person presenting it as being or properly representing the person in whose favour it was drawn, or, in other words, unless there is reasonable ground for disputing the title of the person presenting the draft.

(5) Once the draft has been delivered to the payee or his agent, the purchaser is not entitled to ask the issuing bank to stop payment of the draft to the payee on other grounds such as matters relating to consideration, and the issuing bank can thereafter pay back the amount of the draft to the purchaser of the draft only with consent of the payee. *Tukaram Bapuji Nikam* v. *The Belgaum Bank Limited.*[1]

DIFFERENT TYPES OF BILLS AND NOTES

Joint Notes and Bills

A promissory note or a bill of exchange may be signed by two or more persons jointly. In such cases their liabilities are joint and several.

A negotiable instrument may be payable to two or more persons *jointly*. But it cannot be made payable *to* or *by two* persons *alternatively*. A promissory note signed by *X* or *Y* is valid as against *X* but not as against *Y*.—Sec. 13(2).

Undated Notes and Bills

A negotiable instrument without a date is not necessarily invalid. If the legal requirements for the validity of an instrument are fulfilled, the instrument is valid and the date of execution can be proved by oral or other evidence. The holder in due course can insert the true date on the instrument and such insertion is not considered to be a material alteration.

Bearer Instruments and Order Instruments

A negotiable instrument may be payable to bearer or to the order of a person. An instrument *is payable, to bearer* (*i*) when

[1] AIR (1976) Bom. 185

it is expressed to be so payable, *i.e.*, when words like the following are used : "Pay bearer" or "Pay *X* or bearer", and (*ii*) when the last indorsement on the instrument is an indorsement in blank, *i.e.*, when there is an order to pay but the name of the payee is not mentioned.

When an instrument is payable to bearer, any person lawfully in possession of it as holder is entitled to receive the payment due on it. It is not necessary that his name should be written on the instrument. But after the bearer of the instrument is paid, he may be required to acknowledge receipt of the money by signing on the instrument.

A negotiable instrument is *payable to order* in the following cases :

(*a*) When it is expressed to be payable to order, *e.g.*, "Pay to *X* or order". An instrument payable "to the order of *P*" is payable to *P* or according to his order.

(*b*) When it is payable to a particular person and the instrument does not contain words prohibiting or restricting transfer. *Example* : "Pay to *Q*". The money is payable to *Q* or according to his order.

To negotiate an instrument payable to order, the signature of the holder is necessary.

A Negotiable Instrument is *payable on demand* in the following cases :

(1) "A promissory note or bill of exchange, in which no time for payment is specified, and a cheque, are payable on demand"—Sec. 19.

(2) A cheque is payable on demand.

(3) A promissory note or a bill of exchange is payable on demand if it is marked, "At sight", or, "On presentment."—Sec. 21.

Notes and Bills Payable to the Bearer on Demand

It is provided by Section 31 of the Reserve Bank of India Act that a promissory note or a bill of exchange *payable to the bearer on demand* can be issued only by the Reserve Bank of India or by the Central Government. The reason is that a bill or note payable to the bearer on demand may circulate from hand to hand and be used as money. Private persons are not allowed to create such documents. If a note or bill, is, by error, made payable to bearer on demand it will be treated by law as payable to order.

Ambiguous Instrument

An instrument which owing to faulty drafting, can be interpreted either as a promissory note or as a bill of exchange, is called an Ambiguous Instrument.

Example :

P signs an instrument which purports to be an order upon *B* to pay a certain sum of money to the order of *P* and negotiates the instrument to *C*. *B* is a non-existent person. The instrument is drafted like a bill but it can be interpreted as a promissory note by *P* because *B* being a non-existent person, *P* is liable to pay to the holder the money due on it.

An ambiguous instrument can be treated either as a bill or as a note, at the option of the holder.—Sec. 17. The holder must decide once for all, whether to treat the instrument as a bill or as a note. After he decides one way he cannot change his mind.

Figures versus Words

If the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid.—Sec. 18.

Example :

A promissory note is written as follows. "On demand I promise to pay *B* Rs. 200 (Rupees one hundred only)." The note is valid for Rs. 100 only.

