Unit I

Contract of indemnity and guarantee

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Indemnity and Guarantee Contract

1. Indemnity Contract:

A contract where one party promises to save the other from any loss caused to him by the conduct of promissor himself or any other person is called contract of indemnity, (Section 124) Indian Contract Act, 1872. The term Indemnity literally means "*Security against loss*". In a contract of indemnity one party – i.e. the indemnifier promise to compensate the other party i.e. the indemnified against the loss suffered by the other.

The English law definition of a contract of indemnity is – "it is a promise to save a person harmless from the consequences of an act". Thus it includes within its ambit losses caused not merely by human agency but also those caused by accident or fire or other natural calamities."

The definition of a contract of indemnity as laid down in Section 124 – "A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a contract of indemnity.".

The definition provided by the Indian Contract Act confines itself to the losses occasioned due to the act of the promisor or due to the act of any other person.

Under a contract of indemnity, liability of the promisor arises from loss caused to the promisee by the conduct of the promisor himself or by the conduct of other person. (Punjab National Bank v Vikram Cotton Mills 1970 AIR 1973). Every contract of insurance, other than life insurance, is a contract of indemnity. The definition is restricted to cases where loss has been caused by some human agency. (Gajanan Moreshwar vs Moreshwar Madan, AIR 1942)

Section 124 deals with one particular kind of indemnity which arises from a promise made by an indemnifier to save the indemnified from the loss caused to him by the conduct of the indemnifier himself or by the conduct of any other person, but does not deal with those classes of cases where the indemnity arises from loss caused by events or accidents which do not depend upon the conduct of indemnifier or any other person (Gajanan Moreshwar vs Moreshwar Madan, AIR 1942)

In the case of (Mohit Kumar Saha vs New India Assurance Co AIR 1997), Calcutta HC held that the indemnifier must pay the full amount of the value of the vehicle lost to theft as given by the surveyor. Any settlement at lesser value is arbitrary and unfair and violates art 14 of the constitution.

Indemnity contract includes two parties namely; Indemnifier and Indemnity holder. The person who is promising to pay compensation is called Indemnifier and the person who`s loss is compensated is called Indemnity holder.

Example: There is a contract between X and Y according to which X has to Sell a tape recorder (which is selected) to Y after three months. On the next day of their contract Z has come to X and has insisted on selling the same tape recorder to him (Z). Here Z is promising to compensate X for any loss faced by X, due to selling the tape recorder to Z. X has agreed. Now the contract which has got formed between X and Z is called indemnity contract, where Z is indemnifier and X is indemnity holder.

1.1 Nature of Contract of Indemnity

A contract of indemnity may be express or implied depending upon the circumstances of the case, though Section 124 of the Indian Contract Act does not seem to cover the case of implied indemnity.

A broker in possession of a government promissory note endorsed it to a bank with forged endorsement. The bank acting in good faith applied for and got a renewed promissory note from the Public Debt Office. Meanwhile the true owner sued the Secretary of State for conversion who in turn sued the bank on an implied indemnity. It was held that – it is general principle of law when an act is done by one person at the request of another which act is not in itself manifestly tortious to the knowledge of the person doing it, and such act turns to be injurious to the rights of a third person, the person doing it is entitled to an indemnity from him who requested that it should be done. [Secretary of State v Bank of India].

The Indian Contract Act also deals with special cases of implied indemnity –

- U/s 69 if a person who is interested in payment of money which another is bound by law to pay and therefore pays it, he is entitled to be indemnified. For instance – if a tenant pays certain electricity bill to be paid by the owner, he is entitled to be indemnified by the owner.
- Section 145 provides for right of a surety to claim indemnity from the principal debtor for all sums which he has rightfully paid towards the guarantee.
- Section 222 provides for liability of the principal to indemnify the agent in respect of all amounts paid by him during the lawful exercise of his authority.

The plaintiff, an auctioneer, acting on the instruction of the defendant sold certain cattle which subsequently turned out to belong to someone else other than the defendant. When the true owner sued the auctioneer for conversion, the auctioneer in turn sued the defendant for indemnity. The Court held that the plaintiff having acted on the request of the defendant was entitled to assume that, if it would turned out to be wrongful, he would be indemnified by the defendant. (Adamson v Jarvis 23 Wis. 2d 453 (1964)).

1.2 Validity of Indemnity Agreement

A contract of indemnity is one of the species of contracts. The principles applicable to contracts in general are also applicable to such contracts so much so that the rules such as free consent, legality of object, etc., are equally applicable.

Where the consent to an agreement is caused by coercion, fraud, misrepresentation, the agreement is voidable at the option of the party whose consent was so caused. As per the requirement of the Contract Act, the object of the agreement must be lawful. An agreement, the object of which is opposed to the law or against the public policy, is either unlawful or void depending upon the provision of the law to which it is subject.

1.3 Contract of Indemnity When Enforceable –

The question whether the liability of indemnifier commences only when the indemnified has actually suffered loss or when there is an apprehension that the indemnified by all chances is likely to suffer it.

The former view was held in cases like – Shankar Nimbaji v Laxman Sapdu / Chand Bibi v Santosh Kumar Pal.

The plaintiff filed a suit to recover Rs. 5,000/- and interest from defendant by the sale of a mortgaged property and, in case of deficit, for a decree against the estate of defendant 2 which was in the hands of his sons, the defendant 2 died during the pendency of the suit. It was held that plaintiff cannot sue the defendant in anticipation that the proceeds realized by the sale of the mortgaged property would be insufficient and there would be some deficit. (Shankar Nimbaji v Laxman Sapdu (1940) 42 BOMLR 175)

The defendant's father while purchasing certain property covenanted to pay off mortgage debt incurred by the plaintiff and also promised to indemnify him if they were made liable for the mortgage debt. The defendant's father failed to pay off the mortgage debt and plaintiff filed an action to enforce the covenant. It was held as the plaintiff had not yet suffered any damage, the suit was premature so far as the cause of action on indemnity was concerned. (Chand Bibi v Santosh Kumar Pal AIR 1933 Cal 641)

A different point of view was held by the Courts in the following cases –

Plaintiff company agreed to act as commission agent for the defendant firm for purchase and sale of "Hessian" and "Gunnies" and charge commission on all such purchases and the defendant firm agreed to indemnify the plaintiff against all losses in respect of such transactions. The plaintiff company purchased certain Hessian from one Maliram Ramjidas. The defendant firm failed to pay for or take delivery of the Hessian. Then Maliram Ramjidas resoled it at lesser price and claimed the difference as damages from the plaintiff company. The plaintiff company went into liquidation and the liquidator filed a suit to recover the amount claimed by Maliram from the defendant firm under the indemnity. The defendant argued that in as much as the plaintiff had not yet paid any amount to Maliram in respect of their liability they were not entitled to maintain the suit under indemnity. It was held negative and decided in plaintiff's favour with a direction that the amount when recovered from the defendant firm should be paid to Maliram Ramjidas. (Osmal Jamal & Sons Ltd. v Gopal Purushotham AIR 1929 Cal 208, 118 Ind Cas 882)

After the landmark deicision in the case of Gajanan Moreshwar v Moreshwar Madan Mantri it has been well established that the liability of the indemnifier commences as soon as the loss of the indemnified becomes absolute, certain or imminent. It is not necessary that the promisee should pay for the loss.

1.4 Rights of Indemnified or Indemnity Holder:

Right Of The Indemnity Holder – (Section 125)

An indemnity holder (i.e. indemnified) acting within the scope of his authority is entitled to the following rights –

- ***Right to recover damages*** – he is entitled to recover all damages which he might have been compelled to pay in any suit in respect of any matter covered by the contract.
- ***Right to recover costs –*** He is entitled to recover all costs incidental to the institution and defending of the suit.
- ***Right to recover sums paid under compromise –*** he is entitled to recover all amounts which he had paid under the terms of the compromise of such suit. However, the compensation must not be against the directions of the indemnifier. It must be prudent and authorized by the indemnifier.
- ***Right to sue for specific performance –*** he is entitled to sue for specific performance if he has incurred absolute liability and the contract covers such liability.

The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor-all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorized him to bring or defend the suit ;all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not

It is important to note here that the right to indemnity cannot be claimed of dishonesty, lack of good faith and contravention of the promisor's request. However, the right cannot be negatived in case of oversight. (Yeung v HSBC)

All damages for which he may be forced to pay in any suit subjected to any matter to which the promise to indemnify is applicable;

All costs which he may be forced to pay in any such suit if, in carrying or protecting it, he didn't negate the commands of the promisor, and went about as it might have been judicious for him to act without any agreement of reimbursement, or if the promisor commissioned him to carry or defend a suit;

Every sum which he may have paid under the terms of any bargain of any such suit, if the bargain was not in spite of the requests of the promisor, and was one which it might have been reasonable for the promisee to make without any agreement of indemnity, or if the promisor sanctioned him to bargain the suit.

1.5 Rights of Indemnifier:

After compensation of the indemnity holder, indemnifier reserves the right to all the ways and means by which the indemnifier could have safeguarded himself from the loss.

2. Contract of guarantee

A contract to perform the obligation or to discharge the liability of a third party in case of its default is called contract of guarantee, (Section 126) Indian Contract Act, 1872.

Guarantee contract includes three parties namely;

- ***Creditor***-The person who is granting the loan
- ***Principal Debtor*** **-** the person who is utilizing the amount of loan is principal debtor
- ***Surety*****-** the person who is giving guarantee is called surety or guarantor or favored debtor

In case of guarantee contract there will be two types of liabilities namely; Primary liability and secondary liability. Primary liability will be with principal debtor and Secondary liability goes to surety.

Example: Y is in need of Rs. 10000/-. Upon guarantee by Z, Y has got the amount from X. Here X, Y and Z are creditor, principal debtor and surety respectively.

Guarantee is constituted with the concurrence of the principle debtor, the creditor and the surety, but that does not mean that there must be evidence showing that the principle-debtor undertook his obligation at the express request of the principle-debtor as implied request will be quiet sufficient to satisfy this requirement. The function of a contract of guarantee is to enable a person to get a loan on goods on credit, or an employment. A contract of guarantee is rendered void without valid consideration (Janaki Paul v. Dhokar Mall Kidarbux, (1935) 156 IC 200)

2.1 The Essentials of a Contract of Guarantee are:

Tripartite Agreement: A contract of guarantee entails three parties, principal creditor, creditor and surety. In a successful contract of guarantee, there must be three separate contracts between the three parties and each and every contract must be consenting.

Liability: Here the main liability lies with the principal debtor. Secondary liability lies with the surety which can only be invoked once the principal debtor defaults on its payment.

Essentials of a Valid Contract: Like any other general contract, it maintains free consent, consideration, lawful object and competency of contracting parties as the essentials of a valid contract.

Medium of Contract: The Indian Contract Act, 1872, does not strictly mention the need for any written form of contract of guarantee. Both oral and written form will suffice.

2.2 Rights of a surety:

As against the Creditor:

1. Right to securities.

- As per section 141, a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into whether the surety knows about the existance of such securty or not; and if the creditor loses or without the consent of the surety parts with such security, the surety is discharged to the extent of the value of the security.

  Illustrations –

- C advances to B, his tenant, 2000/- on the guarantee of A. C also has a further security for 2000/- by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent and C sues A on his guarantee. A is discharged of his liability to the amount of the value of the furniture.
- C, a creditor, whose advance to B is secured by a decree, also receives a guaratee from A. C afterwards takes B's goods in execution under the decree and then without the knowledge of A, withdraws the execution. A is discharged.
- A as surety for B makes a bond jointly with B to C to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

This section recognizes and incorporates the general rule of equity as expounded in the case of *Craythorne vs Swinburne 1807* that the surety is entitled to every remedy which the creditor has against the principal debtor including enforcement of every security.

The expression "security" in section 141 means all rights which the creditor had against property at the date of the contract. This was held by the SC in the case of State of MP vs Kaluram AIR 1967. In this case, the state had sold a lot of felled trees for a fixed price in four equal installments, the payment of which was guaranteed by the defendent. The contract further provided that if a default was made in the payment of an installment, the State would get the right to prevent further removal of timber and the sell the timber for the the realization of the price. The buyer defaulted but the State still did not stop him from removing further timber. The surety was then sued for the loss but he was not held liable.

It is important to note that the right to securities arises only after the creditor is paid in full. If the surety has guaranteed only part of the debt, he cannot claim a proportional part of the securities after paying part of the debt. This was held in the case of Goverdhan Das vs Bank of Bengal 1891.

2. Right of set-off

If the creditor sues the surety, the surety may have the benefit of the set off, if any, that the principal debtor had against the creditor. He is entitled to use the defenses that the principal debtor has against the creditor. For example, if the creditor owes the principal debtor something, for which the principal debtor could have counter claimed, then the surety can also put up that counter claim.

According to the Indian Contract Act, 1872 the following rights-

Sec. 133 – The creditor ought not fluctuate terms of the agreement between the creditor and the principal debtor without the surety's assent. Any such fluctuation releases the surety as to transactions ensuing to the difference. However in the event that the change is for the profit of the surety or does not prefer him or is of an irrelevant character, it might not have the impact of releasing the surety.

Sec. 134 – The creditor ought not discharge the principal debtor from his liability under the agreement. The impact of the release of the principal debtor is to release the surety too. Any enactment or exclusion from the creditor which in law has the impact of releasing the principal debtor puts a close to the liability of the surety.

Sec. 135 -In the event that an agreement is made between the Creditor and Principal debtor for intensifying the last's liability or making a guarantee to him growth of time for doing the commitments or swearing up and down to not to beyond any doubt, releases the surety unless he consents to such an agreement.

As Against the Principal Debtor

1. ***Right of subrogation –*** The surety on making good of the debt obtains a right of subrogation.

- ***Sec. 140 –*** the surety can't assert the right of subrogation to the creditor's securities in the event that he has agreed as a security for a part of the contract and security has been procured by the creditor for the

complete debt.

As per section 140, where a guaranteed debt has become due or default of the principal debtor to perform a duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the princpal debtor. This means that the surety steps into the shoes of the creditor. Whatever rights the creditor had, are now available to the surety after paying the debt.

In the case of *Lampleigh Iron Ore Co Ltd, Re 1927,* the court has laid down that the surety will be entitled, to every remedy which the creditor has against the principal debtor; to enforce every security and all means of payment; to stand in place of the creditor to have the securities transfered in his name, though there was no stipulation for that; and to avail himself of all those securities against the debtor. This right of surety stands not merely upon contract but also upon natural justice.

In the case of *Kadamba Sugar Industries Pvt Ltd vs Devru Ganapathi AIR 1993, Kar* HC held that surety is entitled to the benefits of the securities even if he is not aware of theire existence.

In the case of Mamata Ghose vs United Industrial Bank AIR 1987, Cal HC held that under the right of subrogation, the surety may get certain rights even before payment. In this case, the principal debtor was disposing off his personal properties one after another lest the surety, after paying the debt, seize them. The surety sought for temporary injunction, which was granted.

2. ***Right to Indemnity***

- As per section 145, in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the the principal debtor whatever sum he has rightfully paid under the guarantee but no sums which he has paid wrong fully.

Illustrations –

B is indebted to C and A is surety for the debt. Upon default, C sues A. A defends the suit on reasonable grounds but is compelled to pay the amount. A is entitled to recover from B the cost as well as the principal debt.

In the same case above, if A did not have reasonable grounds for defence, A would still be entitled to recover principal debt from B but not any other costs.

A guarantees to C, to the extent of 2000 Rs, payment of rice to be supplied by C to B. C supplies rice to a less amount than 2000/- but obtains from A a payment of 2000/- for the rice. A cannot recover from B more than the price of the rice actually suppied.

This right enables the surety to recover from the principal debtor any amount that he has paid rightfully. The concept of rightfully is illustrated in the case of *Chekkara Ponnamma vs A S Thammayya AIR 1983*. In this case, the principal debtor died after hire-purchasing four motor vehicles. The surety was sued and he paid over. The surety then sued the legal representatives of the principal debtor. The court required the surety to show how much amount was realized by selling the vehicles, which he could not show. Thus, it was held that the payment made by the surety was not proper.

Rights against co-sureties.

1. Effect of releasing a surety

As per section 138, Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other sureties. A creditor can release a co-surety at his will. However, as held in the case of Sri Chand vs Jagdish Prashad 1966, the released co-surety is still liable to the others for contribution upon default.

2. Right to contribution

As per section 146, where two or more persons are co-surities for the same debt jointly or severally, with or without the knowledge of each other, under same or different contractx, in the absernce of any contract to the contrary, they are liable to pay an equal share of the debt or any part of it that is unpaid by the principal debtor.

Illustrations -

A, B, and C are surities to D for a sum of 3000Rs lent to E. E fails to pay. A, B, and C are liable to pay 1000Rs each.

A, B, and C are surities to D for a sum of 1000Rs lent to E and there is a contract among A B and C that A and B will be liable for a quarter and C will be liable for half the amount upon E's default. E fails to pay. A and B are liable for 250Rs each and C is liable for 500Rs.

As per section 147, co-sureties who are bound in different sums are liable to pay equally as fas as the limits of their respective obligations permit.

Illustrations -

A, B and C as surities to D, enter into three several bonds, each in different penalty, namely A for 10000Rs,

B for 20000 Rs, and C for 30000Rs with E. D makes a default on 30000Rs. All of them are liable for 10000Rs each.

A, B and C as surities to D, enter into three several bonds, each in different penalty, namely A for 10000Rs, B for 20000 Rs, and C for 40000Rs with E. D makes a default on 40000Rs. A is liable for 10000Rs while B and C are liable for 15000Rs each.

A, B and C as surities to D, enter into three several bonds, each in different penalty, namely A for 10000Rs, B for 20000 Rs, and C for 40000Rs with E. D makes a default on 70000Rs. A, B and C are liable for the full amount of their bonds.

3. Differences between guarantee and indemnity

A contract of guarantee always has three parties; they are, the creditor, the principal debtor and the surety; whereas a contract of indemnity has two parties, the indemnifier and the indemnity holder. In a contract of indemnity, the indemnifier assumes primary liability, whereas in a contract of guarantee, the debtor is primarily liable and the surety assumes secondary liability. In indemnity, the contingency present is that of the possibility or risk of suffering loss to which the indemnifier agrees to indemnify; while in guarantee, there is an existing debt or duty whose performance is guaranteed by the surety. In case of indemnity contract, indemnifier's interest lies in earning a commission and a premium whereas in a contract of guarantee, the only interest is guarantee itself. In a contract of indemnity, the indemnifier cannot sue a third party. Surety is entitled to file a suit against the principal debtor in his own name if only he has paid the debt. In a contract of indemnity, there is a single promise or contract; a promise to pay if there is a loss. In a contract of guarantee, by contrast, there are multiple promises, including the original promise to pay or perform and the guarantor's promise to pay or perform in the event of default.

In a case study between, Punjab National Bank Ltd. v. Bikram Cotton Mills and Anr. And Gajan Moreshwar vs. Moreshwar Madan, the difference between guarantee and indemnity is clearly visible. There are three parties here, in the Punjab National Bank case where as only two parties in Gajan Moreshwar. Here Moreshwar Madan was the indemnifier and hence he was the only one liable to make good of the money, whereas in the Punjab National Bank case, the debtor, which is the first respondent company, is the primary liability holder and the secondary liability belongs to the surety which is the respondent. The Privy Council in Gajan Moreshwar case held that the indemnity holder has rights other than those mentioned in the sections mentioned. If the indemnity holder has incurred any liability, he can ask the indemnifier to do well of the liability and Moreshwar Madan was directed by the Privy Council to do well of the indemnity holder, Gajan Moreshwar's, liability. In Punjab National Bank case, there was no risk involved, but there is an existing duty to pay off debts as mentioned in the

sections governing guarantee. Hence irrespective of the presence of risk, the principal debtor and surety has to do well of the debts of the creditor. In Gajan Moreshwar case, Gajan Moreshwar can't sue K.D. Mohan, as it is a contract of indemnity. He can only sue Moreshwar Madan. But in Punjab National Bank case, along with the principal debtor, the surety can also be sued.

However, there is no uniformity on the issue of past consideration. In the case of Allahabad Bank vs S M Engineering Industries 1992 Cal HC, the bank was not allowed to sue the surety in absence of any advance payment made after the date of guarantee. But in the case of Union Bank of India vs A P Bhonsle 1991 Mah HC, past debts were also held to be recoverable under the wide language of this section. In general, if the principal debtor is benefitted as a result of the guarantee, it is sufficient consideration for the sustenance of the guarantee.

Difference between Indemnity Contract and Guarantee Contract

Number of Parties: Indemnity contract includes two parties namely, indemnifier and indemnity holder. But guarantee contract includes three parties namely creditor, Principal debtor and surety.

Number of Contracts: In case of indemnity contract, as there are only two parties, there is possibility for existence of one contract only. But a contract of guarantee includes three sub-contracts.

Nature: As indemnity contract includes two parties and one contract, it can be said that indemnity contract is simple in nature. But guarantee contract includes three parties and three sub-contracts and hence be said that guarantee contract is complex in nature.

Liability: In contract of guarantee there will be two types of liabilities namely; primary and secondary liabilities which will be with principal debtor and surety respectively. But in contract of indemnity there is no classification and sharing of liability where the absolute liability rests with indemnifier.

Recovery: In case of indemnity contract the indemnifier, after compensating indemnity holder`s loss, cannot recover that amount from any person. But in contract of guarantee, if surety makes payment to creditor, he (surety) can recover that amount from principal debtor.

Interest of parties: Indemnity contract gets formed upon indemnifier`s interest and guarantee contract gets formed upon principal debtor`s interest.

4. Discharge of surety

Important circumstances under which a surety is discharged from his liability are given below:

1. Notice of revocation: (Sec. 130)

An 'ordinary guarantee' for a single specific debt or transaction cannot be revoked once it is acted upon. But a 'continuing guarantee' may at any time, be revoked by the surety as to future transactions, by giving notice to the creditor (Sec. 130).

Thus, in such a case, the **liability** of the surety comes to an end in respect of future transaction which may be entered into by the principal debtor after the surety has served the notice of revocation. The surety shall, however, continue to remain liable for transactions entered into prior to the notice.

2. Death of surety (Sec. 131):

In case of a 'continuing guarantee' the death of a surety also discharges him from liability as regards transactions after his death, unless there is a contract to the contrary. The deceased surety's estate will not be liable for any transaction entered into after the death, even if the creditor has no notice of the death.

3. Variance in terms of contract (Sec. 133):

"Any variance, made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance."

Although the words "as to transactions subsequent to the variance" are more pertinent in the case of 'continuing guarantee', but the principle as laid down in the Section is equally applicable in 'specific guarantee' as well.

Thus a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor (no matter whether the variation is beneficial to the surety or is made innocently or does not materially affect the position of the surety) because a surety is liable only for what he has undertaken in the contract. "Surety has a right to say:

The contract is no longer that for which I engaged to be surety; you have put an end to the contract that I guaranteed, and my obligation, therefore, is at an end". It is important to note that mere knowledge and silence of the surety does not amount to an implied consent (Polak vs Everett). Again, accepting further security for the same debt is not treated as variance in terms of contract.

Illustrations:

(Appended to Sec. 133). (a) C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's duly accounting for moneys received by him as such clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. A is not liable for subsequent misconduct of B.

(b) C contracts to lend B Rs 5,000 on the first March. A guarantees, repayment. C pays the 5,000 rupees to B on the first January. A is discharged from his liability, as the contract has been varied in as much as C might sue B for the money before the first of March.

4. Release or discharge of principal debtor (Sec. 134):

This Section provides for the following two ways of discharge of surety from liability:

(a) The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released. Any release of the principal debtor is a release of the surety also.

(b) The surety is also discharged by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Illustrations:

(Appended to Sec. 134). (a) A gives a guarantee to C for goods to be supplied by C to B. C supplies good to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his surety ship.

(b) A contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his surety ship (because the contract stands discharged against A, the contractor).

If the principal debtor is released by a compromise with the creditor, the surety is discharged but if the principal debtor is discharged by the operation of insolvancy laws, the surety is not discharged. This was held in the case of Maharashtra SEB vs Official Liquidator 1982.

5. Arrangement by creditor with principal debtor without surety's consent (Sec. 135):

Where the creditor, without the consent of the surety, makes an arrangement with the principal debtor for composition, or promises to give him time or not to sue him, the surety will be discharged.

But in the following cases, a surety is not discharged:

(a) Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with principal debtor, the surety is not discharged (Sec. 136).

Illustration (To Sec. 136):

C, the holder of an overdue bill of exchange drawn by A as surety for B and accepted by B, contracts with M to give time to B. A is not discharged.

(b) Mere forbearance on the part of the creditor to sue the principal debtor, or to enforce any other remedy against him, does not discharge the surety, unless otherwise agreed (Sec. 137).

Illustration (To Sec. 137):

B owes to C a debt guaranteed by A. The debt becomes payable, C does not sue B for a year after the debt has become payable. A is not discharged from the surety ship.

(c) Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other sureties (Sec. 138).

It must be noted that forbearing to sue until the expiry of the period of limitation has the legal consequence of discharge of the principal debtor and thus as per section 134, will cause the surety to be discharged as well. If section 134 stood alone, this inference was correct. However, section 137 explicitly says that mere forbearance to sue does not discharge the surety. This contradiction was removed in the case of Mahanth Singh vs U B Yi by Privy Council. It held that failure to sue the principal debtor until recovery is banned by period of limitation does not discharge the surety.

6. Creditor's act or omission impairing sureties eventual remedy (Sec. 139):

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

In short, it is the duty of the creditor to do every act necessary for the protection of the rights of the surety and if he fails in this duty, the surety is discharged.

Thus, where the integrity of a cashier is guaranteed, it is the duty of the employer to give information to the surety if any dishonest act is done by the employee.

If the employer continues to employ him after an act of dishonesty (which is proved), the surety is discharged, if he is not informed within a reasonable time, because then the surety's right (eventual remedy) to inform police for necessary recovery action is lost or damaged, i.e., may not be so fruitful as it would have been, had a report been lodged earlier.

Illustrations:

(Appended to Sec. 139). (a) B contracts to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages, (the last instalment not to be paid before the completion of the ship).

A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments. A is discharged by this prepayment.

(b) A puts A/as an apprentice to B and gives a guarantee to B for A is fidelity. B promises on his part that he will, at least once a month, see M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

In the case of State Bank of Saurashtra vs Chitranjan Ranganath Raja 1980, the bank failed to properly take care of the contents of a godown pledged to it against a loan and the contents were lost. The court held that the surety was not liable for the amount of the goods lost.

Creditor's duty is not only to take care of the security well but also to realize it proper value. Also, before disposing of the security, the surety must be informed on the account of natural justice so that he can have the option to take over the security by paying off the debt. In the case of Hiranyaprava vs Orissa State Financial Corp AIR 1995, it was held that if such a notice of disposing off of the security is not given, the surety cannot be held liable for the shortfall.

However, when the goods are merely hypothecated and are in the custody of the debtor, and if their loss is not because of the creditor, the suerty is not discharged of his liability.

7. Loss of security (Sec. 141):

If the creditor loses or, without the consent of the surety, parts with any security given to him, at the time of the contract of guarantee, the surety is discharged from liability to the extent of the value of security. The word 'loss' here means loss because of carelessness or negligence.

Thus if the security is lost due to an act of God or enemies of the state or unavoidable accident, the surety would not be discharged. Again, if the securities lost or parted with, were obtained afterwards as a further security, the surety would not be discharged (Bhushayya vs Suryanarayan).

8. Invalidation of the contract of guarantee (in between the creditor and the surety) (Sees. 142 and 143):

A surety is also discharged from liability when the contract of guarantee (in between the creditor and the surety) is invalid. A contract of guarantee is invalid in the following cases:

(i) Where the guarantee has been obtained by means of misrepresentation or fraud or keeping silence as to material part of the transaction, by the creditor or with creditor's knowledge and assent (Sees. 142 and 143). Notice that under these Sections the guarantee remains valid if the misrepresentation or concealment is done by the debtor without the concurrence of the creditor.

Illustrations:

(Appended to Sec. 143). (a) A engages B as clerk to collect money for him. B fails to account for some of his receipts, and A, in consequence, calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

(b) A guarantees to C payment for iron to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt.

This agreement is concealed from A. A is not liable as a surety.

(ii) Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join (Sec. 144).

(iii) Where it lacks one or more essential elements of a valid contract, e.g., surety is incompetent to contract or the object is illegal.

5. Similarities

Guarantees and indemnities have numerous similar attributes. By and large likewise, similar obligations and rights emerge between the parties. This will have impact particularly throughout the time of looking to authorize the agreement. Contracts of indemnity and contracts of guarantee impart certain central commonality. In every contract, one party consents to pay in the interest of another. Also each of these categories of contracts is utilized as a safeguard against misfortunes by people and organizations. One more point of similarity worth

mentioning is that they cannot be used to make unjust enrichments. In a comparative study between Punjab National Bank Ltd. v. Bikram Cotton Mills and Anr and Gajan Moreshwar vs. Moreshwar Madan, it can be seen, that both guarantee and indemnity are used to compensate the creditor and indemnity holder respectively and the principal debtor and surety in the Punjab National Bank case s well as the indemnifier had consented to pay to make good of the debt.

6. Extent of suriety liability

As per section 128, the liability of a surety is co-extensive with that of the principal debtor, unless it is otherwise provided in the contract.
Illustration - A guaratees the payment of a bill by B to C. The bill becomes due and B fails to pay. A is liable to C not only for the amount of the bill but also for the interest.

This basically means that although the liability of the surety is co-extensive with that of the principal debtor, he may place a limit on it in the contract. Co-extensive implies the maximum extent possible. He is liable for the whole of the amount of the debt or the promises. However, when part of a debt was recovered by disposing off certain goods, the liability of the surety is also reduced by the same amount. This was held in the case of Harigopal Agarwal vs State Bank of India AIR 1956.

The surety can also place conditions on his guarantee. Section 144 says that where a person gives guarantee upon a contract that the creditor shall not act upon it untill another person has joined it as co-surety, the guarantee is not valid if the co-surety does not join. In the case of National Provincial Bank of England vs Brakenbury 1906, the defendant signed a guarantee which was supposed to be signed by three other co-surities. One of them did not sign and so the defendant was not held liable.

Similarly, a surety may specify in the contract that his liability cannot exceed a certain amount. However, where the liability is unconditional, the court cannot introduce any conditions. Thus, in the case of Bank of Bihar Ltd. vs Damodar Prasad AIR 1969, SC overruled trial court's and high court's order that the creditor must first exhaust all remedies against the principal debtor before suing the surety.

7. Continuing Guarantee

As per section 129, a guarantee which extends to a series of transactions is called a continuing guarantee. Illustrations. -

1. A, in consideration that B will employ C for the collection of rents of B's zamindari, promises B to be responsible to the amount of 5000/- for due collection and payment by C of those rents. This is a continuing guarantee.

2. A guarantees payment to B, a tea-dealer, for any tea that C may buy from him from time to time to the amount of Rs 100. Afterwards, B supplies C tea for the amount of 200/- and C fails to pay. A's guarantee is a continuing guarantee and so A is liable for Rs 100.

3. A guarantees payment to B for 5 sacks of rice to be delivered by B to C over the period of one month. B delivers 5 sacks to C and C pays for it. Later on B delivers 4 more sacks but C fails to pay. A's guarantee is not a continuing guarantee and so he is not liable to pay for the 4 sacks.

Thus, it can be seen that a continuing guarantee is given to allow multiple transactions without having to create a new guarantee for each transaction. In the case of Nottingham Hide Co vs Bottrill 1873, it was held that the facts, circumstances, and intention of each case has to be looked into for determining if it is a case of continuing guarantee or not.

7.1 **Revocation of Continuing Guarantee**

As per section 130, a continuing guarantee can be revoked at any time by the surety by notice to the creditor.

Once the guarantee is revoked, the surety is not liable for any future transaction however he is liable for all the transactions that happened before the notice was given.

Illustrations

1. A promises to pay B for all groceries bought by C for a period of 12 months if C fails to pay. In the next three months, C buys 2000/- worth of groceries. After 3 months, A revokes the guarantee by giving a notice to B. C further purchases 1000 Rs of groceries. C fails to pay. A is not liable for 1000/- rs of purchase that was made after the notice but he is liable for 2000/- of purchase made before the notice. This illustration is based on the old English case of Oxford vs Davies.

In the case of Lloyd's vs Harper 1880, it was held that employment of a servant is one transaction. The guarantee for a servant is thus not a continuing guarantee and cannot be revoked as long as the servant is in the same employment. However, in the case of Wingfield vs De St Cron 1919, it was held that a person who guarateed the rent payment for his servant but revoked it after the servant left his employment was not liable for

the rents after revocation.

2. A guarantees to B, to the amount of 10000 Rs, that C shall pay for the bills that B may draw upon him. B draws upon C and C accepts the bill. Now, A revokes the guarantee. C fails to pay the bill upon its maturity. A is liable for the amount upto 10000Rs.

As per section 131, the death of the surety acts as a revocation of a continuing guarantee with regards to future transactions, if there is no contract to the contrary.

It is important to note that there must not be any contract that keeps the guarantee alive even after the death. In the case of Durga Priya vs Durga Pada AIR 1928, Cal HC held that in each case the contract of guarantee between the parties must be looked into to determine whether the contract has been revoked due to the death of the surety or not. If there is a provision that says death does not cause the revocation then the constract of guarantee must be held to continue even after the death of the surety.

8. Conclusion

An indemnity, by contrast, accommodates simultaneous obligation with the principal although and there is no compelling reason to "look first" at the principal. Generally it is an agreement that the surety will hold the lender innocuous against all misfortunes emerging from the agreement between the principal and the lender. Generally, a guarantee accommodates an obligation far-reaching with that of the principal. At the end of the day, the guarantor can't be at risk for much more than the client. The document will be understood as a guarantee if, on its actual development, the commitments of the surety are to "remained behind" the principal and just go to the fore once a commitment has been broken as between the principal and the lender. The commitment is an auxiliary one, reflexive in character. An indemnity emerges on event of an occasion, whereas a guarantee emerges on default by a third party. Hence we have explained what indemnity and guarantee means and on what grounds they differ on like the number of parties involved and the nature of risks involved and we have also worked upon the small but significant differences both in working and in principal between guarantee and indemnity. Therefore, though guarantee and indemnity have a few similarities, they are inherently different in nature.

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Unit II

1. Introduction

A 'bailment' is the delivery of goods by one person to another for some purpose upon a contract that they shall, when the purpose is accomplished, be returned or disposed of according to the directions of the person delivering them. The person delivering the goods is called the 'bailor' and the person to whom the goods are delivered is called the 'bailee'. The examples of a contract of bailment are: delivering a watch or radio for repair; leaving a car or scooter at a parking stand; leaving luggage in a cloak room; delivering gold to a goldsmith for making ornaments; leaving garments with a dry cleaner and so on. The essence of bailment is the transfer of possession. The ownership remains with the owner. There cannot be a bailment of immovable property. A 'pledge' is a bailment of goods wherein the goods are delivered as a security for payment of a debt or performance of a promise. The bailor is called the 'pledgor' or 'pawnor' and the bailee is called the 'pledgee' or 'pawnee'. Thus, pledge is a special kind of bailment. Pledge can be made only of movable properties. In order to make the pledge legally valid it is essential that the pledgor has the legal right or title to retain the goods.

2. Unit Objective

Understand the meaning of bailment and kinds thereof understand various duties of bailee and bailor Know the rights of bailors and bailee against wrong-doers. Understand the circumstances under which a contract of bailment terminates to know the duties and rights of finder of lost goods Understand the meaning of pledge and distinction between bailment and pledge Know responsibilities and duties of pawnee and pawnor.

3. Bailment

3.1 Definition

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

The person delivering the goods is called the 'bailor,' the person to whom they are delivered is called the 'bailee,' and the transaction is called the 'bailment.' A 'bailment' is thus a delivery of goods on condition that the recipient shall ultimately restore them to the bailor or dispose of them according to the directions of the

bailor. Common examples of bailment are hiring of goods, furniture or a cycle, delivering of cloth to a tailor for making a suit, delivering a watch or scooter for repair, depositing goods for safe custody, *etc*.

Essential features. From the definition given by Section 148 it follows that a bailment has the following characteristic features:

- It is a delivery of *movable goods* by one person to another person (not being his servant).

Section 149 explains the mode of delivery to the bailee and states that the delivery of goods may be either 'actual' or 'constructive'. When the bailor hands over to the bailee physical possession of the goods that is called 'actual delivery.' 'Constructive delivery,' on the other hand, does not involve handing over the physical possession, but something is done which has the effect of putting the goods in the possession of the bailee. For example, goods stored in a godown can be delivered by handing over the key of the godown, or goods in transit, e.g., when they are at sea or on a railway, can be delivered by handing over the bill of lading or the railway receipt representing the goods.

- The goods are delivered for some purpose. When goods are delivered by mistake without any purpose, there is no bailment within the meaning of its definition in Section 148.
- The goods are delivered subject to the condition that when the purpose is accomplished *the goods are to be returned in specie or disposed of* according to the directions of the bailor, either in their original form or in an altered form.

It is to be emphasised that bailment is concerned with only movable goods. Money is not included in the category of movable goods. Thus a deposit of money with a banker is not a bailment because there is no obligation to return the identical money. But if notes and coins are deposited in a box for safe custody, it is a bailment as they are to be returned in specie.

3.2 Kinds of Bailment

Bailment may be classified from the point of view of (i) benefit, and (ii) reward to the parties.

Kinds from 'benefit' point of view.

From 'benefit' point of view, bailments can be grouped into three classes;

1. *Bailment for the exclusive benefit of the bailor,* e.g., bailor leaves goods in the safe custody of the bailee without any compensation to be paid.

2. *Bailment for the exclusive benefit of the bailee,* e.g., a loan of some article. Thus where *A* borrows *B*'s fountain pen to use in the examination hall, the bailment is for the sole benefit of *A*, the bailee.
3. *Bailment for the mutual benefit of the bailor and the bailee*. It is the most common type of bailment. Contracts for repair, hire, etc., fall within this class, wherein the bailor receives the benefit of service and the bailee benefits by the receipt of the agreed charges.

Kinds from 'reward' point of view.

Bailments may also be classified on the basis of 'reward' into:

1. *Gratuitous bailment.* It is one in which neither the bailor nor the bailee is entitled to any remuneration, e.g., loan of a book to a friend, depositing of goods for safe custody without any charge.
2. *Non-gratuitous bailment*. It is also called as a 'bailment for reward.' Here, either the bailor or the bailee is entitled to a remuneration, e.g., motor car let out for hire, cloth given for tailoring for charges.

Consideration in Relation to Gratuitous Bailments

There arises a necessity of discovering a consideration to support a contract of bailment where it is 'for the exclusive benefit of the bailor' or 'for the exclusive benefit of the bailee,' that is, where it is a gratuitous bailment. Perhaps viewing such a transaction as a whole very carefully shall enable us to see how the doctrine of consideration is satisfied. "The detriment suffered by the bailor in parting with the possession of the goods is suffi-cient consideration to support the promise on the part of the bailee to return the goods."

3.3 Difference between 'Sale' and 'Bailment'

In the case of a 'sale' the ownership is transferred to the buyer and the buyer is under no obligation to return the goods, but in the case of a 'bailment' the ownership in goods is not transferred to the bailee and he is bound to return the goods in specie.

The *explanation* to Section 148 points out that 'if a person already in possession of the goods of another, contracts to hold them as a bailee, he thereby becomes the bailee, and the owner (i.e., *the* buyer) becomes the bailor although such goods may not have been delivered by way of bailment.' Thus, where *A* sells a cycle to *B* but *B* leaves it in *A*'s possession till The completes his other shopping, *A* becomes a bailee although originally he was the owner.

3.4 Difference between 'Bailment' and 'License'

A contract of 'license' is that under which one party is permitted to place his goods in the premises belonging to the other party. It is to be noted that in a contract of license, there is no delivery of goods to the licenser. The licenser merely permits the licensee to use the licenser's place for keeping the licensee's goods. Thus, in a contract of license the goods are not delivered to the licenser, while in bailment the goods are delivered to the bailee and the bailee is responsible for their safety.

Illustration. *A* went to see a horse race. He parked his car in a field belonging to a farmer, who gave a ticket to him. After the race was over, *A* returned to the field and found that the car had been stolen. *A* filed a suit against the farmer. In defence the farmer argued that he was not the bailee of the car and therefore he was under no obligation to look after the safety of the car. He had merely permitted *A* to use his field for parking the car. It was held, that this was a contract of license and not of bailment and the farmer was under no obligation to look after *A*'s car. The car had not been delivered to the farmer, as such he was not liable for any damage or penalty. (Of course the licenser should not be a party to the theft, i.e., he should not cooperate with the thieves).

3.5 Duties of Bailee

A bailee is the person to whom the goods are delivered. His duties are as follows:

1. **Duty to take reasonable care of goods delivered to him**. Section 151 lays down this duty, thus, "In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed." In other words the bailee must take *reasonable care* of goods — namely the care which an average prudent man can be expected to take care of his own goods in similar circumstances.

The bailee is not an insurer of goods bailed to him. If in spite of reasonable care, the goods are lost or destroyed or deteriorated, without any negligence on his part, he is not liable in respect of any damage to the goods. It is open to parties to increase or decrease the obligations of the bailee in the matter of care by special contract. In the absence of any special contract, the standard of reasonable care will apply (Sec. 152). Even where the

Liability of the bailee is increased so as to keep the goods safe from thefts or accidents, he will not be liable for loss caused by State enemies or, by an act of God, e.g., fire, lightning, flood, etc., or by communal riots (*Sunder* vs *Ram Swarup*.

It is important to note that under this duty of reasonable care, the bailee is also bound to take reasonable steps to recover the goods if they have been stolen. Thus, where some goods were stolen from the bailee's custody without his fault, but he made no efforts whether by informing the owner or the police to recover them, he was held liable (*Coldman* vs *Hill*[2]). Also note that the degree of care required from the bailee is the same whether the bailment is gratuitous or for reward.

2. **Duty not to make unauthorised use of goods entrusted to him** (Sec. 154). It is the duty of the bailee to use the goods strictly in accordance with the terms of the bailment. If he makes an unauthorised use of the goods, he is liable to make compensation to the bailor for any damage arising to the goods from or during such use of them. This liability is absolute. It arises even if the bailee is not guilty of any negligence, or the damage is the result of an act of God or inevitable accident. In addition, as per Section 153, the bailor can also terminate the bailment if the bailee makes an unauthorised use of goods.

Illustrations. (a) *A* hired a horse for the purpose of riding to the Exhibition ground. On the Exhibition ground the horse was frightened by the crowd and ran into a ditch and injured itself. The bailee (i.e., *A*) of the horse was not to be blamed for accident. He is not liable for the injury to the horse.

(b) *A* hired a horse for the purpose of riding to the Exhibition ground. But later on he went riding in a different direction in violation of the contract. During the ride the horse became frightened and ran into a ditch and injured itself. *A*, the hirer, was not to be blamed for the accident, but he is liable to the bailor for the injury to the horse, because he made an unauthorized use of the horse.

(c) *A* lends a horse to *B* for his own riding only. *B* allows *C*, a member of his family, to ride the horse. *C* rides with care, but the horse accidently falls and is injured. *B* is liable to make compensation to *A* for the injury done to the horse. [Illustration (a) to Section 154]

(d) *A* goldsmith accompanied by his wife went from his village to another village to attend a marriage. The goldsmith took with him some ornaments entrusted to his care by customers. The object was to enable his wife to wear the ornaments at the marriage. On the way a gang of robbers attacked them and took away all their goods including the ornaments. The goldsmith was held liable to the customers for the price of ornaments because he had made an unauthorised use of the goods entrusted to his care.

3. **Duty not to mix goods bailed with his own goods**. It is also the duty of a bailee that he should not mix his own goods with those of the bailor, without bailor's consent. If the goods are mixed with the consent of the bailor, there is no breach of duty and the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced (Sec. 155) . But if the bailee, without the consent of the bailor, mixes up his own goods with those of the bailor, whether intentionally or accidentally, the following rules apply:

Where the goods can be separated or divided, the property in the goods remains in the parties respectively, but the bailee is bound to bear the expenses of separation as well as any damage arising from the mixture (Sec. 156).

Illustration (to Sec. 156). *A* bails 100 bales of cotton marked with a particular mark to *B*. *B*, without *A's* consent, mixes the 100 bales with other bales of his own, bearing a different mark. *A* is entitled to have his 100 bales returned, and *B* is bound to bear all the expenses incurred in the separation of the bales, and any other incidental damage.

(b) Where the goods mixed cannot be separated, the bailee must compensate the bailor for his loss (Sec. 157).

Illustration (to Sec. 157). *A* bails a barrel of Cape flour worth Rs 45 to *B*. *B*, without *A*'s consent mixes the flour with country flour of his own, worth only Rs 25 a barrel. *B* must compensate *A* for the loss of his flour.

4. **Duty to return the goods**. Section 160 lays down this duty in the following terms: "It is the duty of the bailee to return, or deliver, according to the bailor's directions the goods bailed, without demand, as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished." Where there are several joint bailors, the bailee may return the goods to any one of the joint owners (Sec. 165).

When the bailee fails to return the goods at the proper time, he becomes responsible to the bailor for any loss, destruction or deterioration of the goods from that time (Sec. 161). It is important to note that if the goods are not returned at proper time, the bailee is liable for the loss occurring thereafter even without his negligence, i.e., by an act of God. Of course, this is in addition to the bailee's liability for ordinary damages for breach of contract of bailment.

Illustration. *A* hires a horse from *B* for one week. But *A* defaults in returning the horse on the due date. The horse dies one day after the expiry of the period of bailment without any fault on *A*'s part. *A* is liable for the

price of the horse to *B*, along with damages for the delay. (If the horse dies within one week, i.e., before the expiry of the period of bailment without *A*'s negligence, *A* is not liable for the price.)

5. **Duty to deliver any accretion to the goods** (Sec. 163) . It is the duty of the bailee to deliver to the bailor any natural increase or profit accruing from the goods bailed, unless there is a contract to the contrary.

Illustration (appended to Sec. 163). *A* leaves a cow in the custody of *B* to be taken care of. The cow has a calf. *B* is bound to deliver the calf as well as the cow to *A*.

3.6 Duties of Bailor

A bailor is the person who delivers the goods. His duties are as follows:

1. **Duty to disclose faults in goods bailed**. Section 150 lays down this duty. The Section makes a distinction between a gratuitous bailor and a bailor for reward and provides as follows:

A gratuitous bailor is bound to disclose to the bailee all those faults in the goods bailed, *of which he is aware* and which materially interfere with the use of them, or expose the bailee to extraordinary risks, and if he fails to do so, he will be liable to pay such damages to the bailee as may have resulted directly from the faults. A gratuitous bailor will not be liable for damages arising to the bailee from defects of which he was ignorant.

Illustration (to Sec. 150). *A* lends a horse, which he knows to be vicious, to *B*. He does not disclose the fact that the horse is vicious. The horse runs away. *B* is thrown and injured. *A* is responsible to *B* for damage sustained.

(b) A bailor for reward is responsible *for all defects* in the goods bailed whether he is aware of the defects or not, if he does not disclose them to the bailee. Unlike a gratuitous bailor, ignorance of the defects is no defence for him.

Illustration (to Sec. 150). *A* hires a carriage of *B*. The carriage is unsafe though *B* is not aware of it, and *A* is injured. *B* is responsible to *A* for the injury. (If the carriage were lent gratuitously, *B* would not be liable under the circumstances. Similarly, had *B* told the fault to *A*, then also he would not be liable.)