Inchoate Stamped Instrument

An inchoate stamped instrument is a paper signed and stamped in accordance with the law relating to negotiable instruments and either wholly blank or containing an incomplete negotiable instrument. When one person gives to another such a document, the latter is *prima facie* entitled to complete the document and make it into a proper negotiable instrument up to the value mentioned in the instrument, if any, or up to the value covered by the stamp affixed on it. The person signing the instrument is liable on it, in the capacity in which he signed it, to any holder in due course for such amount. But persons who are *not holders in due course* cannot recover more than the amount intended to be paid by the signatory.—Sec. 20.

Example :

X signs a promissory note without stating the amount payable, puts stamp on it sufficient to cover Rs. 500 and hands it to his clerk

Y, for making certain purchases, instructing *Y* to put in the value of the purchases as the amount payable. *Y* purchases goods worth Rs. 400 but puts in Rs. 500 in the promissory note. The note is negotiated to *Z*, who takes it for consideration without any notice of the real transaction. *Z* can recover Rs. 500 from *X*. But the shopkeeper is presumably aware of all the circumstances and if he had retained the instrument he would have been entitled to recover only Rs. 400.

Inland Instruments and Foreign Instruments

A negotiable instrument drawn or made in India, and made payable in, or drawn upon any person resident in India is called an Inland Instrument.—Sec.11.

Inland instruments are those which are (*i*) made or drawn in India, and (*ii*) payable in India or payable by a person resident in India.

Foreign instruments are those which are (*i*) made or drawn in India but are payable by a person resident outside India, or (*ii*) which are made or drawn outside India but are payable in India.—Sec.12.

The distinction between inland instruments and foreign instruments is important because an inland bill need not be protested for dishonour while a foreign bill may have to be protested for dishonour if the law of the place where it is drawn to requires.

Accommodation Bills

An Accommodation Bill is one which has been signed by a person, as drawer, acceptor or indorser, without any consideration, with a view to oblige some other person, *i.e., to* provide him with funds.

Example :

Y desires to have Rs. 1000 and approaches *X* for the purpose. *X* has no funds in hand but has credit in the market. It is arranged that *Y* will draw a bill on *X* for Rs. 1000, payable after three months, and *X* will accept the bill. *Y* can negotiate the bill and get the money. Before the maturity of the bill *Y* will provide *X* with funds sufficient to meet it. Thus *Y* is able to get the required funds for three months. Such a bill is called an accommodation bill.

The party accommodating (*X*) is called the "Accommodation Party" and the party accommodated (*Y*) is called the "Accommodated Party". Sometimes a party may be accommodated

by indorsing an existing bill without consideration. Such indorser is called the "Backer". Backing a bill gives it value because the endorser is liable to all subsequent parties.

The Negotiable Instruments Act lays down the following rules regarding accommodation bills :

1. The accommodation party is liable to pay the money due on the instrument to any holder for value. Thus in the above example if the bill was endorsed to *P*, *P* can on the maturity of the bill demand the money from *X*. *P* is entitled to receive the money even if he was aware that *X* is an accommodation party, *X* can, of course, recover from *Y* whatever he pays on the bill.—Sec. 43.

2. The accommodated party (*Y*, in the example given above) cannot demand the money from the accommodation party *(X)* if he holds the bill till maturity.

3. An accommodation bill can be negotiated after maturity.—Sec. 59.

4. Non-presentment of an accommodation bill to the acceptor for payment does not discharge the drawer.—Sec. 76.

5. In the case of an accommodation bill, failure to give notice of dishonour does not discharge the liability of the prior parties, as it does in the case of other bills.—Sec. 98.

Fictitious Bills

A Bill is called a fictitious bill when the name of the drawer or the payee or both are fictitious.

A fictitious bill, payable to the order of the drawer, and accepted by a genuine person becomes a good bill in the hands, of a holder in due course. The holder in due course is entitled to payment from the acceptor if he can show that the first endorsement on the bill and the signature of the supposed drawer are in the same handwriting. If the holder knew that the drawer's name is fictitious, he cannot claim the money because, in this case, he is not a holder is due course.—Sec. 42.

Bills in Sets

Sometimes a bill of exchange is drawn in several parts, (two, three or four, as the circumstances may require). This is usually done in the case of foreign bills because they have to be sent over long distances and there exists a possibility of loss or delay.

Rules regarding Bills in Sets. Sections 132 and 133 :

1. Each part of a bill in set must be numbered and must contain a provision that it shall continue payable only so long as the others remain unpaid. All the parts together make a set and the whole set constitutes one bill. Each part requires to be stamped.