It may be mentioned that where the goods bailed are of dangerous nature, it is the duty of the bailor to disclose the fact to the bailee otherwise he will be liable for all the resulting damage (*Great Northern Rly.* Vs *L.E.P.*

Transport Ltd.[3]). For example, *A* delivers to *B*, a Carrier, some explosives in a case but does not warn *B*. The case is handled without extra care necessary for such articles and there is an explosion. The carrier is injured and some other goods are damaged. *A*, the bailor, is liable for all the resulting damage.

2. **Duty to repay necessary expenses in case of gratuitous bailment** (Sec. 158). Where, by the conditions of the bailment, the goods are to be kept or to be carried or to have work done upon them by the bailee for the bailor, and the bailee is to receive no remuneration, it is the duty of the bailor to repay all the necessary expenses incurred by the bailee for the purpose of the bailment. Thus where a horse is bailed without reward for safe custody, it is the duty of the bailor to reimburse the bailee for usual feeding expenses of the horse as well as for the medical expenses, if any.
3. **Duty to repay any 'extraordinary' expenses in case of non-gratuitous bailment.**

Where under the terms of the bailment, the bailee is to receive remuneration for his services, it is the duty of the bailor to bear *extraordinary expenses*, if any, incurred by the bailee in relation to the thing bailed. In such a bailment the bailor is not to bear the ordinary or usual expenses. Thus where a horse is bailed for safe custody and the bailee is to receive Rs 80 per day as custody charges, the bailor is not liable to repay the bailee the ordinary expenses of feeding the horse. But if during the bailee's custody the horse falls ill without any negligence on his part, the bailor must repay the bailee the medical expenses incurred in connection with the treatment of the horse, these being extraordinary expenses.

4. **Duty to indemnify bailee** (Sec. 164). A bailor is also bound to indemnify the bailee for any loss suffered by the bailee, by reason of the fact that the bailor was not entitled to bail the goods because of the defective title.

Illustration. *A* gives his neighbour's scooter to *B* for use without the neighbour's permission. The neighbour sues *B* and receives compensation. *A* is bound to indemnify *B* for his losses.

5. **Duty to receive back the goods**. It is the duty of the bailor to receive back the goods when the bailee returns them after the time of bailment has expired or the purpose of bailment has been accomplished. If the bailor refuses to take delivery of goods when it is offered at the proper time, the bailee can claim compensation for all necessary expenses of, and incidental to, the safe custody.

3.7 Rights of Bailee

1. **Enforcement of bailor's duties**. The duties of the bailor are the rights of the bailee. As such, the bailee can, by suit, enforce the duties of the bailor enumerated above. To recapitulate, the bailee has the following rights against the bailor (based on the bailor's duties discussed above):

- Right to claim damages for loss arising from the undisclosed faults in the goods bailed (Sec. 150).
- Right to claim reimbursement for extraordinary expenses incurred in relation to the thing bailed (Sec. 158).
- Right to indemnity for any loss suffered by him by reason of defective title of the bailor to the goods bailed (Sec. 164).

Right to claim compensation for expenses incurred for the safe custody of the goods if the bailor has wrongfully refused to take delivery of them after the term of bailment is over.

2. **Right to deliver goods to one of several joint bailors** (Sec. 165). Where goods have been bailed by several joint owners, the bailee has a right to deliver them to, or according to the directions of, one joint owner without the consent of all, in the absence of any agreement to the contrary.

3. Right to deliver goods, in good faith, to bailor without title (Sec. 166). The bailee has a right to deliver the goods, in good faith, to the bailor without title, without incurring any liability towards the true owner.

4. Right of lien. The right to retain possession of the property or goods belonging to another until some debt or claim is paid, is called the right of lien. The right depends on possession and is lost as soon as possession of the goods is lost. As such it is also called as 'possessory lien.' Liens may be of two types—'particular' and 'general.'

'Particular lien' means the right to retain only that particular property in respect of which the charge is due. 'General lien' means the right to retain all the goods of the other party until all the claims of the holder against the party are satisfied. In other words, this is a right to retain the goods of another as a security for a general balance of account.

3.8 Bailee's particular lien.

Section 170 confers the right of particular lien upon a bailee and provides that "where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the services he has rendered in respect of them".

Thus a bailee has a particular lien when the following conditions are fulfilled:

i. The bailee must have rendered some service in relation to the thing bailed and must be entitled to some remuneration for it, which must not have been paid.
ii. The service rendered by the bailee must be one involving the exercise of labour or skill in respect of the goods bailed, *so as to confer an additional value on the article*.

Illustration [(a) appended to Sec. 170]. *A*, delivers a rough diamond to *B*, a jeweller, to be cut and polished which is accordingly done. *B* is entitled to retain the stone till he is paid for the services he has rendered. (Jeweller's labour and skill must have enhanced the value of the stone.)

It is to be emphasised that there is no lien if the labour and skill exercised by the bailee does not improve the value of the goods bailed. Thus a person who takes a horse for feeding and keeping at his stable has no lien for his charges because no additional value has been added to the horse by his labour (*Hutton* vs *Car Maintenance Co.*[4]) . Similarly, there is no lien for safe custody charges because there is no exercise of labour or skill (*Vithoba* vs *Maruthi*[5]). In such cases the bailee can only sue the bailor for the charges due.

The services must have been performed in full in accordance with the directions of the bailor, within the agreed time or a reasonable time.

Illustration. *A* gives his watch to *B* for repair. *B* promises *A* to deliver the watch on the third day. But *B* takes one week to repair it, *B* is not entitiled to retain the watch until he is paid.

There must not be an agreement to perform the service on credit.

Illustration [(b) appended to Sec. 170]. *A* gives cloth to *B*, a tailor, to make into a coat. *B* promises *A* to deliver the coat as soon as it is finished, and to give a three months' credit for the price. *B* is not entitled to retain the coat until he is paid.

- The goods must be in possession of the bailee. If possession is lost, the lien is also lost.

If all the above mentioned conditions are satisfied, the bailee can exercise his right of particular lien until he is paid for his services.

The following points must also be noted in connection with the bailee's particular lien:

i. The bailee retaining the article to enforce his lien cannot charge for keeping it.
ii. The bailee cannot exercise his lien for the non-payment of extraordinary expenses incurred in relation to the thing bailed. He should sue for them.
iii. Besides the bailee, other persons who are entitled to exercise the right of particular lien are: finder of goods (Sec. 168), pawnee (Secs. 173-174), agent (Sec. 221), and unpaid seller (Sec. 47 of the Sale of Goods Act).

3.9 Bailee's general lien.

As observed earlier, a general lien is a right to retain the goods of another as a security for a general balance of account. In simple words, this right entitles a person to retain possession of any goods belonging to another for any amount due to him whether in respect of those goods or any other goods. For example, if two loans have been taken against two securities from a banker and the borrower repays one of these loans, the banker may detain both securities until his other loan is paid.

According to Section 171, bailees coming within the following categories have a 'general lien,' in the absence of a contract to the contrary:

Bankers. A banker has a general lien on all goods, cash, cheques and securities deposited with him as banker by a customer, for any money due to him as a banker. Thus, where a customer has a credit balance in one account of the bank and at the same time he owes money to the bank on another account, the banker's general lien entitles him to refuse the customer to operate the account in which he has a credit balance till he clears the debt due to the bank (*Davendra Kumar* vs *Chaudhary Gulab Singh*). But where valuables and securities are deposited for a specific purpose, e.g., for safe custody, the banker has no general lien on them as the acceptance of the goods for a special purpose impliedly excludes general lien (*Cuthbert* vs *Robarts*).

Factors. A factor is an agent entrusted with the possession of goods in the ordinary course of his business for the purpose of sale. He has a general lien on the goods of his principal, if any money is due to him by his principal whether for advances made or for remuneration.

Wharfingers. A wharfinger has a general lien on the goods as regards charges due for the use of wharf against the owner of the goods.

Attorneys of High Court. An attorney or solicitor of a High Court has a general lien on all papers and documents belonging to his client which are in his possession in his professional capacity until the fee for his professional service and other cost incurred by him are paid. But if the solicitor refuses to act any more for the client, he is not entitled to any lien.

Policy brokers. They can retain the policy of fire or marine insurance for their brokerage.

Any other person, if there is an express contract to that effect.

3.10 Rights of Bailor

1. Enforcement of bailee's duties. The duties of the bailee are the rights of the bailor. The bailor can enforce by suit all the duties of the bailee (already discussed) as his Rights. To recapitulate, the bailor has the following rights against the bailee (based on the bailee's duties discussed earlier): Right to claim damages for loss caused to the goods bailed by bailee's negligence (Sec. 151). Right to claim compensation for any damage arising from or during unauthorised use of the goods bailed (Sec. 154). Right to claim compensation for any loss caused by the unauthorised mixing of goods bailed with his own goods (Secs. 155-156). Right to demand return of goods as soon as the time for which they were bailed has expired, or the purpose for which they were bailed has been accomplished (Sec. 160). Right to claim any natural accretion to the goods bailed (Sec. 163).

2. Right to terminate bailment if the bailee uses the goods wrongfully (Sec. 153). The bailor has a right to terminate the bailment, if the bailee does, with regard to the goods. Bailed, any act which is inconsistent with the terms of the bailment, although the term of bailment has not expired or the purpose of bailment has not been accomplished.

Illustration (to Sec. 153). *A* gives on hire to *B* a horse for his own riding. *B* drives the horse in his carriage. The contract of bailment is voidable at the option of *A*.

3. **Right to demand return of goods at any time in case of gratuitous bailment**

(Sec. 159). When the goods are lent without reward (i.e., gratuitously), the bailor can demand their return whenever he pleases even though he lent them for a specified purpose or time and the bailee is not guilty of wrongful use. But if the premature return of goods causes the bailee loss in excess of benefit actually derived by him from the use of such goods, the bailor must indemnify the bailee for the amount in which the loss occasioned exceeds the benefit derived.

4. Rights of Bailors and Bailees against Wrong-doers

If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against the wrong-doer for such deprivation or injury (Sec. 180). Whatever is obtained by way of relief or compensation in any such suit, is to be apportioned, as between the bailor and the bailee, according to their respective interests (Sec. 181). For example, if somebody forcefully takes possession of a coat from a tailor's shop, then either the tailor or the owner of the coat may sue the wrong-doer. If the tailor files the suit, he shall hand over the recovered amount, after deducting his tailoring charges, to the owner of the coat.

3.11 Termination of Bailment

A contract of bailment terminates under the following circumstances:

- If the bailment is for a 'specified period,' the bailment terminates as soon as the stipulated period expires.
- If the bailment is for a 'specific purpose,' the bailment terminates as soon as the purpose is fulfilled.
- If the bailee does any act with regard to the goods bailed, which is inconsistent with the terms of bailment, the bailment may be terminated by the bailor even though the term of bailment has not expired or the purpose of bailment has not been accomplished (Sec. 153).

A gratuitous bailment can be terminated by the bailor at any time, even before the specified time or before the purpose is achieved, subject to the limitation that where such termination causes loss in excess of benefit actually derived by the bailee, the bailor must indemnify the bailee for the amount in which the loss occasioned exceeds the benefit derived (Sec. 159). A gratuitous bailment is terminated by the death either of the bailor or of the bailee (Sec. 162).

3.12 FINDER OF LOST GOODS

A finder of lost goods is under no obligation to take charge of the goods when he comes across. But if he does take the charge of the goods, he becomes responsible for the goods like a bailee in a gratuitous bailment. Section 71 clearly provides to this effect, thus, "a person who finds goods belonging to another and takes them into his custody, is subject to the same responsibility as a bailee."

3.13 Duties of Finder

The more important duties of a finder of goods are as follows

1. **Duty to find the true owner.** It is the duty of the finder to make reasonable efforts to find the true owner of the goods. For example, if one finds goods of little value at a public place, he should shout three times in search of the true owner, and if the goods found are valuable proper advertisement in newspapers etc., should be given. If the finder fails in this duty, he will be liable as a trespasser or a thief.

2. **Duty to take reasonable care of the goods as a bailee.** A finder must take as much care of the goods as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same description. If in spite of reasonable care, the goods are lost or destroyed, he is not liable for any loss.

3.14 Rights of Finder

The rights of a finder of goods are as follows:

1. **Right to retain possession of the goods until the true owner is found**. A finder has the right to retain possession of the goods against the whole world, except the true owner. It is important that the finder never becomes the owner of the goods. The ownership will always remain with the true owner, and the finder only enjoys the right to retain possession against everybody except the true owner. If anybody deprives him of the possession of the goods, he can maintain an action for trespass.

2. **Right of lien over the goods for expenses** (Sec. 168). A finder has a right to retain the goods against the true owner until he receives reasonable compensation for trouble and expense incurred by him to preserve the goods and to find out the true owner. But he has no right to file a suit against the owner to recover expenses incurred by him because there is no contract between him and the true owner. He incurred the expenses voluntarily and not at the request of the true owner.

3. Right to sue for reward (Sec. 168). The finder can file a suit against the true owner to recover any reward, which was offered by the true owner for the return of the goods lost, provided he came to know of the offer before actually finding out the goods. He may also retain the goods until he receives the reward.

4. **Right of sale** (Sec. 169). If the true owner cannot be found with reasonable diligence, or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell the goods in the following cases: (a) when the thing is in danger of perishing or of losing the greater part of its value, or When the lawful charges of the finder, in respect of the thing found, amount to two-third of its value. The true owner, however, is entitled to get the balance of sale proceeds, if there is a surplus left after meeting the lawful charges of the finder.

Illustration. *A* finds a lost horse. After a diligent search *A* discovers the true owner and offers to return the horse to him, on condition that the true owner pays The lawful expenses amounting to Rs 150. The true owner refuses to pay. *A* cannot file a suit for the recovery of the expenses in the absence of privity of contract. He cannot also sell the horse until his lawful charges amount to two-third of the value of the horse.

4. PLEDGE OR PAWN

4.1Definition

'The bailment of goods as security for payment of a debt or performance of a promise is called 'pledge'. The bailor in this case is called the 'pawnor.' The bailee is called the 'pawnee' (Sec. 172).

Illustration. *A* borrows Rs 100 from *B* and keeps his watch as security for payment of the debt. The bailment of watch is called a pledge.

Thus a pledge is only a special kind of bailment. Here goods are deposited with a lender or promisee as security for the repayment of a loan or performance of a promise. Otherwise, like bailment, a pledge also in-volves only a transfer of possession of goods pledged. The ownership remains with the pledger. The pledgee or pawnee has only a special interest in the goods pledged. The general interest remains in the pawnor and wholly reverts to him on discharge of the debt. Further, like bailment, a pledge is concerned with only movable goods. The movable goods include any kind of goods, valuables and documents of title, e.g., railway receipt, bill of lading, etc. (*Morvi Mercantile Bank* vs *Union of India*). Even a savings bank, Pass book issued by post office (which must accompany any withdrawal) may be pledged (*J. & K. Bank* vs *Tek Chand*).

4.2 Distinction between Bailment and Pledge

1. ***As to purpose*.** Pledge is the bailment of goods for a specific purpose, i.e., to provide a security for a loan or for the fulfilment of an obligation, whereas there is no such purpose in case of bailment. A bailment is for a purpose other than the above two, e.g., for repairs, safe custody, etc.
2. ***As to right of sale*.** In case of pledge, the pledgee has a right of sale (of the goods pledged) on default after giving notice to the pledger but there is no such right of sale to the bailee in case of bailment. The bailee may either retain the goods or sue the bailor for non-payment of his dues.
3. ***As to right of using the goods*.** In case of pledge, the pledgee has no right of using the goods pledged, while no such restriction, exists for a bailee in case of bailment if the nature of transaction so requires.

4.3 Rights of Pawnee

1. **Right of retainer** (Sec. 173). The pawnee has the right to retain the goods pledged until his dues are paid. He has the right to retain the goods pledged, not only for payment of the Debt or performance of the promise, but for the interest due on the debt and all necessary expenses incurred by him in respect of

the possession or for the preservation of the goods pledged. Thus this right may be termed as the pawnee's right of 'particular lien.'

2. **Right of retainer for subsequent advances** (Sec. 174). When the pawnee lends money to the same debtor after the date of the pledge without any further security, it shall be presumed that the right of retainer over the pledged goods extends even to subsequent advances. This presumption can be rebutted only by a contract to the contrary. It will be noticed that although a pawnee has a 'particular lien' only, but this Section allows him to track his subsequent advances to the original debt in the absence of any agreement to the contrary.
3. **Right to extraordinary expenses** (Sec. 175). The pawnee also has the right to recover from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged. But he cannot retain the goods, if such expenses are not paid. He has only a right to sue the pawnor for recovery of such extraordinary expenses.
4. **Right to sue the pawnor or sell the goods on default of the pawnor.** (Sec. 176). Where a pawnor makes default in the payment of the debt or performance of the promise, the pawnee may exercise either of the following rights: He may bring a suit against the pawnor for the recovery of the amount due to him and retain the goods pledged as a collateral security; or He may himself sell the thing pledged, after giving to the pawnor a reasonable notice of his intention to sell. In connection with the alternative right of sale, the following points must be noted:

i. The requirement of a "reasonable notice' is a statutory obligation and cannot be waived by agreement. A sale without notice is void, notwithstanding any contract to the contrary.

ii. The pawnee cannot sell the goods to himself and if he does so then such a sale is void as against the pawnor and the pawnor can recover the goods on paying the amount due.

iii. If the proceeds of such sale are insufficient to meet the full claim of the pawnee, he may recover the balance from the pawnor, but if there is surplus, he must pay it over to the pawnor.

4.4 Duties of Pawnee

Pledge being a special kind of bailment, the duties of a pawnee are just like a bailee.[11] Thus a pawnee's duties may be enumerated as follows:

1. To take reasonable care of the goods pledged.
2. Not to make any unauthorised use of the goods pledged.
3. Not to mix the goods pledged with his own goods.

4. Not to do any act in violation of the terms of the contract of pledge and of the provisions of the Contract Act. For example, he should not sell the goods pledged without a reasonable notice to the pawnor.
5. To return the goods pledged on receipt of his full dues.
6. To deliver any accretion to the goods pledged, e.g., bonus shares must also be delivered where shares from the subject-matter of pledge. The accretion remains the property of the pawnor (*M.R. Dhawan* vs *Madan Mohan*[12]).

4.5 Rights of Pawnor

- **Enforcement of pawnee's duties**. The duties of the pawnee are the rights of the pawnor. The pawnor can, therefore, enforce by suit all the duties of the pawnee (enumerated above) as his rights. For example, if the pawnee makes an unauthorised sale (without giving the notice as required under Section 176), the pawnor can file a suit for redemption of goods, treating the sale as void (of course after depositing with the Court the full amount due), or for damages for conversion. Similarly, the pawnor has a right to receive the pledged goods back along with accretion, if any, on making the payment on stipulated date, and so forth.
- **Defaulting pawnor's right to redeem** (Sec. 177). A pawnor, who defaults in payment of the debt amount at the stipulated date, has a right to redeem the debt at any subsequent time before the actual sale of goods pledged. Thus an agreement that the pledge should become irredeemable, if it is not redeemed within a certain time, would be invalid. Ofcourse, the pawnor redeeming after the expiry of the specified time must pay to the pawnee, in addition, any expenses which have arisen from his default.

4.6 Duties of Pawnor

The more important duties of a pawnor are as follows:

- To compensate the pawnee for any extraordinary expenses incurred by him (Sec. 175)
- To meet his obligation on stipulated date and comply with the terms of contract.

Pledge by Non-owners

The owner of goods can always make a valid pledge, but in the following cases pledge made by non-owners will also be valid:

Mercantile agents (Sec. 178). A 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) of the Sale of Goods Act]. A mercantile agent who is, with the consent of the owner, in possession of the goods or the documents of title to goods (e.g., railway receipt or bill of lading), can make a valid pledge of the goods while acting in the ordinary course of business of a mercantile agent. Such a pledge will be valid even if the agent had no actual authority to pledge, provided that the pawnee acts in good faith and has not at the time of the pledge any notice that the pawnor has no authority to pledge (Sec. 178).

It must be noted that a person in bare possession of goods cannot make a valid pledge. For example, a servant to whom goods are entrusted by his master during his (master's) absence cannot make a valid pledge. Similarly, a person entrusted with goods for a specific purpose cannot pledge the goods, e.g., goods held for safe custody or under a contract of hire cannot be pledged.

1. **Person in possession under voidable contract** (Sec. 178- A). A person having possession of goods under a voidable contract can make a valid pledge of the goods, provided the contract has not been rescinded at the time of the pledge and the pledgee has acted in good faith and without notice of the pledger's defect of title. For example, where *A* purchases a ring from *B* by exercising coercion and pawns it with *C* before the contract is rescinded by *B*, the pledge is valid. *C* will get a good title to the ring and *B* can only claim damages from *A*.
2. **Pledger having limited interest** (Sec. 179). Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest. Thus, a person
3. Having a lien over the goods may pledge them to the extent of his interest. For example, *A* delivers a suit length to *B*, the tailor master, for making a suit and agrees to pay Rs 1,500 as sewing charges. *B* pledges the suit with *C* for Rs 3,000. The pledge is valid to the extent of *B*'s interest in the suit, namely, Rs 1,500 (sewing charges) . *A* can, therefore, recover the suit only on paying Rs 1,500 to *C*, the pledgee (*Thakurdas* vs *Mathura Prasad*[13]).
4. **Seller in possession of goods after sale** [Sec. 30 (1) of the Sale of Goods Act]. A seller, left in possession of goods sold, is no more owner of the goods, but a pledge created by him will be valid, provided the pawnee acted in good faith and had no notice of the sale of goods to the buyer. The original buyer can obtain damages from the seller but cannot recover the goods from the pledgee.
5. **Buyer in possession of goods under an "agreement to sell"** [Sec. 30(2) of the Sale of Goods Act]. Where a buyer under an 'agreement to sell', wherein the goods to become the property of the buyer on fulfilment of certain condition or on expiry of some time, obtains possession of goods with the seller's consent before the payment of price and pledges them, the pledge is valid, provided the pledgee acted in good faith and had no notice of the pledger's defect in title of the goods pledged. It may be mentioned

that under an 'agreement to sell' the ownership remains with the seller until the 'agreement to sell' becomes a 'sale' by the fulfilment of agreed condition.

Illustration. *A* agrees to buy a car if his solicitor approves and obtains possession of the car and pledges it. The pledge is valid, although at the time of pledge *A* was not the owner and later on also he does not become owner as the solicitor disapproves the purchase.

6. **Co-owner in possession**. Where there are several joint owners of goods, one of the co-owners in sole possession thereof with the consent of other co-owners may make a valid pledge of the goods.

5. TEST QUESTIONS

1. Define a bailment and briefly state the rights and duties of bailor and bailee.

2. Define bailment and give its characteristics. How does bailment differ from 'sale'? What is a bailee's lien?

3. Explain the nature of the bailee's particular lien. How does it differ from the general lien of bankers and factors?

4. What are the rights and obligations of a finder of goods? What is the nature of the lien which finder of goods has over the goods?

5. Define pledge and distinguish between pledge and bailment. When will a pledge made by a non-owners of the goods be valid?

6. PRACTICAL PROBLEMS

Attempt the following problems, giving reasons for your answers:

1. *A* gives some cloth to a tailor for making a suit of it. The tailor's charges are settled at Rs 1,000. After the suit is ready *A* tenders Rs 1,000 for the charges but the tailor refuses to deliver the suit till *A* pays an old debt of Rs 200. Is the tailor entitled to do so?

[**Hint.** The tailor is not entitled to refuse to deliver the suit for the old debt of Rs 200, because a bailee, who renders a service involving the exercise of labour or skill in Respect of the goods bailed, so as to confer an

additional value on the article, is entitled only to a right of 'particular lien', i.e., a right to retain only that particular thing in respect of which the charge is due. (Sec. 170)]

2. *A* lady employed a goldsmith for the purpose of melting old jewellery and making new ones. Every evening as soon as the goldsmith's work for the day was over, the lady used to receive the half made jewellery from the goldsmith and put it into a box Which was left in a room in the goldsmith's house of which she retained the key. One night the box was stolen. Is the goldsmith liable to make good the loss?

[**Hint.** The goldsmith is not liable to make good the loss of jewellery because he cannot be said a bailee of the goods. The bailment must be taken to have come to an end as soon as the lady was put in possession of the half made jewellery. Again, the lady herself took away the key and therefore there was no effective delivery of the contents of the box to the goldsmith either actually or constructively. As such the goldsmith cannot be regarded as bailee thereof and cannot be made liable for the loss (*Kaliaperumal Pillai* vs *Visalakshmi,* A.I.R., 1938, Mad. 32).]

3. *A,* finds a horse which carries a reward of Rs 200 to the finder offered by *B,* the owner. *A* telegraphically informs *B* about the horse and spends Rs 15 thereon. *B* comes to take the horse after two days and during the intervening period *A* spent Rs 80 on feeding the horse. *A* returns the horse to *B* without insisting prepayment of his lawful charges of Rs 95 and the amount of reward. Subsequently *B* refuses to pay. *A* files a suit against *B* for the recovery of Rs 295. Will he succeed?

[**Hint**. *A* will succeed only for the recovery of the amount of reward, i.e., Rs 200 because here there is a contract between *A* and *B. B,* while offering the reward, made a general offer which *A* accepted by returning the horse. But *A* cannot recover the amount of expenses, i.e., Rs 95 as there is no contract between the two in that regard. *A* also cannot exercise the right of lien as possession has been lost (Sec. 168).

4. *A* pledges with *B* jewels worth Rs 60,000 and borrows Rs 30,000 at 12 percent interest per annum, promising to repay the amount and redeem the jewels within a year. *B,* having apprehension about the safety of the jewels, because of increasing burglaries in the town, not only insures the jewels but also buys a strong safe at a cost of Rs 800, there being no safety vault in that town and keeps the jewels in that safe. Now, when *A* comes to repay the loan, *B* claims the amount due for principal and interest, cost of insurance and cost of the safe. But *A* admits liability only for the principal and interest. Decide?

[**Hint.** *B* is entitled to recover from *A* the amount of the principal and the interest plus the cost of insurance and of the safe. There is no dispute so far as the amount of principal and interest is concerned. As regards cost of insurance and of the safe, it should be noted that under Section 175, *B,* the pawnee, is entitled to these expenses also as they have been incurred for the preservation of the goods pawned and are such which any person of ordinary prudence would reasonably incur in the given circum-stances.]

5. *B* handed her jewellery to *M* to value it and tell her what advance he could make on them, it being agreed that *M* was to keep the jewellery as security if he made the advance. On the same day *M* pledged the jewellery with *A*, a pawnbroker, who advanced £1,000 in good faith. Four days later *M* advanced £500 to *B* on the security of her jewellery. Subsequently on coming to know of the transaction between *M* and *A*, *B* paid the amount she had borrowed and sued *A* for the recovery of her jewellery contending that when *M* advanced the money, no valid pledge could arise as there was no delivery of goods in pursuance of the contract of pledge and *M* had already parted with the possession of the goods by pledging them with *A*. Will *B* succeed? Give reasons.

[**Hint.** No, *B* will not succeed as the pledge is valid. The facts in the instant case are similar to *Blundell* vs *Atten* (1921,3 K.B. 233). In that case it was held that the pledge was valid. Delivery made four days before was a good delivery for the purpose of creating a pledge, whenever that pledge was created. "Delivery of possession and advance need not be simultaneous and a pledge may be perfected by delivery before or after the advance is made" (*Lallan Prasad* vs *Rahmat Ali*, A.I.R. 1967, SC, 1322).

Unit III

1. Definition and test of agency
   1.1 Test of agency
   1.2 Agency distinguished from other relation
2. Agency and sale
3. Creation of agency
4. Ratification of agency
5. Termination of agency
6. Rights and duties of principle and agent
7. Rights of agent
8. Duties of principle
9. Rights of principle
10. Agents authority

LAW OF AGENCY

Agency is based upon the principle, *qui facit per alium per se* (he who does a thing through another does it himself). According to this principle, all acts which a person can do, or is bound to do, except those which from their very nature can only be performed personally, can be done though an agent. The principal is bound by the acts of his agent and can get the benefit of such acts as if he had done them himself. However, no person can do through an agent what he himself is legally incompetent to do personally. For instance, a minor who has no contractual capacity cannot, by an agent, make a contract which he himself is incapable of making.

1. Definition and test of agency

Agency in law connotes an authority or capacity in one person to create legal relations between a person occupying the position of principal and third parties. According to cheshire and fifoot, "agency is a comprehensive word which is used to describe the relationship that arises where one man is appointed to act as the representative of another. The act to be done may vary widely in nature. It may, for example, be the making of a contract, the institution of an action, the conveyance of land or, the case of a power of attorney, the exercise of any proprietary right available to the employer himself."

Section 182 of the indian contract act, 1872 (herein after called the act) defines an agent and a principal thus:

"an 'agent' is a person employed to do any act for another or to represent another in dealings with third persons.

The person for whom such act is done, or who is so represented, is called the 'principal'. "

According to this definition, an agent is a connecting link between the principal and third parties, and thereby establishes privity of contract between them.

1.1 Test of agency

The usage of the word 'agent' is not conclusive for determining the correct relationship between two parties. Accordingly, every relationship in which one works for another need not be agency relationship.

The above observations make it clear that the pharase to do an act for another' used in section 182 of act is very wide. As such, every person who acts for another cannot be an agent, and every relationship in which one works for another need not be agency relationship. The use of the word 'agent' or the expression 'agency agreement' in a contract between two parties does not necessarily establish agency relationship between them.

Whether a particular relation between two persons is or is not agency, does not depend upon the words or expressions used in the contract, but the relationship as gathered from the terms and conditions of the contract and the functions and responsibilities of the person employed to do any act or to represent a person in dealings, with third persons. *The essential element of agency is the exercise of delegated authority to do a lawful act on behalf of another; and establish privity of contract between such a person and a third party.*

1.2 Agency distinguished from other relations

(a) agent and servant

The concepts of agent and servant may overlap, and in some cases, the same person may act as both an employee and an agent. For instance, a person may be a servant only. *E.g.* Chauffeur, or both a servant and agent, *e.g.* A sales representative, and the driver of a milk van.

Yet, the status of an agent is different from that of a servant due to the following reasons :

A servant has no representative character. He acts under the direction and control of his employer. His occupation has no relation to the transaction of business with third parties. The agent, on the other hand, is authorised to act on behalf of his principal, and has power to create legal relations between the principal and third persons.

A servant is a paid employee hired to do work. He has no discretion in doing the work. He has to do what he is told to do and the only way his master directs. But, with regard to an agent, it was pointed out by the supreme court in lakshminarayanam ram gopal & sons verses. Hyderabad government , that "a principal has the right to direct what the agent has to do; but a master has not only that right, but also the right to say how it is to be done."

Thus, in case of agency, the agent has more discretion as to the time and manner of performance, and he is not under the direct control and supervision of the principal with regard to every minute detail.

In the case of a master-servant relationship, the master is liable for the servant's wrong if committed in the course of his employment. In the case of principal-agent relationship, however, the principal is liable for the acts of the agent provided the acts of the agent are within the scope of his authority. This is in accordance with the maxim *qui sent it cornmodurn sentire debet it onus* (he who gains advantage has to sustain the burden).

A servant is paid for his services either salary or wage, while the agent usually gets his commission.

An agent may work for a number of principals at the same time, while a servant works only for one master at a time.

2. Agency and sale

In **tirumala venkateshwara timber and bamboo firm verses. Commercial tax officer, rajamundry,** at was held that the essence of a contract of sale is the transfer of title to the goods for a price paid a promised to be paid. The transferee in such case is liable to the transferor as a debtor for the price to be paid and not as agent for proceeds of the sale. The essence of agency to sell is the delivery of the goods to a person who is to sell these, not as his own property but as the property of the principal who continues to be the owner of the goods and therefore will be liable to account for the sale proceeds.

Agent and independent contractor

An independent contractor is one who is employed to accomplish a given end, and in this respect; he is like a servant. However, he is neither an agent nor a servant. For instance, if a agrees to build a house for b, a is an independent contractor who buys his own materials, engages his own labour and does the work in a manner suitable to himself. So is an electrician.

An independent contractor is defined as "one who undertakes to produce a given result, but so that in the actual execution of the work he is not under the order or control of the person for whom he does it, and may use his own discretion in things not specified beforehand."

Although the contractor is like an agent, he does not represent his employer in relation to third persons. The employer is also not liable for the conduct of the contractor. While the agent is paid commission, the servant is paid salary or wages, the independent contractor is paid in installments as the work progress. Thus, an agent stands midway between a servant and an independent contractor.

Capacity

Since the purpose of agency is to empower the agent to bring the principal into contractual relationship with third persons, any person who is competent to enter into contracts himself, may act through an agent. Generally, a person who is suffering from legal disability cannot appoint an agent. According to section 183 of the act, *"any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent."* Thus, any person who is *sui juris* has a right to appoint an agent for any purpose whatever.

Since a contract by an agent is, in effect, the contract of the principal, it is immaterial whether or not the agent has legal capacity to make a contract for himself. Accordingly, even a minor can be an agent and this is clear from section 184 of the act which lays down that, "as between the principal and third persons any person may become an agent, but no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal according to the provisions in that behalf herein contained."

According to this section, a person who is not of the age of majority can certainly bring about contractual relation between the principal and the third party. However, such a person will not be responsible to the principal. To be responsible, he too should be a person of the age of majority. In case a minor happens to be an agent and he mismanages the affairs of the agency, the principal cannot hold him liable for his misconduct and recover compensation from him.

Consideration

One of the essential requisites of a valid contract is consideration. But section 185 of the act specifically states that *"no consideration is necessary to create an agency."* accordingly, this may be considered to be an exception to the rule that for 'an agreement made without consideration is void', although not stated independently under section

25 of the act. In fact, the detriment to the principal in consenting to be represented by the agent is sufficient to support the promise by the agent to act in that capacity, though gratuitously.

In most cases there is an express or implied agreement to pay remuneration for the agent's services. But, if the agent has to work without remuneration, the contract should specifically make a mention of it.

3. Creation of agency

In the normal case, agency arises by agreement, i.e., the principal actually authorises the agent to act on his behalf and the agent agrees to do so. In such a case, the power of the agent to affect his principal's relations with third parties flows from the authority conferred on him by virtue of the agreement. In other words, the principal authorises the agent to do an act and the agent does it.

Sometimes, however, the power arises as a result of the conduct of the principal which creates the appearance of authority although it does not, in fact, exist. It is, therefore, necessary to know the various methods by which agency relationship arises. These methods are:

(a) agency by express authority

Just as a contract may be express or implied, so also a contract of agency may be express or implied. According to section 187 of the act, "an authority is said to be express when it is given by words spoken or written." Express authority may thus be given by a principal to his agent orally or in writing. As such, authorities by words of mouth and by writing are of the same order within the meaning of this section. In some cases, however, a formal document becomes necessary. If, for instance, the agent is authorised to make a written contract for the principal, the authorization which is called the power of attorney should be in writing.

A power of attorney is the usual form of a written contract of agency. It is a formal instrument by which one empowers another to represent him, or act on his behalf for certain purposes. A power of attorney may be general, special or particular. A general power of attorney authorises an agent to do all lawful acts on behalf of the principal or to act generally in the business of the agency. A special power of attorney authorises an agent to enter into a single transaction of a special nature. A particular power of attorney authorises an agent to do a single act.

Agents appointed to execute a deed of conveyance of property, to sign the prospectus of a company, to act as a proxy for a shareholder, etc., should be authorised in writing. Similarly, a special power of attorney known as *vakalatnama,* authorising an advocate to appear on behalf of his client in a legal suit should also be in writing.

(b) agency by implied authority or inferred from circumstances

Agency may be inferred from the circumstances of the case. According to section 187 of the act, "an authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted circumstances of the case."

Agency is said to be implied when it is to be inferred form the circumstances of the case, e.g., by implication of the law or conduct of the parties or situation of the parties or from the necessity of the case. In **malukchand verses. Sham mogham,** (1890) 14 bom 590, it was held that a power of attorney authorising the holder "to dispose of certain property in any way he think fit does not imply an authority to mortgage the property.

According to the illustration to section 187, a owns a shop in serampur, living himself in calcutta, and visiting the shop occasionally. The shop is managed by b, and he is in the habit of ordering goods from c in the name of a for the purpose of the shop, and of paying for them out of a's funds with a's knowledge. B has an implied authorit

To order goods from c in the name of a for the purposes of the shop. It is necessary to remember in this context that in the case of implied agency, the principal cannot limit the authority of the agent by private instructions to the prejudice of a third party, without notice to such a third party.

Agency may be inferred from the circumstances in the following cases:

(c) Agency by estoppel:

Agency by estoppel arises by the conduct of the principal, who, without conferring any authority upon an agent, causes an inference to be drawn that authority has been conferred upon him.

If a person, for instance, knowingly and without objection, permits another to act as his agent, the law will find in his conduct an expression of authorization to the agent, and the principal will not be permitted to deny that the agent was, in fact, authorized.

For example, a tells b within the hearing of c that he (a) is c's agent. C does not object to this statement of a. Later b supplies certain goods to a. C is liable to pay the price of goods to b.

In other words, the conduct of the principal makes room for the application of the principal of estoppel, and the person who is permitted to act as the agent is deemed in law to have been permitted by the principal to act as such. The persons who deal with him are entitled to assume that the agent has authority to represent the principal. The principal will not, later, be permitted to deny such authority of the agent.

The principle of estoppel applies to the principal-agent relationship in three ways. In *the first place,* a person may hold out another as his agent, whereas that other is not, in fact, and never has been his agent; *secondly,* he may hold out one who is his agent as having a more extensive authority than he has in fact; and *thirdly,* he may hold out as being still his agent a person who has been his agent, but is no longer so. In each of these cases, he may be liable for anything done by the other person within the authority which he is held out as having.

Section 237 of the act has laid down that, "when an agent has without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority. " this section thus deals with the principle of estoppel.

According to illustration (a) to this section, a consigns goods to b for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of b's instructions, enters into a contract with b to buy the goods at a price lower than the reserved price. A is bound by the contract.

Similarly, if the owner of a hotel allows another person to occupy the position and assume the duties of a hotel clerk, the authority of the clerk to act as such may be inferred from the owner's conduct. Again if a person entrusts another with possession of a bill of lading or a negotiable instrument endorsed in blank, he holds out such a person as having authority to sell or negotiate them as the owner. Further, if a person delivers goods to a mercantile agent, it is presumed that the person has authorised the agent to sell or pledged the goods in the ordinary course of business.

(d) Agency by necessity: a person may act on behalf of another under certain circumstances which are compelling in nature. In such cases, his acts will be binding upon the person on whose behalf he acts, although without any authority. Thus, when a person is compelled by urgent necessity of circumstance to act as an agent of another, he becomes an agent of necessity, and the law confers authority upon him to act as an agent. Agency by necessity arises in the following cases:

(e)deserted wife: if a husband wrongfully deserts his wife without providing for her subsistence, she becomes his agent of necessity. As such, she has the authority to pledge his credit for necessaries for herself and her Children. Her authority to pledge the credit of her husband does not depend upon cohabitation, but it arises from the facts of her marriage. Accordingly, if she herself deserts the husband unless justified by the conduct of the husband, her authority is defeated. Further, her authority subsists until she is able to obtain a decree from the court for her maintenance. But she has no authority which the law confers on her if she has sufficient means to support herself and her children.

It is necessary, in this context, to distinguish between implied agency and agency by necessity, in relation to husband and wife.

Marriage between a man and a woman does not, by itself, create agency relationship between them. Accordingly a husband is not the agent of his wife and vice-versa, although such a relationship may be created expressly or impliedly. If the husband, by written or spoken words, authorises the wife to buy goods for him on

his behalf the wife's agency is express. On the other hand, if the wife herself buys the goods without being authorised to do so, and later the husband habitually pays for the same, the agency is implied.

However, when the husband and wife are living together, there is a presumption that the wife is entitled to pledge his credit for necessaries of life. This is a case of implied agency and not agency by necessity. But, if the wife is living apart without her fault, and she is uncared for, she becomes the agent of necessity.

Accordingly, one important condition subject to which the wife becomes the agent impliedly, is that the husband and wife should live together. Secondly; they should be living in a domestic establishment. Thirdly, the wife can pledge the credit of the husband only for necessaries suitable to the style in which the husband chooses to live. Necessaries include "clothing, both for the wife and her children, articles of household equipment, food, medicines and medical attendance, and the hiring of servants."

This presumption can be rebutted by the husband on his proving that he expressly warned the tradesman not to supply his wife with goods on credit, he had expressly forbidden the wife to pledge his credit, the wife was already supplied with the articles in question and the wife was supplied with sufficient means for the purpose of buying the articles, or the order, though for necessaries, was excessive or extravagant.

(2) person entrusted with property: where a person is entrusted with the property of another, and in an emergency it is necessary to do something for the preservation of the property, and it is impossible to communicate with the owner, the person entrusted with the property becomes an agent of necessity with implied authority to do what is necessary to save the property.

The principle of agency by necessity was first applied to marine adventures in order to enable the master of a ship to face an eventuality threatening the ship and the cargo, without being able to communicate with the owner. This principle has now a wider application.

Thus, a master of a ship, is an agent of necessity to raise money on the security of the ship and cargo, for the safety of the cargo. He can also incur expenses as agent of the cargo-owner for the preservation of the cargo. He can pledge the ship as security for the cost of repairs necessary to enable the ship to continue the voyage. This principle is applicable to carriers by and also.

In great northern railway verses. Swaffjeld (1874), a horse was consigned to the defendant at a certain railway station. There was none to receive the horse at the destination. There was no way of communicating with the defendant, and there was no accommodation for the horse at the railway station. The plaintiff company, therefore, sent the horse to a livery stable. It was held that the company was the agent of necessity to incur expenses reasonably necessary to keep the horse alive on behalf of the owner, and that as they had themselves paid those expenses, they could recover them.

Similarly, a person may become an agent of necessity when he incurs expenses on medical aid to an injured person.

Thus, the following conditions must be satisfied for creation of agency by necessity:

- It should be impossible to communicate with the principal
- There should be an actual and definite commercial necessity
- The agent of necessity must act bona fide in the interests of all the parties concerned

(3) agent exceeding his authority bonafide in an emergency:

According to section 189 of the act, "an agent has authority, in an emergency to do all such acts, for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances. "

Subject to the conditions referred to above, agency by necessity arises when the agent exceeds his authority in an emergency.

Illustration (b) to this section says that a consigns provisions to b at calcutta, with directions to send them immediately to c at cuttack. B may sell the provisions at calcutta, if they will not bear the journey to cuttack without spoiling.

Accordingly, the sale by agent, although beyond the scope of the agent's authority, will bind the principal and in this case, there arises agency of necessity.

4. Ratification of agency

Where a person performs an act for someone without any authority, or a person acting as the agent of another exceeds the authority actually conferred on him, the person on whose behalf the act is done may either disown the act, or adopt it. If he adopts it, the effect of such adoption is the same as though the act had been done with his authorization. This adoption is known as 'ratification.'

In other words, ratification means the subsequent adoption or affirmation by a person of an unauthorized act done by another without authority. It is thus a cure for the lack of precedent authority. An agent who possesses

limited authority, but exceeds his authority, may bind the principal, if his act done in excess of the authority is later ratified by the principal.

According to section 196 of the act, "where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority. "

In stating the effect of ratification, this section does not distinguish between an unauthorized act of an agent and the act of a total stranger who purports to act as agent for the principal. In both the cases, the effect is the same, i.e., an unauthorized act is converted into an authorised act from the moment that act was done, and not from the time the act was ratified.

Thus, ratification is retrospective, and relates back to the time of performance of the unauthorized act. This is in accordance with the maxim *omins ratihabitio retrotrahitur et priori mandato* (every ratification has a retrospective effect and is equal to a previous mandate). Accordingly, ratification is also known *ex post facto* agency.

Unauthorized acceptance may, therefore, be ratified even if the offer has, in the meantime, been withdrawn. *This ratification tantamounts to prior authority.*

(a) a, without authority, buys goods for b. Afterwards b sells them to c on his own account. B's conduct implies a ratification of the purchase made for him by a.
(b) a, without b's authority, lends b's money to c. Afterwards b accepts interest on the money from b. B’s conduct implied a ratification of the loan.

Conditions of valid ratification: ratification becomes valid only when the following conditions are fulfilled:

1. **The agent must have purported to act for a principal:** since the unauthorized act has to be ratified by the principal, the act must have been done on behalf of an identifiable principal. Although it is not necessary to name the principal, he should be identifiable by some designation and the agent should profess to act on his behalf. This is so, inasmuch as the undisclosed principal cannot step in and ratify the unauthorized act of the person purporting to contract on behalf of a person who is not in the knowledge of third parties.

2. **The principal must be in existence:** for ratification to become valid, the principal must have been in existence at the time the contract was made.

This question arose in **kelner verses. Baxter,** (1866), in which kelner agreed to sell hotel to baxter, who was acting as the agent of a company yet to be formed. The company ratified the contract after its incorporation. Subsequently, it went into liquidation and kelner sued baxter upon the contract. Baxter contended that the liability had passed to the company by ratification and hence, did not attach to him. The court rejected this contention on the ground that ratification can only be by a person in existence either actually or in contemplation of law and observed that, "when the company came afterwards into existence it was totally a new company having rights and obligations from that time, but no rights or obligations by reason of anything which might have been done before."

According to this ruling, a preliminary contract cannot be ratified by a company before it actually comes into existence. It is only with a view to mitigating the rigour of this rule that sections 15 (h) and 19 (e) of the specific relief act, 1963 provide for the enforcement of a contract entered into by the promoters, by the company as well as by third parties, provided the company accepts the contract and communicates its acceptance to the other party to the contract.

3. **The principal should have contractual capacity:** ratification is not possible if, at the time the contract was entered into by the agent on behalf of the principal, the principal was incapable of contracting. In other words, the principal can ratify the act by the agent provided he himself could do the act which he purports to ratify.
4. **The act should be capable of ratification:** the act which the principal purports to ratify should be legal, and not void from its inception. In this context, section 200 of the act lays down that, *"an act done by one person on behalf of another, without such other person's authority, which, if done with authority, would have the effect of subjecting a third person to damages, or of terminating any right or interest of a third person, cannot, by ratification, be made to haw such effect. "*

Similarly, an act which tends to be injurious to the interests of a third person cannot be ratified. This is clear from illustration (b), according to which "a holds a lease from b terminable on three months' notice. C, an authorised person, gives notice of termination to a. The notice cannot be ratified by b, so as to be binding on a."

5. **The principal should have full knowledge of material facts: in** order that ratification may be binding on the principal, he must either have had full knowledge of everything which he assumes to adopt or

have intended to dispense with such knowledge and to adopt the acts of the person purporting to act as his agent whatever they might be.

According to section 198 of the act, 'we valid ratification can be made by a per son whose knowledge of the facts of the case is materially defective."

6. **Ratification cannot be partial:** the person ratifying has no choice of ratifying a part of the transaction and repudiate the rest. In other words, a contract cannot be ratified partially. This condition is referred to in section 199 of the act according to which, *"a person ratifying any unauthorized act done on his behalf ratifies the whole of the transaction of which such act formed apart."*

This section clearly states that ratification of a part of the transaction amounts to ratification of the whole of the transaction. As such, the person ratifying cannot ratify that part of the transaction which is beneficial to him and repudiate the rest.

7. **Ratification should be done within a reasonable time:** ratification can be effective only if it is made within a reasonable time after the act is done on his behalf. For instance, in the case of a contract to be performed within the time stipulated, ratification should be made before the time of performance, as otherwise, ratification will not be effective.