2. The entire bill is extinguished when one of the parts is extinguished (*e.g.*, when payment is made on one part).

3. When a person accepts or indorses different parts of the bill to different persons, he and the subsequent endorsers of each part are liable on each such part as if it were a separate bill. Therefore the acceptor should only accept one part of the set.

4. As between holders in due course of different parts of the same set he who first acquired title to his part is entitled to the other parts and the money represented by the bill.

Documentary Bills

A documentary bill is one to which documents of title like bills of lading are annexed. When the bill is accepted or paid, the documents of title are handed over. This is the usual practice in foreign trade transactions.

Escrow

A bill delivered conditionally is called Escrow. A bill may be endorsed or delivered to a person subject to the understanding that it will be payable only if certain conditions are fulfilled. *Examples* : a promissory note given as collateral security for raising capital for a partnership ; an instrument left with a person for safe custody.

In the case of an escrow, there is no liability to pay unless the conditions agreed upon are fulfilled. But the rights of a holder in due course are not affected.

REASONABLE TIME

The following rules are laid down in the Act regarding the interpretation of the term "reasonable time" which is used at various places in the Act.

Rule : In determining what is a reasonable time for presentment for acceptance or payment, for giving notice of dishonour and for noting, regard shall be had to the nature of the instrument

and the usual course of dealing with respect to similar instruments; and in calculating such time, public holidays shall be excluded.—Sec. 105.

Reasonable time of giving notice of dishonour : If the holder and the party to whom notice of dishonour is given carry on business or live (as the case may be) in different places, such notice is given within a reasonable time if it is despatched by the next post or on the day next after the day of dishonour.—Sec. 106 (para 1).

If the said parties carry on business or live in the same place, such notice is given within a reasonable time if it is despatched in time to reach its destination on the day next after the day of dishonour.—Sec.106 (Para 2)

Reasonable time for transmitting such notice : A party receiving notice of dishonour, who seeks to enforce his right against a prior party, transmits the notice within a reasonable time if he transmits it within the same time after its receipt as he would have had to give notice if he had been the holder.—Sec. 107.

EXERCISES

1. What are the essential features of a Negotiable Instrument ? Define Negotiable Instruments. Give examples. (Pages 301-303, 289)
2. Distinguish between :
   (*a*) A promissory note and a bill of exchange. (Page 293)
   (*b*) A bill of exchange and a cheque. (Page 298)
   (*c*) Cheque crossed generally & cheque crossed specially. (Pages 295-296)
   (*d*) Holder and holder in due course. (Page 299)
   (*e*) Cheque and Promissory Note. (Pages 294, 289)
3. Define a promissory note and give some examples of a pro-note. (Pages 289-292)
4. (*a*) What is a Bill of Exchange ? (*b*) Who can accept a Bill of Exchange ? (Pages 292-294)
5. What is a Bill of Exchange ? Who is the Drawee in case of need ? (Pages 292-294)
6. (*a*) What is a Bill of Exchange ? (Page 292)
   (*b*) State the principal features of a Bill of Exchange and a Promissory Note. (Pages 292-294)
7. State the various ways in which a cheque can be crossed. (Pages 295-297)

8. Define a 'Negotiable Instrument'. What are its characteristic features ? What is the effect of crossing a cheque with the words "Not negotiable" written across its face ?
(Pages 289, 301-303, 296)
9. What are the rights of a 'holder in due course' of a Negotiable Instrument ? (Page 299)
10. Can a holder of a cheque cross the cheque after it is issued ?
(Pages 297-298)
11. Who can cross a cheque ? (Page 298)
12. What is the effect of crossing a cheque with the words—'Not negotiable', or 'Account payee only' ? (Pages 296-297)
13. Write notes on : Banker's Draft ; Order Instruments ; Ambiguous Instrument ; Inchoate Stamped Instrument ; Accommodation Bill ; Fictitious Bill ; Reasonable time. (Para 4, page 290)
14. Problem : Is the following a Promissory Note ?—"I promise to pay *B* Rs. 500 and all other sums which shall be due to him."
15. Objective questions. Give short answers.
(*i*) "A bank note is a promissory note". True or False ?
(Pages 289-290)
(*ii*) Who is a drawee in case of need ? (Page 292)
(*iii*) Enumerate two essential features of negotiable instruments.
(Pages 301-302)
(*iv*) What are bills in sets ? (Pages 308-309)