In other words, if an agent purports to make a contract between the principal and a third party, but has no authority to do so, no contract arises between the third person and the principal. As such, the third person, not being bound by the contract, may repudiate the same. Therefore, the principal has to ratify the contract and make it binding on the third person, before the third person repudiates it. If ratification is made subsequently, it has no effect. Ratification cannot also be made after the third party brings an action against the agent.

5. Termination of agency

Agency is terminated (a) by the act of parties, or (b) by the operation of law. According to section 201 of the act, "an agency is terminated by the principal revoking his authority; or by the agent renouncing the business of the agency; or by the business of the agency being completed; or by either the principal or agent dying or becoming of unsound mind; or by the principal being adjudicated an insolvent under the provisions of any act for the time being in force— for the relief of insolvent debtors. "

Although this section enumerates the different circumstances in which a contract of agency is terminated, it is not exhaustive since it does not mention all the circumstances under which an agency can be terminated. For example, termination by breach, destruction of the subject-matter, efflux of time, happening of an event rendering continuation of agency relationship impossible, etc., have not been mentioned in this section.

(a) termination by the act of parties

An agency may be terminated by the act of parties in the following ways:—

Agreement: the principal-agent relationship based on mutual consent can be terminated, like any other contract, at any time, by agreement between the principal and the agent.

Revocation: according to section 203 of the act, "the principal may, save as is otherwise provided by the last preceding section, revoke the authority given to his agent at any time before the authority has been exercised so as to bind the principal. "

Thus, this section empowers the principal to revoke the authority given to the agent, at any time before the agent exercises such authority. However, this power cannot be exercised by the principal in the case of agency in which the agent himself has interest in the subject-matter. Since such a revocation is prejudicial to the agent's interests, section 202 of the act imposes this condition, and this is, in fact, what the phrase 'save as is otherwise provided by the last preceding section' means.

Further, though empowered to revoke the agent's authority, the principal cannot do so when the authority is partly exercised. Section 204 states that *"the principal cannot revoke the authority given to his agent after the authority has been partly exercised, so far as regards such acts and obligations as arise from acts already done in the agency. "* accordingly, when the authority is partly exercised, the principal becomes bound by the acts and obligations arising from such exercise of the authority. Consequently, revocation is only prospective and not retrospective. The principal cannot exonerate himself from the obligations created by the part exercise of the authority by the agent.

Again, the principal cannot revoke the agent's authority if there is an express or implied contract that the agency should be continued for any period of time. This is in accordance with section 205 of the act, and the principal must make compensation to the agent, if he revokes the latter's authority without sufficient cause.

It is also necessary for the principal to give reasonable notice of revocation to the agent, and in case of failure to do so, he must, according to section 206 of the act, make good the damage thereby resulting to the agent.

Further, according to section 208 of the act, "the termination of the authority of an agent does not, so far as regards the agent, take effect before it becomes known to him, or, so far as regards third persons, before it becomes known to them. " while according to section 206 of the act notice of revocation is necessary from the point of view of the agent and the principal, this section enjoins upon the principal to give notice of revocation

to third parties also. As such, termination of the agent's authority, so far as third parties are concerned, does not take effect before it becomes known to them.

Revocation of the agent's authority may either be express or implied. If, for instance, a empowers b to let a's house and later, lets it himself, there is implied revocation of b's authority.

(3) **renunciation:** section 201 of the act empowers the agent to renounce his authority, just as the principal can revoke the agent's authority. Renunciation may also be express or implied. Further, the provisions of section 205 and 206 of the act regarding compensation for premature renunciation without sufficient cause and notice, are equally applicable to the agent in the case of renunciation.

According to the illustration appended to section 207, a empowers b to let a's house. Afterwards a lets it himself. This is an implied revocation of b's authority.

(b) termination by the operation of law

The principal-agent relationship is automatically put to an end by the operation of law in the following cases:

(1) completion of the agency business. Completion of the business of the agency is one of the circumstances by which an agency is determined as per section 201 of the act. If the agency is for the accomplishment of a specific object, the relationship automatically terminates with the accomplishment of the object. Similarly, if the agency is constituted for a definite period of time, the relationship ceases upon the expiry of the time agreed upon. While in the case of the former agency comes to an end after the business of the agency is completed, in the case of the latter, however, it comes to an end after the expiry of the period although the business might not have been completed.

Death of either party. Since the agent acts on behalf of the principal, and his contracts are the contracts of the principal, it naturally follows that the relationship between the principal and agent ceases upon the death of the principal. In the-same way, since the principal chooses a person as his agent only because he has trust and confidence in him, he cannot accept performance at the hands of the agent's representatives as his substitutes. Accordingly, agency is terminated on the death of the agent also.

Insanity of either party. Section 201 of the act states that an agency is terminated by the insanity of either the principal or the agent.

Section 209 of the act enjoins upon the agent to take, on behalf of the representatives of his principal who has died or has become a person of unsound mind, all reasonable steps for the protection and preservation of the interests entrusted to him, when the agency is terminated by the death or insanity of the principal.

(4) **insolvency of the principal.** According to section 201, insolvency of the principal puts an end to the agency relationship. Although insolvency of the agent terminates agency by the operation of law, this section is silent on this on this point. However, it was held in **dixon verses. Ewart,** (1817) , that the bankruptcy of the agent also terminates the agency except in cases where the act authorized to be done by the agent is only formal.

Destruction of the subject-matter. As in the case of a general contract, the destruction of the subject-matter renders the contract void, even in the case of agency, if an agent is appointed to deal with a particular subject matter on behalf of the principal, the destruction of the subject-matter automatically puts an end to the agency. If, for instance, an agency is employed to sell his principal's motor car, and the car is destroyed by fire in a civil disobedience movement, the agency gets terminated.

Principal becoming an alien enemy. If the principal and the agent belong to two different countries, and war breaks out between the two countries, the authority of the agent ceases. This is obvious for the reason that a contract of agency stands suspended during a period of war and performance becomes unlawful.

Termination of sub-agent's authority. Section 210 of the act has laid down that termination of the authority of an agent causes the termination of the authority of all sub-agents appointed by him.

Irrevocable agency

Although section 201 of the act empowers the principal to revoke the authority conferred upon the agent by his unilateral action, he cannot revoke the authority of the agent at his pleasure in the following cases:

(1) authority coupled with interest: the authority of an agent becomes irrevocable if it is coupled with interest in the subject-matter of the agency. This exception is stated in section 202 of the act thus: *"where the agent has himself an interest in the property which forms the subject-matter of the agency, the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest."* illustrations appended to the section are as follows:

A gives authority to b to sell a's land, and to pay himself out of the proceeds, the debts due to him from a. A cannot revoke this authority, nor can it be terminated by his insanity or death.

A consigns 1,000 bales of cotton to b, who has made advances to him on such cotton, and desires b to sell the cotton, and to repay himself, out of the price, the amount of his own advances. A cannot revoke this authority, nor is it terminated by his insanity or death.

This section is, no doubt, intended to protect the interest of the agent. But, it is not any interest that will suffice to render an agency irrevocable. An inerest should exist at the time of creation of agency, and the same should be in the property which forms the subject-matter of the agency.

(2) **agent's personal liability.** The principal cannot revoke the agent's authority, if the agent has, in the exercise of his authority, incurred any personal liability. This becomes clear from the following illustration (a) appended to section 204; a authorises b to buy, 1,000 bales of cotton on account of a, and to pay for it out of a's money remaining in b's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke b's authority so far as regards payment for the cotton.

(3) **part exercise of authority.** According to section 204 of the act, where the agent has partly exercised his authority, the principal cannot revoke the agent's authority so far as regards such acts and obligations as arise from such an exercise of the authority.

See illustration (a) given above. Illustration (b) appended to the section is as follows:

A authorises b to buy 1,000 bales of cotton on account of a and pay for it out of a's money remaining in b's hands. B buys 1,000 bales of cotton in a's name, so as not to render himself personally liable for the price. A can revoke b's authority to pay for the cotton.

6. Duties and rights of agent and principal duties of an agent

The duties of an agent to his principal are the following: (a) to follow principal's instructions

According to section 211 of the act, it is the duty of an agent to conduct-the business of his principal according to the latter's, directions, and in the absence of any such directions, according to the custom which prevails in business of the same kind at the place where the agent conducts such business. When the agent acts otherwise, and if any loss is sustained, he must make it good to his principal, and if any profit accrues, he must account for it.

Similarly, according to illustration (b), b, a broker, in whose business it is not the custom to sell on credit, sells goods of a on credit to c, whose credit at the time was very high. C, before payment, becomes insolvent. B must make good the loss to a.

According to illustration (a), a, an agent engaged in carrying on for b a business, in which it is the custom to invest from time to time, at interest, the money's which may be in hand, omits to make such investments. A must make good to b the interest usually obtained by such investments.

Where, however, the principal's order is ambiguous, he is bound by the course of action taken by the agent, provided the same is bona fide.

To conduct the business with skill and diligence

Section 212 of the act has cast a duty on the agent to conduct the business of the agency with as much skill as is generally possessed by persons engaged in similar business, unless the principal has notice of his want of skill.

It is also the duty of an agent to exercise reasonable diligence in the performance of the work entrusted to him, and to display such skill as he possesses. If, as a direct consequence of his negligence, want of skill or misconduct, the principal suffers any loss or damage, the agent is responsible for any such loss or damage caused indirectly or remotely. Illustrations (a), (b), (c) and (d) appended to the section are as follows:

A, a merchant in calcutta, has an agent, b, in london, to whom a sum of money is paid on a's account with orders to remit. B retains the money for a considerable time. A, in consequence of not receiving the money, becomes insolvent. B is liable for the money and interest from the day on which it ought to have been paid, according to the usual rate; and for any further direct loss as, by variation of rate of exchange but not further.

A, an agent for the sale of goods, having authority to sell on credit, sells to b on credit, without making the proper and usual inquiries as to the insolvency of b. B, at the time of such sale, is insolvent, a must make compensation to his principal in respect of any loss thereby sustained.

A, an insurance broker, employed by b to effect an insurance on a ship, omits to see that the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing be recovered from the underwriters. A is bound to make good the loss to b.

A, a merchant in england, directs b, his agent, at bombay, who accepts the agency to send him 100 bales of cotton by a certain ship. B, having it in his power to send the cotton, omits to do so. The ship arrives safely in england. Soon after the arrival, the price of cotton rises. B is bound to make good to a the profit which he might have made by the 100 bales of cotton at the time the ship arrived, but not any profit he might have made by the subsequent rise.

To render proper accounts

According to section 213 of the act, an agent is bound to render proper accounts to his principal on demand rendering proper accounts, within the meaning of this section means, not only producing accounts with the relevant vouchers, but also explaining them. When the agent renders accounts to his principal and the principal keeps the same with him for a length of time, the accounts will be considered stated and settled, and will not be reopened unless instances of fraud are proved.

Duty to communicate with the principal

According to section 214 of the act, "it *is the duty of an agent, in cases of difficulty, to use all reasonable diligence in communicating with his principal, and seeking to obtain his instructions."*

However, even in cases of difficulty, if the principal cannot be contacted without losing time, and there is the need for taking immediate action to save the property of the principal, the agent can act on his own by becoming an agent of necessity.

Not to deal on his own account

According to section 215 of the act, the agent should not deal on his own account in the business of the agency by becoming a principal as against his employer, and make his interests conflict with those of the principal. If the agent has to deal on his own account, it is his duty to acquaint the principal with all material circumstances which have come to his knowledge, and obtain his consent.

Even if the agent has brought to the knowledge of his principal all material circumstances relating to a transaction in which he is personally interested, the principal can repudiate the transaction if he could show that there has been dishonest suppression of a material fact, or that the transaction is disadvantageous to him. Illustrations to this section make the point clear:

A directs b to sell a's estate. B buys the estate for himself in the name of c, a, on discovering that b has bought the estate for himself, may repudiate the sale, if he can show that b has dishonestly concealed any material fact, or that the sale has been disadvantageous to him.

A directs b to sell a's estate. B, on looking over the estate before selling it, finds a mine on the estate which is unknown to a. B informs a that he wishes to buy the estate for himself, but conceals the discovery of the mine. A allows b to buy in ignorance of the existence of the mine. A, on discovering that b knew of the mine at the time he bought the estate, may either repudiate or adopt the sale at his option.

In **armstrong verses.** Jackson, (1917), the plaintiff employed the defendant, a stock broker, to buy some shares for him. The defendant sent a contract note to the plaintiff purporting to show that the shares had been bought, but the note was, in fact, a sham. The defendant had sold his own shares to the plaintiff. In a suit by the plaintiff, it was held that he was entitled to rescind the contract.

Not to make secret profit

The relationship of the agent with his principal is of a fiduciary nature. As such, the agent has to conduct the agency business in absolute good faith, and not make secret profit. Section 216 in this context lays down that the principal is entitled to claim any benefit which may have resulted from a transaction entered into by the agent without his knowledge. The term 'any benefit', used in this section, includes all secret profits and advantages, including bribe made or received by the agent, beyond the commission or other remuneration to which he is entitled.

According to the illustration appended to this section, a directs b, his agent, to buy a certain house for him. B tells a it cannot be bought, and buys the house for himself. A may on discovering that b has bought the house, compel him to sell it to a at the price he gave for it.

To pay sums received

Section 218 of the act lays down that it is the duty of the agent to pay to his principal all sums received on his account, after retaining all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting the business. Even if the agent receives money on behalf of his principal under an illegal or void contract, he has to account to the principal for the money so received. He cannot withhold the money by setting up the plea of illegality.

Not to delegate authority

It has already been pointed out that under section 190 of the act, an agent, to whom the principal has delegated authority for doing a particular work, cannot further delegate, except under the two circumstances mentioned therein, and the others enumerated in that context,

To protect and preserve the principal's interest

According to section 209 of the act, on the principal's death or insanity, when the agency is terminated, it is the duty of the agent to protect and preserve the interests of his principal on behalf of the latter.

7. Rights of agent

Besides the duties of an agent enumerated above, there are also some rights which he enjoys against the principal. These rights are:

Right of retainer

Section 217 of the act confers upon an agent the right to retain, out of any sums received on account of the principal in the business of the agency, all money due to himself in respect of advances made or expenses properly incurred by him in conducting such business.

This right can be exercised by the agent only so long as he is in possession of money for which he is accountable to the principal. Although this right extends to his remuneration also, he does not enjoy any equitable lien in respect of these. He has no right to have his claims satisfied in priority to general creditors, out of specific funds of the principal which are not in his hands. But, such a right can be exercised by a solicitor. As such, he is entitled to an equitable lien on the proceeds of an action conducted by him till his costs are paid.

Right to remuneration

The agent is entitled to remuneration for his services, unless he has consented to act gratuitously. The amount of remuneration depends upon the terms of the contract, if there is an express contract to that affect. In the absence of any such contract, the right to remuneration and the conditions under which the same is payable, are dependent upon the custom or usage of particular business in which the agent is employed.

According to section 220 of the act, an agent who is guilty of misconduct in the business of the agency is not entitled to any remuneration in respect of that part of the business which he has misconducted. The following two illustrations are appended to section 220:

A employs b to recover 1,00,000 rupees from c, and to lay it out on good security. B recovers the 1,00,000 rupees, and lays out 90,000 rupees on good security, but lays out 10,000 rupees on security which he ought to have known to be bad, whereby a loses 2,000 rupees. B is entitled to remuneration for recovering the 1,00,000 rupees and for investing the 90,000 rupees. He is not entitled to any remuneration for investing the 10,000 rupees, and he must make good the 2,000 rupees to b. (it must be noted that the last word in this illustration is b in the act, but it should obviously be a).

A employs b to recover, 1,000 rupees from c. Through b's misconduct the money is not recovered. B is entitled to no remuneration for his services, and must make good the loss.

Right of lien

Section 221 of the act confers upon an agent the right of particular lien. The agent is entitled to retain goods, papers and other property, whether movable or immovable, of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or accounted for to him.

The right of lien by the agent is subject to the condition that the property of the principal should have been received by him lawfully, and not by a wrongful act. In other words, the property should have been received in the ordinary course of business of the agency. Further the right can be exercised only in the absence of a contract to the contrary. The right of lien is only a limiting one and not an absolute one. As such, the right enables the agent to retain possession of the property of the principal till his dues are paid.

The agent has no right to sell the property of the principal and dispose of the same in any other manner without the latter's consent. Further, the lien is limited only to the extent of the rights that the principal has on the property.

Right to indemnity

The agent is also entitled to be indemnified by the principal against the consequences of all lawful acts done by him in the exercise of the authority conferred upon him. This right has been conferred upon him by section 222 of the act.

According to illustration (a) to this section, b, at singapore, under instructions from a, of calcutta, contracts with c to deliver certain goods to him. A does not send the goods to b, and c sues b for breach of contract. B informs a of the suit, and a authorizes him to defend the suit. B defends the suit and is compelled to pay damages and costs and incurs expenses. A is liable to b for such damages, costs and expenses.

Right to compensation

If, in the course of conducting agency business, any injury is caused to the agent by the principal's negligence, or want of skill, the agent has a right to be compensated by the principal. This right of an agent is recognised by section 225 of the act.

According to the illustration to the section, a employs b as a bricklayer in building a house, and puts up the scaffolding himself. The scaffolding is unskillfully put up, and b is in consequence hurt. A must make compensation to b.

Equitable right to sue the principal for accounts arising under special circumstances

In english law an agent has a right to have an account taken and where the accounts are of a simple nature they can be taken in an ordinary action in a queen's /king's branch division. The legal position in india is different. Though an agent has no statutory right for an account from his principal, nevertheless there may be special circumstances rendering it equitable that the principal should account to the agent. Such a case may arise where all the accounts are in the possession of the principal and the agent does not possess accounts to enable him to determine his claims for commission against his principal.

8. Duties of principal

The rights of an agent are obviously the duties of a principal. These duties are:

- To remunerate the agent for his services (section 219). (2) to indemnify the agent against the consequences of all lawful acts (section 223).
- To indemnify the agent against the consequences of an act done in good faith, even though the act causes injury to the rights of third persons (section 222).
- To make compensation to the agent in respect of injury caused to such agent by his negligence or want of skill (section 212).

9. Rights of principal

To see that the agency business is conducted according to his instructions, or in their absence, according to the custom which prevails in the place where similar business is conducted (section 211).

- To be entitled to compensation for loss, or any profit accruing, owing to departure from instructions
- (section 211).
- To be entitled to compensation in respect of the direct consequences of the agent's negligence, want of skill, or misconduct. (section 212).
- To get proper accounts on demand (section 213).
- Right to give instructions in cases of difficulty, when contacted by the agent (section 214).
- To repudiate the transaction, if a material fact is concealed or the dealing by the agent on his own account is disadvantageous to him (section 215).
- To claim the benefit, if any, arising from a transaction entered into by the agent on his own account (section 216).
- To receive all moneys due to him, subject to such deductions by the agent as are permissible (section 218).
- To remunerate the agent only after the completion of the act (section 219).
- To refuse to pay the remuneration if the agent is guilty of misconduct (section 220),

10. Agent's authority

Having considered the rights and duties of an agent and his powers to alter his principal's legal relations with the third parties, it is now necessary to examine the principal's rights and liabilities in relation to third parties. Before discussing this it will be better to discuss first agent's authority.

The authority of an agent means his capacity to bind the principal. According to montrose, j.l. It is "the sum total of the acts it has been agreed between the principal and agent that the agent should do on behalf of the principal." if the agent does any of these acts he is said to have acted within his authority.

As regards the enforcement and consequences of agent's contracts section 226 provides that "contracts entered into through an agent, and obligations arising from an act done by an agent may be enforced in the same manner, and will have the same legal consequences as if the contracts had been entered into and the acts done by the principal in person". The following two illustrations are appended to the section:

A buys goods from b, knowing that he is an agent for their sale, but not knowing who is the principal. B's principal is the person entitled to claim from a the price of the goods, and a cannot in a suit by the principal set off against that claim a debt due to himself from b.

A, being b's agent with authority to receive money on his behalf receives from c a sum of money due to b. C is discharged of his obligation to pay the sum in question to b. The authority of an agent to bind the principal may be of the following two types:

1. Actual or real authority
2. Ostensible or apparent authority.

1. **Actual or real authority.** Actual authority of an agent is the authority conferred on him by the principal. Section 186 provides that, "the authority of an agent may be express or implied."

Section 187 gives the definition of express and implied authority. These have already been explained under the heading "creation of agency". To repeat section 187 *"an authority is said to be express when it is given by words*

Spoken or written. An authority is said to be implied when it to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted circumstances of the case ".

Section 188 provides the extent of agent's authority. It is reproduced below:

"an agent having authority to do an act has authority to do every lawful thing which is necessary in order to do such act".

"an agent having an authority to carry on a business has authority to do every lawful thing necessary for the purpose, or usually done in the course of conducting such business."

The following illustrations are appended to the section:

A is employed by b, residing in london to recover at bombay a debt to b. A may adopt any legal process necessary for the purpose of recovering the debt, and may give a valid discharge for the same.

A constitutes b, his agent to carry on his business of a shipbuilder. B may purchase timber and other material, and hire workmen, for the purpose of carrying on the business.

2. **ostensible or apparent authority:** ostensible or apparent authority is the authority of an agent as it appears to others. In **smith and watt's** *mercantile law* (8th ed. 1924, page 177) the "implied" and "ostensible" authority have been distinguished as given below.

"implied authority is real authority, the exercise of which is binding not only as between the principal and the third party, but also between principal and agent. It differs only from an express authority in that it is conferred by no express words, it is to be gathered from surrounding circumstances. The term 'ostensible authority', on the other hand, denotes no authority at all. It is a phrase conveniently used to describe the position which arises when one person has clothed another, or allowed him to assume an appearance of authority to act on his behalf, without actually giving him any authority either express or implied by which appearance of authority a third party is misled into believing that a real authority exists."

Unit IV

1. Definition of partnership
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3. Mode of determining of partnership
4. Salaried partner
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THE NATURE OF PARTNERSHIP

1. Definition of partnership

The first part of section 4 of the indian partnership act, 1932 defines 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.

The second part of section 4 states that "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".

The definition of partnership adopted in section 4 of the indian partnership act. 1932 is that suggested by pollock with only a slight change. It brings out very clearly the fundamental principle of mutual agency, *e.g.*, the partners, when carrying on the business of the firm, are agents as well as principals. Thus it is probably the most business-like definition of the term "partnership." it also suggests that partnership is not an agreement itself or an association of persons but is the relation arising out of an agreement.

Partnership is the relation—partnership is regarded differently by different persons either a contract between persons or an association of persons or as a combination of capital, labour or skill by two or more persons or as a relation between persons. It cannot be regarded as a contract between persons because partnership arises out of contract and it is not the contract itself. Although association is the result of partnership it .is better to use the word relation because association denotes many other forms of unions and combinations of persons. As said earlier it is not necessarily combination of capital, labour or skill or some or all of them because every partner need not contribute capital, labour or skill or some or all of them. Therefore, partnership is the relation arising out of contract and not the contract itself.

2. Essentials of partnership

An analysis of the definition gives the following essentials of partnership:

- There must be *two or more persons* as principals carrying on a business.
- Partnership is the result of an *agreement.*
- It is organized to *carry on a business.*
- The persons agree to *share the profits* of the business.
- The business is carried on *by all or any one of them acting for all*
- These essentials are discussed below:

1. Two or more persons

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. Business is carried on by several individuals on behalf of a single person, there will be no partnership, but if it is run by one person (or more) on behalf of himself and others there may be a partnership. Thus a sleeping or dormant partner may be carrying on a business for the purposes of the act.

A contract of partnership may be entered into by every person who is competent to contract. A person ordinarily enters into a contract of partnership in his individual capacity. But sometimes he may be a *karta* of a joint hindu family. But where two *kartas* of two joint hindu families enter into a contract of partnership it will be a partnership between two *kartas* each being counted as one person, and other members of the family do not *ipso facto* become partners. *The word 'persons' includes artificial as well as natural persons and there may thus be a partnership between a company and individual or between two or more companies.* A partnership firm is not recognized as a separate legal entity therefore, where a firm enters into a contract of partnership with another firm or individual, all the members of the firms or firm become partners in their individual capacity.

Thus there must be at least two per sons, natural or artificial competent to contract acting as principals for the existence of partnership. Section 11 of the companies act, 1956 provides that the maximum number of persons who can enter into a contract of partnership in the case of banking business is ten, and for any other business twenty. Any partnership formed in contravention of this section will be treated as illegal association. The section does not apply to joint hindu family as such carrying on a business and where a business is carried on by two or more joint hindu families, minor members shall be excluded in computing the number of persons.

There can be a valid contract of partnership even though one of the partners is a benamidar of or represents some other person or persons.

2. Agreement

The definition of the partnership stresses that 'partnership is the relation between persons *who have agreed.....*" therefore,

There must be an agreement entered by two or more persons to share the profits of a business. This element relates to the voluntary contractual nature of partnership. The partnership is not created by status. The term "agreement" will have to be taken in the sense in which it is defined in section 2 of the contract act. It must satisfy the requirements of a valid contract as stated in section 10 of the contract act. The agreement may be either express or implied. An express agreement means an agreement which is made by means of words, written or spoken, and an implied agreement means one which is inferred from the conduct of the parties. Further the agreement must be of voluntary nature.

Thus a partnership may be created by means of an express agreement. If the agreement is in writing the instrument is called the partnership deed. Writing is advantages, but it is not compulsory. An oral agreement to form a partnership is as valid as a written one. The existence of partnership can be inferred from the conduct of the parties involved.

On the death of the sons the business came to the hands of their descendents and one of them demanded partition of the business as though it were a family property. On behalf of the defendant it was contended that since the property belonged to the partnership firm the claim should be for dissolution of the firm and not for partition. It was noted as facts that the business was in existence and it had been carried on since the death of its founder. One of the plaintiffs was earlier working as an employee and after receiving the share of an heir in the business by way of gift, he discontinued taking salary and instead given a share in the profits of the business. Further, the other plaintiff was taking fewer shares of the profits instead of equal to which he was entitled. Taking all these circumstances into consideration, the court said, 4we are clearly of the opinion that the firm must be regarded as a partnership concern'. The muslim law does not recognize any such thing as a mohammedan joint family carrying on business as a legal entity.

Thus partnership can only arise as a result of an agreement (express or implied) between two or more persons. This element distinguishes partnership from noncontractual relations, such as joint hindu family. **It is so essential that section 5 of the indian partnership act states that the relation of partnership arises from contract and not from status; and in particular, the member of hindu undivided family carrying on a**

family business as such or a burmese buddhist husband and wife carrying on business as such are not partners in such business.

Joint hindu family business—*in* case of joint hindu family business, the relation of the member with each other, as also their rights and liabilities, are substantially governed by hindu law and not by the general law of partnership embodied in indian partnership act, 1932. The term family business means (a) an ancestral business, *i.e.*, a business which descends like both Property on the member of a joint hindu family from father, grandfather or great grandfather; and (b) a new business started by the managing member or by the members of a joint hindu family with the aid of ancestral or joint hindu family *(niamat rai* verses. *Din dayal.* It may be noted that according to hindu law a male child of a hindu acquires an interest in family business by birth. Similarly, a burmese buddhist husband and wife become on marriage joint owners of a business which they or any of them are conducting.

Thus a partnership cannot be created without an agreement between persons. The act does not provide the form of partnership agreement. Thus it may be either written or oral or may be inferred from the conduct of the persons. Where there is no written agreement or any other documentary evidence of the existence of partnership, it can be inferred from the conduct of the persons, the mode in which they deal with each other or with other people, the account books of the business, the testimony of clerks, agents and other persons, by letters and admissions, and by any other mode by which facts can be established. In this connection section 6 states 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."

The agreement must be enforceable by law. As stated earlier it must have all the essential elements of valid contract as laid down in indian contract act, 1872. The agreement must be lawful. The persons must be competent to contract there can not be a partnership consisting of one adult and one minor or a partnership consisting of all minors. There must be at least two adult members as partners. As regards consideration it is stated in **lindley on partnership** that "any contribution in shape of the capital or labour, or any act which may result in liability to third parties, is a sufficient consideration to support such an agreement."

Mere use of the word 'partner' or partnership in an agreement does not necessarily show that there is a partnership.

3. Carrying on of business

A partnership for the purposes of the partnership act means a business partnership in order that an agreement to share the profit may constitute partnership such profit must arise out of a business. Thus there must be an agreement to share the profits of a business and for this purpose **business 'includes every trade, occupation and profession'** (section 2). Thus the word business has been used in a very wide and extensive sense. Virtually any commercial activity or adventure amounts to a business for the purposes of the act. In *smith verses anderson,* 15 ch d 247, james l.j. Said that the term business must be taken in a practical sense, *i.e.,* in a sense in which men of business would use that term. Thus it refers to any activity which if successful would result in profit. Section 8 of the act provides that there may be partnership-even in a single adventure or undertaking. Therefore, it is not necessary that the business should consist of a long and permanent undertaking. For instance, where two persons agreed to produce a film and share the profits of hiring it out, it was held to be sufficient to form a partnership *(mind verses roshan lal shorey,*).

Business must be in existence—whether temporary? Or permanent, the business must actually have been embarked upon; until it is commenced, there is no partnership. An agreement to carry on business in future does not result in present partnership. For instance, in r.r. Sarna verses. Reuben, the plaintiff deposited a sum of the money in the name of civil engineering co. With the kanpur municipal board for obtaining a licence to produce electricity. The licence was refused and money refunded. The other partner contended that it would be paid after meeting partnership liabilities. But it was held that there was no partnership as yet.

A society for religious or charitable or social purposes is not a partnership.

Agreement to make a formal deed—in harichand verses. *Govind,* (1923), it was held that where an oral agreement of partnership stipulates that a formal document should be drawn by a lawyer, the fact that no such deed is executed or its execution is delayed does not militate against the existence of the firm, provided that some business operations have come into being.

4. Sharing of profits

The word "partnership" is derived from the word "to part", which means "to divide". The division of profits is an essential condition for partnership. A person can claim himself to be a partner in a business only when he has a right to a share in the profits of the business. Thus an agreement to share the profits of a business in the sense of the net gain resulting after payment of all outgoings is an essential element of partnership. It follows that societies and clubs, the object of which is not to earn profit, are not partnership and their members as such are not liable for each other's acts. It is stated in lindley on partnership 14th ed p. 13 that "the terms" "partnership" and "partner" are evidently derived from "to part" in the sense of to divide amongst or share, and doubtless the division of profits amongst the partner is the general, if not universal, object of partnership."

The act does not prescribe any particular manner of distribution of profits, monthly, yearly, or otherwise. The act does not prescribe the degree or kind of participation of profits, for, rent paid to a propertied member may be taken as his share of profit. *Girdharbhai* verses. *Saiyed md. Kadri,]*.

It is not necessary that the profits of the business should be shared at any particular time. Partner can leave their profits in the business. They may also not to take whole of the profits for their own personal use and reserve a part of the profits for charitable purposes. Thus what is to be looked at is the substance of the relationship between the parties and where it appears that in substance there is partnership, the mere fact that participation in profits is described in the agreement not as sharing profits but by any other expression, will not change the real relation between the parties.

"the receipt by a per son of a share of the profits of a business or a payment contingent upon the earning of profits or varying with the profits earned in a business, does not of itself make him a partner with the persons carrying on the business: and, in particular, the receipt of such share or payment:—

- By a lender of money to persons engaged or about to engage in any business,
- By a servant or agent as remuneration,
- By the widow or child of a deceased partner, as annuity, or
- By a previous owner or part owner of the business, as consideration for the sale of the goodwill or share thereof, does not of itself make the receiver a partner with the persons carrying on the business "

In *murlidhar* verses. *Bansidhar,* payment of salary out of profit to a retiring partner was held to be not sufficient for creation of partnership in the absence of mutual agency. Thus sharing of profits is no longer the conclusive test of the existence of partnership.

5. Sharing of loss. In *raghunandan nanu kothare* verses. *Hormasjee bezonjee bamjee,* it was held that the partners may agree to share the profits in any way they like and partner can receive a fixed annual or monthly sum in lieu of a sum varying in accordance with the profits actually earned. The partners may also agree that only one of them will bear all loses of the business and this agreement applicable among themselves, for whatever their agreement may be, they would all be liable to outside parties.

6. Mutual agency

The last words in the definition of partnership in section 4 stress that the business may be carried on by all or any of them *acting for all.*

It means that partners when carrying on the business of the firm are agents as well as principals. An [4] agent' is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, and who is so represented, is called the "principal". (section 182 of the indian contract act, 1872). This element of mutual agency is the most important factor in determining the true relationship between persons carrying on any business common between them. Relationship of mutual agency between the partners is the real or conclusive test of partnership. This is the principle *of cox verses hickman,* (1860). The facts of this case were as follows

3. Mode of determining existence of partnership

Section 4 of the act defines partnership. Section 6 prescribes the mode of determining the existence of partnership. Section 5, as discussed earlier, and the two explanations to section 6 contain some useful explanatory rules for the guidance of the courts in doing so. The courts must, in the first instance apply the provisions of section 4 and section 6 while determining the existence of partnership. The courts must also seek assistance of other sections of the act and particularly section 5 and the two explanations to section 6, section 6 is reproduced below:—

"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 partners as shown by all relevant facts taken together.

Explanation 1.—the sharing of the profits or of gross returns arising from property by persons holding a joint or common interest in that property does not of itself make such persons partners.

Explanation 2.—the receipt by a person of a share of the profits of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business, does not of itself make him a partner with the persons carrying on the business ;

And, in particular, the receipt of such share or payment—

- By a lender of money to persons engaged or about to engage in any business,
- By a servant or agent as remuneration,
- By the widow or child of a decreased partner, as annuity, or
- By a previous owner of the business, as consideration for the sale of the goodwill or share thereof, does not itself make the receiver a partner with the persons carrying on the business." the law to determine the existence of partnership was stated in *ross verses. Purkyns,* (1875) l.r. 20 eq. 331, at page 335 jessel, mr., as follows:—

"It is said (and about that there is no doubt) that the mere participation in profits *inter se* affords cogent evidence of partnership. But it is now settled by the cases of *cox verses hickman (1* 860) 8 hl cas 268; *bullen verses. Sharp,* (1865) lr 1 cp 86 ex ch *and mollow march and co. V: court of wards,* (1872) lr 4 pc 419, sup. Vol. Ia 86, that although a right to participate in profits is a strong test of partnership. And there may be cases whereupon a simple participation in profits there is a presumption, not of law, but of fact, that there is a partnership, yet whether the relation of partnership does or does not exist must depend upon the whole contract between the parties, and that circumstance is not conclusive."

Section 6 has restated the law as stated above. The section also prescribes the manner in which general principle is to be applied to particular circumstances. *Thus the question whether a relation of partnership exists or not depends upon the real intention and contract of the parties as appearing from the whole facts of the case and not merely on their expressed intention. Two persons in a written agreement may have stated that they are not partners, yet they may be held to be partners, or they may have stated that they are partners and yet may not be held to be partners. Thus in considering whether a partnership was intended or not, the court is not bound by the terminology used by the parties.* The Supreme Court in its decision in m p. *Davis* verses. *Cait,* refused to accept that the relations created by a declaration of partners were those of partners.

It determining whether partnership exists between a numbers of persons, the court must have regard to the real relation between them. The real relation between them is to be ascertained from all relevant facts taken together. The court must consider all the facts and circumstances of the case and draw an inference from them as a whole without attributing undue weight to any one of them. *The cumulative effect of all the facts and circumstances should be considered while deciding the existence of partnership.*

The real relation or intention of the parties is to be deduced from the written agreements, if any, verbal agreements, together with surrounding circumstances at the time when the contract was entered into, conduct of the parties, as well as other facts that may be relevant, such, for instance, as the right to control the property, the manner in which accounts of the business are kept, the right to receive profits and the liability to share the losses. It is stated in **lindley on partnership,** ed. 14 page 12, that "as partnership, even for long terms of years, very often exist in this country without any written agreement, the absence of direct documentary evidence of any agreement for a partnership is entitled to little weight. As between the alleged partners themselves the evidence relied on, where no written agreement is forthcoming, is their conduct, the mode in which they have dealt with each other, and the mode in which each has, with the knowledge of the other, dealt with other people. This can be shown by books of accounts, by the testimony of clerks, agents, and other persons, by letters and admissions and in short, by any of the modes by which facts can be established."

As said earlier the true test for determining whether a person receiving a share of profits of a business is or is not a partner is to see whether there is a relationship of mutual agency between him and other concerned person or persons. The test is one of agency and authority. *To constitute a partnership there must be community of benefit and not a conflict of interest as in the case of debtor and creditor** sharing of profits is a strong evidence of partnership but in no sense conclusive or even presumptive evidence of it. Although section 2 (3) of the (english) partnership act, 1890 states that receipt by a person of a share of the profits of a business is *"prima facie"* evidence that he is a partner in the business, but section *6 of the indian partnership act, 1932 deliberately avoids the use of the expression "prima facie " and emphasizes that real relation is to be determined by examining all relevant facts together.* The use of the expression *"prima facie"* has been criticized by **sir fredric pollock** in his work on partnership, 14th ed. Page 17-18. He observed. "it is to be regretted that the learning and scholarship of both houses of parliament were not able to devise a better english equivalent for the barbarous *"prima facie "* which though common and convenient in everyday professional use, is hardly becoming an act of parliament, and not being a term of art known to the law, is capable of leading to ambiguity."

Section 4 of the act defines partnership is silent about sharing of losses. It means community or sharing of losses is not essential for partnership. Thus sharing of losses is a legal consequence arising out of the relation and is not a test of a partnership. Two partners may agree that one of them only shall bear all losses of the business. Such agreements are usually made where the entire business is to be conducted by one of the partners. Sharing of losses of a business, though not essential for partnership, is nevertheless a very important incident of the relation. An unqualified agreement to share a definite proportion of the losses is a very strong evidence of partnership. Where persons have agreed to share the profits as well as losses of a business partnership have almost always been inferred [chokalinga verses. Muthuswami, (1825) 48 mad lj 518; manbharibai verses b.r. Mill (1956) nag 225; bansi ram verses. Jagon math, brett verses. Beckwith].

Although partnership usually results from a combination of capital, labour or skill, the contribution of capital by partners of the existence of any partnership property is not essential for the existence of partnership between them. Sometimes there is partnership in the profits and the property with which the business is carried belongs only to one of the partners or is the property of the partners without its being treated as property of the firm.

Two or more separate firms by the same partners—in *commissioner of sales tax* verses. *K. Kelukutty,* (1985), it was held that an agreement between the partners to carry on a business and share its profits may be followed by a separate agreement between the same partners to carry on another business and share the profits therein. The intention may be to constitute two separate partnerships and therefore two distinct firms or to extend merely partnership, originally constituted to carry on one business, to the carrying on of another business. It will depend on the intention of the partners. The intention of all the partners will have to be decided with reference to the terms of the agreement and all surrounding circumstances, including evidence as to interlacing or interlocking of management, finance and other incidents of the respective businesses.

In *cit* verses. G. *Parthasarthy naidu,* (1998) , two firms were held two different legal entities for the purposes of assessment under the income tax act, 1961 as the partners have expressed their intention to such effect, there was no interlacing or intermixing between the two firms and the business of the two firms was different.

widow or child of a deceased partner receiving annuity—an agreement to pay annuity out of the profits to the widow or child of a deceased partner does not make her or the child a partner in the firm. In *holme* verses, *hammond,* (1872) lr 7 ex. 218, three persons agreed to become partners for seven years, and to share profits and losses equally. They also agreed that if a partner died within seven years, the survivors should continue the business and pay to the executors of the deceased partner the same share of the profits which he would have had if living. One of the partners died and his share of the profits was paid to his executors as provided by the agreement although executors took no part in the management of the business. The plaintiff sued the executors in respect of a contract made by the surviving partners after the death of the deceased partner, but it was held that the executors were not liable as they were not partners. There was no evidence whatsoever to establish a contract of partnership between the executors and the surviving partners; there was no mutual agency between them.

seller of goodwill receiving share of profits.—the seller of goodwill receiving a share of the profits of a business would not by reason only of such receipt be deemed to be a partner of the person carrying on such business, or be subject to his liabilities. In *rawbinson verses clarke,* (1846) 153 er 860, a doctor sold the goodwill of his medical practice to a purchaser but agreed that he would continue to attend to his Old profession and introduce patients, he being allowed a certain share of the profits. It was held that there was no partnership.

4. Salaried partner

In *stekel verses ellice,* (1973) i all er 465, megarry j of the chancery division observed that "the term 'salaried partner' ..... Is a convenient expression which is widely used to denote a person who is held out to the world as being a partner, with his name appearing as a partner on the note paper of the firm and so on. At the same time he receives a salary as remuneration, rather than as a share of the profits, though he may, in addition to his salary, receive some bonus or other sum of money dependent on the profits."

Is paid a fixed salary irrespective of profits and that as between himself and his copartner he is not liable for the partnership debts." the concept of a salaried partner has found further recognition in the decision of megarry j of the chancery division in *stekel verses ellice,* (1973) 1 all er 465. His lordship said:

"it is impossible to say that as a matter of law a salaried partner is necessarily a partner in the true sense. He may or may not be a partner depending on the facts. What must be done is to look at the substance of the relationship between the parties."

In this case s (the plaintiff) joined e (the defendant) in a firm of chartered accountants as a salaried partner; property, profits and goodwill, including clientage, remaining that of e. All losses were to be borne by e. They were not to engage in any other business. It was held that s no doubt became a partner, but he was not entitled to dissolution as he had no interest in assets.

The learned judge said: "certainly the relationship between the parties under the agreement seems to satisfy the statutory definition as being the relation which subsists between persons carrying on a business in common with a view of profit.

True again, the plaintiff had no share of the profits and so there is no *prima facie* evidence that he is a partner in the business; but the absence of one possible head *of prima facie* evidence does not negate the other evidence of partnership."

5. Partnership and co-ownership

According to explanation i to section 6 of the act "the sharing of profits or of gross returns arising from property by persons holding a joint or common interest in that property does not of itself make such persons partners. "

Thus, if two persons jointly own a house, they remain as co-owners of the house but not as partners. Even if they should agree to let out the house and share the rent, they continue to be co-owners in the absence of the application of the principle-of agency.

The following are the main points of distinction between partnership and co-ownership:

- **Mode of creation**.—co-ownership is not necessarily the result of agreement, whereas partnership is.

- **Community of profit or loss**.—co-ownership does not necessarily involve community of profits or of loss, but partnership does.
- **Transfer of interest.**—one co-owner can, without the consent of the other, transfer his interest to a stranger. A partner cannot do this.
- **Business**—business is necessary for existence of partnership; mere co-ownership is not a business and it can also exist without business.
- **Mutual agency.**—mutual agency is a pre-condition for the existence of partnership; but mere co-owners are not business agents and therefore one co-owner can act for oneself and not on behalf of the other part owners.
- **Remedy.**—a co-owner can sue the other part-owner for division of the joint property. Partners, on the other hand, can sue only for dissolution and accounts and not for direct division of assets among them. (see *champaran cane concern* verses. *State of bihar,* and *laxmibai* verses. *Roshanla*.

Mode of creation—a partnership arises on the basis of a contract as stated in sections 4 and 5 of the act. A joint hindu family firm arises on the basis of status, *i.e.* By the operation of law, upon the fact of marriage, birth or adoption.

Admission of new members—no new partner can be admitted into partnership without the consent of all the existing partners. The Membership of a joint hindu family firm is automatic by the birth or in case of adoption into the family of male members if that family is carrying on a business. A minor can also be a member. Thus the membership of a joint hindu family keeps changing, whereas in the partnership the members remain more or less fixed and constant.

Management and representative capacity—while in a partnership all the members are entitled to take an active part in the management of the business, in the case of a joint hindu family business it is only the manager or *karta* who is the senior male member entitled to manage the business. The other members of the family do not have the representative capacity as held by sarkaria j in *nanchand gangaram selhji* verses. *Mm. Sadalge,* (1976) 3 scr 287. In partnership, as stated in section i 8, every partner becomes an agent of the firm for the purposes of the business of the firm. There is mutual agency among partners. The existence of mutual agency enables partner to bind the other partners for the acts done by him in the ordinary course of the business of the firm.

Nature and extent liability—according to section 25 every partner is liable jointly with others as well as personally for the acts of the firm. In case of the joint hindu family business the members are not personally liable. The liability of the members of a family is limited to their share in the property and profits of the family business. It is only the manager or *karta* who is personally liable to an unlimited extent. In case of partnership the liability of the partners is unlimited.

Mode of effecting separation—in case of partnership the remedy against each other is a suit for dissolution of the firm, whereas in case of joint hindu family the remedy is a suit for partition of the family assets. A family is not dissolved; it can split into smaller units.

Number of members—in case of partnership the maximum number of partners is ten for partnership 'doing banking business and twenty in any other business. But there is no such limit in case of joint hindu family business.

Right to share in the profits—a partner has right to demand his share of profits of the business; but a co-parcener has no such right. He can only demand partition and separate himself from the family business.

Death of a partner or member—the death of a partner brings about the dissolution of partnership unless there is a contract to the contrary as per section 42; but the death of a co-parcener does not dissolve the joint family business.

Thus, a firm is only an aggregate of the individuals who are partners in a business. It is not a distinct legal entity, but a name given to the partners collectively. It is impossible to think of a firm apart from the members constituting it. The property of the firm belongs to the partners jointly. The death or insolvency of a partner puts an end to its existence, and persons who deal with the firm do so with the partners jointly. The firm does not carry on the business, but only the partners who do so in the name of the firm.

According to **lindley** (lindley and barks on partnership, 16th ed., page 26) legal notion of the firm is different from that of its commercial or mercantile notion.

6. Restriction on number of partners

The restriction on the maximum number of partners is contained in the companies act, 1956. As per the companies act, partnerships should not have large number of members because unidentified number of members can create complex problems of rights and liabilities of the members *inter se* and in respect of their relations with others. Therefore, section 11 of the companies act, 1956 provides that no company, association or partnership consisting of more than 20 persons (10 in case of banking business) shall be formed for the purpose

of carrying on any business that has for its objects the acquisition of the gain for itself or for its members unless it is registered as a company under the companies act or is formed in pursuance of some other law, thus if there is a partnership firm consisting of more than 20 partners (10 in case of banking business) and it is not registered as a company, it becomes an illegal association.

- The section, however, does not apply to a joint hindu family carrying on business.
- *Consequences of illegal association.*— following are some of the consequences of illegal association.
- Every member of such an association shall be personally liable for all liabilities incurred in the business.
- Members of an illegal association are punishable with a fine which may extend to one thousand rupees.
- Members of an illegal association cannot maintain an action in respect of any contract made by it.

There can be no suit between the members of an illegal association for dissolution or for rendition of accounts. In *badri prasad* verses. *Nagarmal,* an association of cloth merchants consisting of 25 members was held to be an illegal association. It was further held that members have no remedy against each other in respect of contracts which the law declares to be illegal. The supreme court in the aforesaid quoted with approval the decision of the privy council in *senaji kapurchand. Pannaji devichand,*

7. Duration or types of partnership

1. Partnership at will

Section 7 of the act provides as follows:

Where no provision is made by contract between the partners for duration of their partnership, or for the determination of their partnership, the partnership is "partnership at will".

Section 7 provides that where there is a provision in the contract for the duration of partnership, the partnership is not at will. Similarly, if there is a provision in the contract for the determination of partnership, it is not partnership at will. Thus section 7 recognizes two exceptions to the partnership at will.

The duration of partnership can be expressly provided in the contract or it may be implied from the conduct of the parties. The same principle applies to a case determination.

In *uduman* verses. *Aslum,* (1991) the partnership deed provided that the partnership was to continue till there were two partners. The supreme court held that this was a provision as to duration and therefore, the firm was not "at will". Therefore, a suit for dissolution on the basis of notice was not maintainable.

In *karmuthu thiagarajan chettiar* verses. Em *muthappa chettiar,* the partnership deed provided that in case of death or retirement of a partner his legal heirs would be admitted on the same terms; that the death would not dissolve the firm and the same would be carried on by the remaining partners along with legal heirs; that retirement would require six months' notice; that on retirement etc. There would be no valuation of assets and the outgoing partner would get only the amount standing to the credit side of his account at the time. The supreme court held that the partners never intended that the partnership be dissolved at the sweet will of any of the partners, rather their intention was that the business should continue as long as possible, notwithstanding death or retirement of the partner.

Section 32(l)(c) of the act provides that a partner may retire where the partnership is at will, by giving notice in writing to all other partners of his intention to retire. Section 43(1) provides that where the partnership is at will, the firm may be dissolved by any partner by giving notice in writing to all other partners of the intention to dissolve the firm. Section 43(2) provides that 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.

In *narayan lal bansilal pitti* verses. *Tarabai motilal,* (1970), the partnership business, was agreed to be for two years; whether this was extended for another three years or whether there was an agreement under which one partner was to pay out the other, over this question the trial court dismissed the suit, the high court reserved it and the supreme court restored the order of the trial court. It was held that there was no agreement to extend the partnership for the next three years.

2. Particular partnership

Section 8 of the act provides as follows:

A person may become a partner with another person in particular adventure or undertaking. Section 8 of the act makes it clear that there can be a partnership in a single venture and brief business venture provided the requisites of partnership as given by section 4 are present. Under section 4 there must be a "business" and there must be an agreement to share the profits of that business, and the business must be carried on by all or any of the partners acting for all. Thus relation of partnership need not be a permanent bond.

In *karmali abdulla* verses. *Vora karirnji jiwanji,* (1995), karim (delhi merchant) and rashid (bombay merchant) decided to have a joint speculation in brown sugar to be shipped from mauritius to hong kong. The preamble to their agreement declared that their purpose was doing business in partnership. Purchases were to made jointly in mauritus by either of them after consultation with the other and after taking advice from bombay houses. A ship was then to be chartered after consultation, and loaded with the purchased sugar and dispatched to hong kong,

there was a loss in the very first transaction. One of the merchants became bankrupt. The question was whether the other merchant was liable for a bill drawn by the former in connection with the consignment. Lord dunedin held that there was a partnership. His lordship further held that it was a partnership of limited character.

An instance of particular partnership was before the Supreme Court in *gherulal parekh* verses. *Mahadeo das,* air 1959 sc 781. In this case, the appellant and the respondents entered into a partnership to carry on wagering contracts with two firms of hapur for a particular season only. They agreed to make the contracts in the name of the respondent on behalf of the firm and to divide the profit and loss resulting from the transactions in equal shares.

The respondent sued the appellant for settlement of accounts of the dissolved firm. The supreme court held that in the present case the partnership was not unlawful within the meaning of section 23 of the contract act, and therefore, the appellant was liable to bear his share of the loss. It was further held that it was a valid particular partnership, and section 42 of the partnership act was applicable in the present case.

8. PARTNERSHIP PROPERTY

There are various reasons to determine the joint property of the partners that is the property of the firm as opposed to the personal property of the partners. For instance, section 49 provides that on the dissolution of a firm, "where there are joint debts due from the firm, also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of debts of the firm, and 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." secondly section 15 provides that "subject to contract between the partners, the property of the firm shall be held and used by partners exclusively for the purpose of the business of the firm." section 28(2) of the provincial insolvency act (section 17 of the presidency towns insolvency act) provides that where a person carrying on business with others becomes insolvent his share in the property of the firm vests in official receiver or assignee for the benefit of his creditors. The question of determining the partnership property may also arise in case of dispute between the partners themselves.

What is partnership property mainly depends on agreement of partners. Such an agreement may be express or may be implied from the facts and circumstances of the case. Section 14 of the partnership act which lays down rules for ascertaining the intention of the parties for this purpose is reproduced below;—

"14. Subject to contract between the partners, 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. Unless the contrary intention appears, property and rights and interests in property acquired with money belonging to the firm are deemed to have been acquired for the firm."

Thus the section lays down the following rules:—

(1) property originally brought in. Unless different intention appears, the property **of the** firm includes the property and rights and interests in property originally brought **into the** stock of the firm. In *robinison* verses. *Ashton,* (1875), the owner of a mill agreed to carry on the manufacture in partnership with others, and was **credited in** accounts of the firm with the value of the mill as his capital. From time **to time** sums were spent in making additions to and improvements in the mill: and in the annual balance sheets the mill was entered as an asset at the original value, **increased** by the amount so expended. It was held that the mill had become the property **of the firm.**

(2) property subsequently acquired. The property of the firm includes, unless there is a different intention, what is added to the common stock of the firm from time to time by or for the firm, or for the purposes and in the course of the business of the firm.

(3) partner's property in firm name. When the personal property of a partner is being used in the business of the firm it is a question of fact to be determined by reference to the partner's intention whether it has become the property of the firm.

(4) Partner's tenancy rights: section 14 requires that there must be some evidence either in terms of the agreement or, conduct of the partners to show that the property stood converted into the common hotchpotch. In *helper girdharbhai verses saiyed mohammad,* air 1987 sc 1782, it was held that if there was a partnership firm of which tenant of the premises in which the business of the firm was carried on has been the partner, the fact of carrying on of business of the partnership in the demised premises would not *ipso facto* tantamount to sub-letting, transfer of interest on assignment, inviting forfeiture of the leasehold or tenancy rights. Similarly in *budhalal chhotalal zavery verses lalavatiben ratilal,* (1994), use of a shop for partnership purposes by the tenant of the shop who was also a partner of the shop did not amount to subletting or assignment so as to invite forfeiture of the tenancy.

In *jayalakshmi* verse. *Shanmugham,* air 1988 ker 128, it was held that the property of a partner whether it be in the shape of a tenancy right or anything else, cannot become the property of the firm by the mere fact that it was

being used in business. Only such properties answering the description in section 14 of the partnership act will be partnership properties. All joint properties need not necessarily be partnership properties.

Goodwill: section 14 specifically lays down that unless there is a contract to the contrary, the goodwill of the business is to be regarded as the property of the firm." the term "goodwill" is not defined in the act. Lord macnaghten in *inland revenue commissioners verses muller & co. Margarine ltd.* (1901) ac 217 observed that the term "goodwill" is a thing very easy to describe but very difficult to define. In *trego verses hunt* (1896) ac 7, goodwill was described as advantage which is acquired by business beyond the mere value of the capital stock fund or property employed therein in consequence of general public patronage and encouragement which it receives from constant or habitual customers. It was further held that it is composed of a variety of elements and is bound to differ in its composition in different trades and different business in same trade. The goodwill can be an advantage connected with the premises in which the business was previously carried on.

9. Relations of partners to one another

9.1 Duties of partners

Duties of the partners can be broadly divided into the following two categories:

1. Absolute duties

2.duties subject to contract to the contrary.

Absolute duties

Section 9 and 10 reproduced above, have imposed certain duties which cannot be varied by agreement between the partners. These duties are discussed below:—

1. Duty to carry on the business to the greatest common advantage and to be just and faithful to each other. Section 9 provides that partners are bound to carry on the business of the firm to the greatest common advantage and be just and faithful to each other. Duty to carry on the business to the greatest common advantage and the duty to be just and faithful to each other are two sides of the same coin, which is the duty of good faith. All the endeavors of a partner must be to secure the maximum profits to the firm. He should not try to make a personal profit for himself at the cost of his co-partners. Duty to carry on the business to the greatest common advantage must be read along with the provisions of section 16. If a partner makes any personal profit, he has to account for it to the firm, as making personal profit would be acting not to the greatest common advantage.

2. Duty to render true accounts and full information affecting the firm. According to section 9 a partner is bound to render true accounts and full information of all things affecting the firm to his co-partners or their legal representatives. In other words the partners must make a full and frank disclosure of facts affecting the affairs of the firm to each other. The duty to render accounts is not confined to submitting statements of accounts, but it includes the duty to handover to the firm the balance of the moneys of the firm which have come in the hands of a partner. He must also be ready to explain to his other partners the true accounts and produce vouchers relating to everything coming into his hands.

3. Duty to indemnify for fraud. Section 10 provides that "every partner shall indemnify the firm for any loss caused to it by his fraud in the conduct of the business." the section makes the liability, to indemnify' for fraud absolute and not subject to contract, i.e. Partners are not allowed to contract themselves out of liability for fraud. Though partners may agree amongst themselves that the extent of a partners liability to his co-partners is to be limited or that he is not liable to compensate them for loss occasioned by his wrongful act, omission, neglect, want of skill, misconduct or negligence, but it is not open to them to contract themselves, or any one of them, out of liability for loss occasioned to the firm by fraud.

4. Duty of due diligence. Section 12 (b) provides that subject to contract between the partners, "every partner is bound to attend diligently to his duties in the conduct of the business." diligent functioning means working with careful effort and absence of carefulness is negligence. But section 13 provides liability only where there is willful negligence.

5. Duty to indemnify for wilful neglect. Section 13 (f) provides that subject to contract between the partners, "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". Unlike the duty to indemnify for fraud under section 10, a partner can contract himself out from this duty. To attract clause (f) the loss caused to the firm must be by partner's wilful neglect. Mere neglect on the part of partner, i.e. A mere inadvertence or accident, is not sufficient to attract application of this clause and the loss caused has to be due to wilful neglect, i.e. A deliberate, intentional and purposeful commission or omission of a certain act. In case such wilful neglect amounts to fraud provisions of section 10 are attracted.

6. Duty to work without remuneration. According to section 13 (a), subject to contract between the partners, a partner is not entitled to receive remuneration for taking part in the conduct of the business.

7. Duty to contribute to losses. Section 13(b) providers that subject to contract between the partners, the partners are bound to contribute equally to the losses sustained by the firm.

8. Duty to apply the property of the firm for purposes of the business of the firm. Section 15 provides that "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." thus it is a duty of the partners that the property of the firm shall be held and used by them exclusively for the purposes of the business of the firm. If a partner uses the property of the firm for his personal purposes he will be accountable to the firm as per section 16, for any private advantage obtained by him. However, the failure of the partner to submit an account of use of partnership property for personal use will not make him liable for criminal breach of trust under section 409 of the indian penal code. In *yelji raghavji* verses. *State of maharashtra,* air 1965, sc 1433, a partner who was assigned the work of realizing the dues of the partnership, failed to deposit in bank some collections, the supreme court held that he was not liable for criminal breach of trust under section 409, ipc as he was authorised by other partners to spend the money for the business of the firm.

9. **Duty to account for personal profits.** Section 16 provides that subject to contract between the partners,—

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;

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.

A. Duty to account for secret profits. According to section 16 (a) a partner is liable to account for profits derived for himself arising out of the following:—

- From any transaction of the firm;
- From the use of property of the firm;
- From use of business connection of the firm; and
- From use of the firm name.

Thus section 16 (a) gives a fairly wide coverage to the liability to account for personal profits. The advantages arising from things connected with the firm should belong to all the partners and not merely to the partner whose mechanism brings them about. A partner being an agent, makes a profit out of the concerns of his principal, and while acting for him, he must disclose it to the principal; he cannot make a profit out of his

principal's business for himself. One of the aspects of his duty is that there should not be a conflict of partner's personal interest with his duty to the firm. For example, if he is authorised to purchase something for the firm he should not supply from his own stock, and if he is asked to sell something for the firm, he should not purchase for his personal use without first informing the other partners. (see *bently verses craven*, discussed earlier). In *gordon verses holland,* (1913) 82 lj pc 81, a partner, improperly and without the knowledge of the other partner, sold 'partnership property to a *bonaflde* purchaser for value and without notice. The partner afterwards purchased the property from him. The partner was held liable to account for profits by subsequent dealings, with the property.

B. Duty not to compete. Section 11 (2) provides that notwithstanding anything contained in section 27 of the indian contract act. The partners may agree that they, or some, or any of them, shall not carry on any business other than that of the firm while he is a partner in the firm. Section 16 (b) of the indian partnership act provides that if a partner carries on any business of the same nature as and competing with that of the firm, he shall account for all profits made by him in that business.

9.2 Rights of partners

Subject to contract between the partners, the indian partnership act confers the following rights upon all the partners:

1**. Right to take part in the conduct of the business [section 12(a)|.** Subject to contract between the partners, every partner has a right to take part in the conduct of the business of the firm. This right cannot be taken away except by a contract. Unequal capital contribution or no capital contribution is no bar to his right. It is sometimes provided by express agreement that this or that partner will not take active part in the conduct of the business and also for payment for salary to managing or active partner.

2. Right to be consulted [section 12(c)|. Subject to contract between the partners, any difference arising as to ordinary matters 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 by the majority of the partners. This power, though not in itself of a judicial kind, is subject to the rule of natural justice. Every partner must have an opportunity of being heard, and the decision must be made in good faith with a view to collective interest of the firm. Further, no change may be made in the nature or place of the business without the consent of all the partners. Thus in the cases of fundamental matters, the consent of all the partners becomes necessary.

3. Right to have access to firm's books [section 12(d)]. Subject to contract between the partners, every partner has a right to have access to and to inspect and copy any of the books of the firm. The term 'books', used is section 12 (d), is more comprehensive than the term 'accounts' used in section 30 (2) of the act. As such, no exception can be made to any books of the firm, even though a particular book may contain business secrets.

This right can be exercised by the partner personally or by an agent, who is not objectionable. However, the extracts of the books should not be used by a partner for purposes hostile or injurious to the firm after he has ceased to be a partner.

4. Right to share the profits [section 13(b)|. Subject to contract between the partners, the partners are entitled to share equally in the profits earned, and shall contribute equally to the losses sustained by the firm. Since this provision is subject to the contract between the partners, it is open to the partners to divide the profits and losses of the firm in a different ratio. The contract may provide that a particular partner will bear all the losses of the business. The contract to the contrary may even provide that one of the partners is to have a fixed salary.

5. Right to interest (section 13(c) and section 13(d)|. Unless otherwise agreed, the partners are not entitled to any interest on their capital. Section 13(c) provides that where a partner is entitled to interest on the capital subscribed by him such interest shall be payable out of

Profits. Section 13(d) provides that subject to contract between the partners, 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 from the firm. A partner has the right of interest on advances whether there are profits or not. But a partner is not entitled to interest after the date of dissolution. The contract may provide a different rate of interest. Subject to contract between the partners, a partner is not entitled to receive remuneration for taking part in the conduct of the business [section 13 (a)].

6. Right to indemnity (section 13(e)|. Subject to contract between the partners,. The firm shall indemnify a partner in respect of payments made and liabilities incurred by him—

In the ordinary and proper conduct of the business, and (ii) in doing such act, in an emergency, for the purposes of protecting the firm from loss, as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

7. Right to use the property of the firm for the purposes of the business of the firm (section 15|. 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. If a partner uses the property of the firm for his own purposes, he will be liable to account to the firm for the profits, if any, that he may make. A contract of partnership is uberrimae fidei i.e., a contract of absolute good faith.

8. Rights of an outgoing partner. The rights of an outgoing partner have been explained in a subsequent chapter. These rights are:

- Right to carry on competing business [section 36(1)]; and
- Right in certain cases to share subsequent profits [section 37].

9.3 Implied authority of a partner

A partner's authority may be express or implied. An authority is said to be express when it is given by words, spoken or written. It is implied where there is no express agreement between the partners, in which case, the law impliedly gives certain powers to a partner and also negatives certain other powers as regards partners. The word "implied" suggests that authority of a partner which is apparent from his position in a partnership firm in relation to the business of the firm. Section 19 deals with the subject of implied authority of a partner. It is reproduced below:—

- open a banking account on behalf of the firm in his own name,
- compromise or relinquish any claim or portion of a claim by the firm,
- He may borrow money for the purposes of the business of the firm,

- He may pledge or sell moveable property of the firm,
- He may buy goods on account of the firm which are necessary for or usually required for the purposes of the business of the firm,
- He may receive payment of debts on account of the firm and give valid discharge by issuing a receipt for the same,
- He may pay debts on account of the partnership firm,
- He may employ servants for the partnership.
- He may sue on behalf of the firm and for this purpose may engage a lawyer. Similarly he can defend a suit brought against the firm and may engage a lawyer for this purpose.
- Submit a dispute relating to the business of the firm to arbitration,
- Open a banking account on behalf of the firm in his own name,
- Compromise or relinquish any claim or portion of claim by the firm.
- Withdraw a suit or proceeding filed on behalf of the firm.
- Admit any liability in a suit or proceeding against the firm,
- Acquire immovable property on behalf of the firm.
- Transfer immovable property on behalf of the firm.
- Enter into partnership on behalf of the firm."

9.4 Liability of a firm for wrongful acts of a partner

Sections 26 and 27 of the act deals with the question of liability of the firm for the wrongful acts of a partner and for misapplication of money or property by a partner. Section 26 provides for the liability of the firm for wrongful acts of a partner in general and section 27 provides for the liability for particular torts and breaches of trust by a partner, namely misapplication of money or property of third persons. Section 26 is as follows:—

"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 to the same extent as the partner."

The liability of the firm under section 26 arises only (1) if the act is done in the ordinary course of the firm or done with the authority of the other partners or on behalf of the firm in its name and the firm subsequently ratifies them with full knowledge of what those acts were, and (2) the result of the wrongful act or omission is the injury to any third party, or any penalty is incurred.

The rule is based on principle of agency. Lord macnaghten in *lloyd verses grace smith & co.,* (1912) a.c. 716 stated the principle in relation to the law of agency which is equally applicable as the principle of the partnership liability. His lordship said:—

"it is now settled that a principal is liable for the fraud or any other intentional wrong of his agent acting within the scope of his authority, whether the fraud is committed for the benefit of the principal or for the benefits of the agent or whether the principal in fact derives any benefit or not. The only difference between the case where principal receives the benefit of the tortuous act, and the case where he does not, is that in the latter case the principal is liable for the wrong done to the person injured by his agent acting within the scope of his agency, in the former case he is liable on that ground and also on the ground that by taking the benefit he has adopted the act of his agent, cannot approbate and reprobate." the expression "acting in the ordinary course of the business of the firm" in section 26 has a wider scope than the implied authority under section 19. What is essential is that the act must be shown to have been done by a partner in the ordinary course of the business of the firm, i.e., done in conducting or carrying on the business of the firm, whether wrongful or unauthorized, would not absolve the firm from liability. Even if the act is done not in the ordinary course of the business of the firm but is done with the authority of the partners of the firm, or the act is subsequently ratified" with full knowledge of the facts, the firm is liable. Further, if one partner in conducting the business of the firm is guilty of breach of revenue laws, the partners are jointly and severally answerable for the consequent penalties, although they may not themselves have authorised or been parties to the wrongful act of their co-partner.

In *mellow verses shaw,* (1861) 1 b&s 437, one of the partners in a coal-mine acted as a manager, and was guilty of personal negligence. His partner was held jointly liable for injury caused from the negligence. In *blyth* verses. *Fladgate,* (1891) 1 ch 337, a partner of a firm of solicitors received money while acting within the scope of his duty. But he was negligent in investing the sum of money on a proper security. The security resulted in a loss to the plaintiff. All the partners were held liable though they had no personal knowledge of the transaction.

In *hamlyan* verses. *John housten & co.,* (1903) 1 kb 81, one of the two partners without the knowledge of his sleeping copartner, by bribery induced a clerk of the plaintiff, a competitor in trade, in breach of duty to his employer to give confidential information in regard to the plaintiffs business. It was in the ordinary course of the business of the firm to obtain such information by legitimate methods, and the partner acted in the interest of the firm. Both partners were held liable to the plaintiff.

10. Liability for holding out

It has long been established that a person who is not a partner becomes liable as if he were one to persons towards whom he so conducts himself as to lead them to act upon the supposition that he is a partner in point of fact. The partnership act 1932 contains the following section on this subject:

"28. Holding out—(1) anyone who by words spoken or written or by contract represents himself, or knowingly permits, himself to be represented, to be a partner in a firm, is liable as a partner in that firm to anyone who has on the faith of any such representation given credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit."

(2) where after a partner's death the business is continued in the old firm name, the continued use of that name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate for any act of the firm liable done after his death.

10.1 Meaning of holding out

The above section reproduces the doctrine of "holding out" which is a part of the law of estoppel as laid down in section 115 of the indian evidence act, 1872 which is as follows:

"when one person has, by his declaration, act or omission intentionally caused or permitted another person to believe a thing to be true and to act upon such belief, neither he nor his representative shall be allowed, in any suit or proceeding between himself and such person or his representative to deny the truth of that thing."

The principle under lying the rule was very clearly stated as early as in 1793 by eyre, c.j., in *waugh verses carver*, (1793) 2 h blacks 235, as follows:—

"now a case may be stated in which it is clear sense of the parties to the contract that they shall not be partners, that a is to contribute neither labour nor money, and, to go still further, not to receive any profits. But if he will lend his name as a partner he becomes as against all the rest of the world a partner, not upon the ground of the real transaction between them, but upon principles of general policy, to prevent the frauds to which creditors would be liable, if they were to suppose that they lend their money upon the apparent credit of three or four persons, when, in fact, they lent it only to two of them, to whom without the others they would have lent nothing."

According to the section if a person who is not a partner represents himself to be a partner in a firm or allows others to do it, he is estopped or prevented from denying this as regards persons who have acted on the faith of such representation. In such a case he is liable as a partner to such person. The motive of the representation or the state of the knowledge of the person making is immaterial. "moreover, if a person has been induced by promises of irresponsibility or by fraud to hold himself out as a partner with others, this circumstance does not relieve him from liability to third parties who have been induced by his conduct to trust him as well as them, and who had nothing to do with promises made to or the fraud practiced upon him.

To hold a person liable on the basis of holding out the following two elements must be present:

- He must have by words, spoken or written, or by conduct represented himself or knowingly permitted himself to be represented as a partner in a firm.
- Credit must have been given to the firm on the faith of such representation.

In *kirkwood verses. Chetham & co., (*1862) , a butter dealer, c, appointed a servant smith and started the business under name of c. Smith & co. Goods were supplied to this firm by the plaintiff. The court held both c and smith liable.

A.r. Porter verses. *W. Incell,* (1905) is a case on representation by conduct. The defendant gave loan to a person who established a cattle farm. The defendant took deep interest in the business and he used his personal influence to obtain a lease of premises for the farm. The defendant was constantly present there receiving parties and their demands. The plaintiff supplied certain goods to the firm under the impression that the defendant was a partner. He was held liable as a partner by holding out.

Holding out may also arise where a person "knowingly permits" 01 aiffers" himself to be represented as a partner.

In tower cabinet co. Verses ingram, (1949), a and b carried on business as household furnishers. B retired and a continued the business under the same name. After the retirement of, the appellant company supplied to the firm some furniture. The payment of furniture was never made. B's name appeared on the paper of the firm on which the contract was concluded. But that representation was made by a without b's knowledge and without his authority. The plaintiff company sought to hold b liable, but he was not held liable as he did not knowingly suffered himself to be so represented.

11. Liability of retired partner.

It is often seen that after a reconstitution of the partnership after their retirement or expulsion of a partner, the business of the firm is continued by the remaining partners or partner in the name of the old firm. In this connection section 32(3) based upon *scarf verses. Jardine,* (1882) provides as follows:

"notwithstanding the retirement of a partner from a firm, he and the partners, continue to be liable as partners, to third parties for any act done by any of them which would have been an act of the firm if done before the retirement, until public notice is given of the retirement. Provided that a retired partner is not liable to any third party who deals with the firm without knowing that he was a partner."

Thus a notice of retirement must be given either by the partner who retires or any partner of the reconstituted firm. If no such notice is given, the retiring partner will be liable for the subsequent act of the firm to all persons having knowledge of the fact of his being a partner. But he will not be liable for future acts of the firm to third parties dealing with the firm without knowing that he was partner. Similarly, remaining partner who carry on the business would continue to be liable by estoppel to third parties for subsequent acts of the retiring partner which would have been binding on the firm if done by him when he was a partner. Thus it is in the interest of both the retiring partner and the remaining partners of the reconstituted firm to give a public notice of retirement by any one of them.

12. Minors admitted to the benefits of partnership.—(section 30)

A person who is a minor according to the law to which he is subject may not be a partner in a firm, but with the consent of all the partners for the time being, he may be admitted to benefits of partnership.

- Such minor has a right to such share of the property and of the profits of the firm as may be agreed upon, and he may have access to and inspect and copy any of the accounts of the firm.
- Such minor's share is liable for the act of the firm, but the minor is not personally liable for any such act.
- Such minor may not sue the partners for an account or payment of his shares of the property or profits of the firm, save when severing his connection with the firm, and in such case the amount of his share shall be determined by a valuation made as far as possible in accordance with the rules contained in section 48:

- Provided that all the partners acting together or any partner entitled to dissolve the firm upon notice to other partners may elect in such suit to dissolve the firm, and thereupon the court shall proceed with the suit as one for dissolution and for settling accounts between the partners, and the amount of the share of the minor shall be determined along with the shares of the partner.
- 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, such persons may give public notice that he has elected to become or that he has elected not to become a partner in the firm. And such notice shall determine his position as regard the firm:
- Provided that, if he fails to give such notice, he shall become a partner in the firm on the expiry of the said six months.
- Where any person has been admitted as a minor to the benefits of partnerships in affirm, the burden of proving the fact, that such person had no knowledge of such admission until a particular date after the expiry of the six months of his attaining majority shall lie on the persons asserting that fact.

Where such person becomes a partner:—

- His right and liabilities as a minor continue upto the date on which he become 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, and
- His share in the property and profits of the firm shall be share to which he was entitled as a minor.
- Where such person elects not to become a partner:-
- His rights and liabilities shall continue to be those of a minor under this section upto the date on which he gives public notice,
- His share shall not be liable for any acts of the firm done after the date of the notice, and
- He shall be entitled to sue the partners for his share of the property and profits in accordance with sub-section

Nature of minor's agreement

An agreement enforceable by law i.e. A contract is an essential element for the existence of partnership. Section 11 of the indian contract act. 1872, provides that a person must be competent to contract for entering into a contract. After *mohori bibee* verses. *Dharmodas ghose,* pc (1903) 30 ia 114: ilr 30 cal 539 it is settled law in india that a minor is incompetent to contract within the meaning of the indian contract act, 1872. Section 30 of the indian partnership act does not render a minor competent to contract. Therefore, a minor cannot enter into an agreement of partnership as an agreement with a minor is absolutely void. A guardian of a minor also cannot enter into an agreement of partnership on behalf of his ward to make a minor full-fledged partner.

Admission of minor to benefits of existing firm

Sub-section (1) lays down that a minor cannot become a partner though, with the consent of all the partners for the time being. He may be admitted to the benefits of partnership in an existing firm. There must be either an express agreement between the partners to admit the minor to the benefits of partnership or there must be some positive conduct on their part from which it can be inferred that they agreed to so admit the partner. Allotment of a share or distribution of a part of the profits of the firm to a minor or something of an analogous character is indicative of admission of a minor to the benefits of partnership. In *shri ram sardarmal didwani verses. Gourishanker,* air 1961 bom. 136, it was held that there must be a partnership of at least twp partners before a minor can be admitted to the benefits of partnership.

Thus there are two pre-requisites of admission of a minor to the benefits of the partnership firm. They are: (1) there should be an existing firm and (2) all the partners must have consented the admission of a minor.

12.1 Position of minor so admitted before attaining majority

Sub-section (2) provides certain rights of the minor during partnership. A minor admitted to the benefits of partnership is entitled to such share of the property and of the profits of the firm as may be agreed upon at the time of admission. He is also entitled to inspect and copy any of the accounts of the firm. Sub-section (4) provides for the remedy to such minor to enforce his rights. It states that a minor cannot sue for his share of the property or profits except when severing his connections with the firm. The amount of the minor's share in such a case is to be determined as far as possible in accordance with the rules stated in section 48. The proviso to this subsection further safeguard the partners being saddled with a debt which the business cannot meet to convert a minor's suit into one for dissolution and for accounts as between all the partners. Sub-section (3) lays down the extent of liability of such minor during minority. He is not personally liable for any act of the firm and his liability is confined only to the extent of his share in the property and profits of the firm which would include capital contributed on his behalf, if any. Thus his liability is limited. Therefore, he cannot be adjudged insolvent.

13. Incoming and outgoing partners

Sections 31 to 38 deal with the legal consequences which follow from the coming in of a new partner or the going out of an old partner. Most of these sections allow a change in the constitution of the firm without any dissolution.

13.1 Incoming partner (admission of partner)

Section 31 of the act provides:

"(1) subject to contract between the partners and to the provisions of section 30, no person shall be introduced as a partner into a firm without the consent of all the existing partners.

(2) subject to the provisions of section 30, a person who is introduced as a partner into a firm does not thereby become liable for any act of the firm done before he became a partner."

Admission with unanimous consent and by nomination

It is one of the fundamental principles of partnership law that no person may be introduced as a partner without the consent of all existing partners as partnership requires mutual trust and confidence. Of course, if the partnership deed gives a right to a partner, to introduce a new partner it will be otherwise. Thus, for instance, if the partnership agreement provides tha

A partner shall have the right of introducing a new partner at any time during his life or on his death or retirement, the agreement will be binding on the partners even though when the time comes or the event happens, one or more of the partners may be unwilling to accept the new partner. It has been held that an introduction of a new partner under such circumstances will be enforced by the court by way of specific performance.

The rule has been very well stated in *love grove* verses. *Nelson,* (1834) 3 my & kl, "to make a person a partner with two others, their consent must clearly be had, but there is no particular mode or time required for giving that consent: and if they enter into partnership by a contract which provides that, on one retiring, one of the remaining two, or even a fourth person, who is no partner at all, shall name the successor to take the share of the one retiring, it is clear that this would be valid contract which the court must recognize and the new partner would come in as entirely by the consent of the other two, as if they had adopted him by name."

Nomination clause and dissolution by death of partner

In *commissioner of income-tax verses. Seth govindram sugar mills,* air 1966 sc 24, the supreme court held that if a firm consists of two partners only, the firm automatically comes to an end on the death of one of them. While in the case of a partnership where there are more than two partners, if there is a contract to the contrary firm may be continued by the surviving partners. If there are only two partners and one of them dies, there is no partnership for a third party to be introduced. In *p. Ananda rao verses g. Raja rao,* it was held that "an agreement between the two partners that on the death of anyone of them his legal heir or nominee would take the place of the deceased partner, will not have the effect of automatically making such heir or nominee partner of the firm. It is however, open to the surviving partner to enter into a new partnership with the heir of the deceased partner, but that would constitute a (new) partnership."

Liability of new partner

Sub-section (2) provides that a person who is introduced as a partner into a firm does not thereby become liable for any act of the firm done before he became a partner, unless he agrees to be liable for obligations incurred by the firm, prior to the date of his admission. Even when he agrees with his partners to be liable for pre-existing debts such an agreement does not give any right to a creditor to sue the new partner for preexisting debts. An incoming partner becomes liable to creditors for pre-existing debts only when there is complete novation (section 62 of the indian contract act, 1872) by tripartite contract. The tripartite contract must satisfy the following two conditions:—

The new firm as reconstituted after his admission must agree to take over the liability of the old firm.

The creditors must agree, expressly or impliedly, to accept the new firm as debtor and to discharge the old partnership from its liability—

Section 31 (2) is subject to the provisions of section 30. Where a minor admitted to the benefits of partnership chooses to become a partner, after he attains majority, he is necessarily an incoming partner. According to section 30(7)(a), he becomes personally liable for all the acts of the firm since he was admitted to the benefits of partnership.

13.2 Outgoing partner

An outgoing partner is one who ceases to be a partner in a firm. A partner ceases to be a partner owing to his retirement, expulsion, insolvency or death. The rights and liabilities of an outgoing partner are laid down in section 32 to 38 of the act.

13.3 Retirement of a partner

Section 32 provides as follows:— "(1) a partner may retire—

- With the consent of all other partners,
- In accordance with an express agreement by the partners, or
- Where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire.

A retiring partner may be discharged from any liability to any third party for acts of the firm done before his retirement by any agreement made by him with such third party and the partners of the reconstituted firm, and such arrangement may be implied by a course of dealing between such third party and the reconstituted firm after he had knowledge of the retirement.

Notwithstanding the retirement of a partner from a firm, he and the partners continue to be liable as partners, to third parties for any act done by any of them which would have been an act of the 'firm if done before the retirement, until public notice is given of the retirement:—

Provided that a retired partner is not liable to any third party who deals with the firm without knowing that he was a partner.

(4) notice under sub-section (3) may be given by the retired partner or By any partner of the reconstituted firm."

According to sub-section (1) a partner may retire (a) with the consent of all the partners, (b) in accordance with an express agreement by the partners, or (c) where the partnership is at will; by giving notice in writing to all the other partners of his intention to retire. If there is a subsisting agreement between the partners about retirement, a partners can retire in accordance with the agreement whether other partner are willing or not, whereas in the case of retirement by consent all the partners have to agree to the retirement.

A retiring partner ceases to be a partner and the firm becomes reconstituted without dissolution. On retirement of a partner the firm continues to exist as such, which is not the case when a partnership is dissolved. The old firm continues with the continuing partners as members. Following the supreme court decision in *e.f.d. Mehta verses m.fd. Mehta,* 1653 and *cit verses seth govindram sugar mills,* the allahabad high court in *sri kishan gupta verses ram babu gupta,* held that the question of retirement in the case of partnership having two partners only cannot arise at all. In *e.f.d. Mehta verses m.f.d. Mehta,* the supreme court said: "when the partnership consisted of only two partners and one partner agreed to retire, there can be no doubt that the agreement that one of the partners will retire amounts to dissolution of partnership."

Liability of retiring partner for acts of the firm done upto his retirement

Sub-section (2) provides that a retired partner remains liable to the creditors for acts of the firm done before his retirement. A retired partner will, however, be discharged from liability to a third party where there is an agreement *(novation)* between the partners and the third party whereby the third party agrees to make the continuing partners as the persons liable to him in place of the old partners. Such an arrangement may be express or can be implied from the course of dealing between the continuing partners and the third party after he had knowledge of the retirement.

14. Dissolution of firms

Modes of dissolution

The act provides the following modes of dissolution:

1. Dissolution by agreement (section 40);
2. Compulsory dissolution (section 41);
3. Contingent dissolution or dissolution on the happening of certain contingencies (section 42);
4. Dissolution by notice (section 43);
5. Dissolution by court (section 44).

1. Dissolution by agreement

Section 40 provides:"a firm may be dissolved with the consent of all the partners or in accordance with a contract between partners"

Thus a firm, whether for a fixed period or otherwise, may be dissolved at any time with the consent of all the partners. A firm may be dissolved in accordance with a previous contract between the partners. The consent may be express or implied. The mere closure of business of a partnership is not by itself evidence of an agreement to dissolve the firm because it has to be dissolved in one way or the other known to law *[chunni lal verses sheo charan lal man,*]. Discontinuing of the business in itself does not lead to the inference of dissolution by common consent *[gimdappa verses sidduppa,*]. Cessation of business of a firm coupled with other surrounding circumstances may lead to the inference that the firm was dissolved *[baijnath verses chhote lal,* (1928) 26 all lj. 243]. The most material fact evidencing dissolution is the making of final accounts *[joopoody sarayya verses lakshmanaswamy,* ilr (1913) 36 mad 185. A partnership in chit fund cannot be deemed to have been dissolved till all the outstanding have been realized *[sathappa chetty verses s.n. Subramhmanyan,*]. A dissolution is also not to be inferred from the mere refusal of some partners to co-operate with the others *[chunni lal verses. Sheo charan lal* (1935) 33 all lj 1251

2. Compulsory dissolution

Section 41 declares:— "a firm is dissolved,—

By the adjudication of all the partners but one as insolvent, or

By the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership:

Provided that, where more than one separate adventure or undertaking is carried on by the firm, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventure and undertakings."

Thus a firm is compulsorily dissolved by the adjudication of all or all but one of the partners as insolvent as the existence of a firm pre-supposes that there are two or more partners carrying on its business. As discussed earlier under section 34 (1) a partner ceases to be a partner of the firm on being adjudicated as insolvent. Secondly a firm is compulsorily dissolved by the happening of an event which makes carrying on of partnership business or the continued existence of partnership, unlawful however, if the firm is carrying on more than one business, the illegality of one or more does not cause the dissolution of the firm in respect of its lawful business. Also see sections 23, 56 and 65 of the indian contract, act, 1872.

3. **Contingent dissolution or dissolution on the happening of certain contingencies**

Section 42 provides:—

"subject to contract between the partners, a firm is dissolved—

- If constituted for a fixed term, by the expiry of that term;
- If constituted to carry out one or more adventures or undertakings, by the completion thereof;

4. **By the death of a partner;**

Clause (c) of section 42 provides that subject to contract between the partners, a firm is dissolved by the death of a partner. The contract to the contrary may be express or implied. The courts infer an implied agreement from the conduct of the business being kept up as before the death and the representative of the deceased partner stepping into his shoes.

5. **By the adjudication of a partner as an insolvent**

." section 42 operates if there is no agreement to the contrary. The partners may agree to rule out the operation of all or any of the grounds of dissolution mentioned in section 42.

6. **Expiry of term [section 42(d)].**

A partnership constituted for a fixed term is dissolved by the expiry of that term, unless there is contract to the contrary. Such an agreement may be express or implied. If a fresh term is not stipulated in the agreement then it will become a partnership at will. In *saligram ruplal khanna verses kanwar rajnath,* the supreme court held on the facts the case before it that, in the absence of an agreement to the contrary, there was no question of the survival of a firm after the expiry of the term. It was further held that the partners decision, subsequent to the

expiry of the term, to refer their disputes to arbitration did not amount to an agreement to the contrary. In *samuel verses thangayya,* a partnership was formed to run a chit fund business. The term was fixed at 50 months. The period of 50 months expired and the business activity continued until all the dues were collected from the subscribers. The court held that a suit for taking the accounts of partnership would not be barred unless the defendant proved that there had been dissolution of the partnership more than three years prior to the institution of the suit.

7. Completion of business [section 42(b)}.

While defining particular partnership section 8 states that a person may become a partner with another person in particular adventures or undertakings. The present sub-section provides that if a firm is constituted to carry out one or more adventures or undertakings, it will be dissolved on the completion of those adventures or undertakings except when there is a contract to the contrary. The contract to the contrary may be express or inferred from the circumstances.

In *gherulal parekh verses mahadeodas,* a partnership was constituted to carry out, wagering contracts with specified persons during a particular season. It was held to be a particular partnership as it was constituted to carry out one or more adventures or undertakings. The firm stood dissolved after the completion of the said contracts. The suit, by one partners against the other partners, for recovery of losses resulting from wagering transaction was held to be maintainable as the firm stood dissolved although the firm was not registered. In *ram kumar verses kishaii lal chhotey lal* (1971) all lj 108, a partnership was formed for purchase and sale of 400 bags of sugar the allahabad high court held that when these bags were sold in the year 1949 the partnership stood dissolved.

8. Dissolution by notice of partnership at will

Section 43 provides:—

"(1) where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the 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 notice."

According to section 7 where no provision is made by contract between the partners for the duration of their partnership, or for the determination of their partnership, the partnership is "partnership at will". Further where a firm constituted for a fixed term continues to carry on business after the expiry of that term, and there is nothing

to show that the parties had agreed to continue in partnership for a particular additional period the partnership is deemed to have become a partnership at will.

It is only when these conditions are fulfilled that the partnership will be duly dissoloved. In *chain karan verses radha krishan,* the notice only stated that the appellant should send accounts and not to proceed with some construction works and the failure of which necessary action would be taken. This was held not to be a notice of dissolution. In *tilakram ghosh verses gita rani,* a partner wrote a letter to his own lawyer, appointing him as the arbitrator in the dispute between him and other partners and also asking him to consider the matter of dissolution of firm. This was held neither a notice of dissolution nor having the effect of dissolving the firm.

9. Dissolution by retirement of all but one

When all the partners except one retires, the firm's dissolution is inevitable though a contingency of this kind is not provided for in section 41, 42 and 43. This gap can be filled by the partners by entering into an agreement. In *abbashbhai verses r.g. Shah,* the partnership provided that in case of retirement all the partners except one, the remaining partner can continue the firm and for this purpose he might take other partners with him. The clause was held valid.

10. Dissolution by the court

Section 44 provides where, there being no possibility of a dissolution either by mutual consent, or under any of the provisions of the previous sections, recourse has to be had to a court of law for dissolving the partnership. The section provides:—

"at the suit of a partner, the court may dissolve a firm on any of the following grounds; namely:—

- That a partner has become of unsound mind, in which case the suit may be brought at will by the next friend of the partner who has become, of unsound mind as by any other partner;
- That a partner, other than the partner suing has become in any way permanently incapable of performing his duties as partner;
- That the partner, other than the partner suing, 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;
- That a partner, other than the, partner suing, willfully or persistently commits breach of agreement relating to the management of the affairs or conduct of its business, or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for other partners to carry on the business in partnership with him;

That a partner, other than the partner suing, has in any way transferred the whole of his interest in the firm to a third party, or has allowed his share to be charged under the provisions of rule 49 of order xxi of the first

schedule to the code of civil procedure, 1908, or has allowed it to be sold in the recovery of arrears of land-revenue or any dues recoverable as arrears of land revenue due by the partner;

- That the business of the firm cannot be carried on save at a loss; or
- On any other ground which renders it just and equitable that the firm should be dissolved."

Section 44 confers an absolute and independent right on a partner to have the partnership dissolved on any of the grounds specified therein and it is not open to the parties to take away that right by means of a contract between them. A minor admitted to the benefits of the firm, being not a full fledged partner, cannot file a suit under section 44. The provisions of section 44 do not apply to a partnership "at will". The following are the grounds of dissolution of a firm under section 44:—

11. **U*nsoundness of mind [section 44(a)].*** When a partner has become of unsound mind, any partner, including the insane, may apply for dissolution of the firm. Dissolution may be necessary to protect the interest of the insane partner and that of other partners. But lunacy of a partner is not dissolution by itself. Dissolution requires an order of the court.

The court is not bound to make an order to dissolve the firm if a partner becomes of unsound mind. The power of the court to dissolve the firm is discretionary. The court will pass an order which is in the best interest of all the partners after considering the interest of the insane and other partners. The court may not make an order for dissolution of the firm if a dormant partner becomes of unsound mind as it may not at all affect the business of the firm. The court may make an order for dissolution of the firm on the ground of insanity in very special circumstances. If the court makes an order for dissolution of the firm on the ground of insanity, the date of dissolution will be the date of order or any other date fixed by the court.

As defined in section 12 of the indian contract act 1872, a person is said to be of sound mind for the purpose of making a contract if, at the time when he makes, it, he is capable of understanding it and of forming a rational judgement as to its effect upon his interest. Section 52 of the indian lunacy act, 1912 also empowers the high court in the presidency towns to dissolve and dispose of the property of a partnership where a partner becomes lunatic. Under the indian lunacy act, 1912, a person of unsound mind is one who is totally unsuited to manage himself and his affairs due to incapacity of his mind. A person who merely possess weak intellect and, therefore, not able to manage his property as efficiently as may be desirable is not an idiot or person of unsound mind.

12. **Permanent incapacity [section 44(b)\.** When any partner, other than the partner suing, has become *permanently* incapable of performing his duties as a partner, *any other partner* may apply to the court for

dissolution of the f in. The court may not order dissolution in case of permanent incapacity of a dormant partner except under very special circumstances.

13. **Transfer of interest [section 44(e)**\ where a partner has transferred the *whole* of his interest in the firm to a third party, a suit for dissolution may be brought by *any other partner.* The transfer by a partner of his share must be to a *third party* and of the *whole* of his share and not merely a part of it. Thus a partner may transfer his share to his copartner or transfer a part of his share to a third party unless there is a contract to the contrary. The transfer of share must be by a partner, other than the partner suing.

When two out of three partners assigned their shares it was held that the case fell under this clause *[domaty verses ramen chetty,*)].

14. **Perpetual losses [section 44(f)].** If the business of the firm cannot be carried on except at a loss, the firm may be dissolved at the suit of a partner. A partnership is always established in order to attain a given objective and when it becomes no longer possible to attain that objective with which the partnership was started a case is made out for dissolution which may be the only remedy under the circumstances. Therefore, if it appears that the partnership business can only be carried on at a loss, the attainment of common objective with a view to which the partnership was entered into; has become impossible. Thus in such case the court may dissolve the firm. In *handyside verses campbell* (1990), it was observed that before dissolution would be ordered on this ground, and where there are special circumstances to which the loss could be attributed and where the loss could not be traced to any inherent defect in the business itself, the court would not infer impossibility of profit. The loss in that case could not be attributed to any inherent defect in the business but was due only to mismanagement. The court refused to grant dissolution.

15.REGISTRATION OF FIRMS

15.1 Procedure for registration

Sections 58 and 59 prescribe the procedure for registration of firms. Particulars of application and choice of name

According to section 58(1) the registration of a firm may be effected at any time by sending by post or delivering to the registrar of the area in which any place of business of the firm is situated, or proposed to be situated a statement in the prescribed form and accompanied by the prescribed fee, stating—

- The firm name,
- The place or principal place of business of the firm,
- The names of any other places where the firm carries on business,

- The date when each partner joined the firm,
- The names in full and permanent addresses of the partners, and
- The duration of the firm,
- The statement shall be signed by all the partners, or by their agents specially authorized in this behalf.

15.2 Registration when complete

Section 59 provides that when the registrar is satisfied that the provisions of section 58 have been duly complied with, he shall record an entry of the statement in a register called the register of firms, and shall file the statement. This amounts to registration of the firm. In *cit verses. Jayalakshmi rice and oil mills,* the supreme court held that the registration is complete only when the requirements of section 59 are complied with. In other words the registration of the firm is effected only when an entry of the statement is recorded in the register of firms and the statement is filed by the registrar as provided in section 59. Section 58(1) is not to be read in isolation and has to be considered along with the other provisions of the act, namely, section 59 and section 60. Registration is not effected by merely sending an application. Registration of a firm takes place only when the necessary entry is made in the register of firms under section 59. It follows that if the registrar is making delay the party can get an order from a court directing the registrar to do his duty. In *hiralal agarwal verses state of bihar,* it was held that the registrar cannot refuse to register a firm whose proposed name is similar to that of a firm already registered as there is no provision in this regard in the indian partnership act.

Subsequent changes and alterations

Sections 60 to 65 deal with the recording of changes in the particulars of a registered firm so as to make the register of firms complete and up to date. These sections are reproduced below:—

Recording of alteration in firm name and principal place of business (section 60)

- When an alteration is made in the firm name or in the location of the principal place of business of a registered firm, a statement may be sent to the registrar accompanied by the prescribed fee, specifying the alteration, and signed and verified in the manner required under section 58.
- When the registrar is satisfied that the provisions of sub-section (1) have been duly complied with, he shall amend the entry relating to the firm in the register of firms in accordance with the statement, and shall file it along with the statement relating to the firm filed under section 59.
- Noting of closing and opening of branches (section 61)
- When a registered firm discontinues business at any place or begins to carry on business at any place such place not being its principal place of business, any partner or agent of the firm may send intimation

thereof to the registrar, who shall make a note of such intimation in the entry relating to the firm in the register of firms and shall file the intimation along with the statement relating to the firm filed under section 59.

- Noting of changes in names and addresses of partners (section 62)
- When any partner in a registered firm alters his name or permanent address, an intimation of the alteration may be sent by any partner or agent of the firm to the registrar, who shall deal with it in the manner provided in section 61.

Recording of changes in and dissolution of a firm (section 63)

(1) when a change occurs in the constitution of a registered firm, any incoming, continuing or outgoing partner and when a registered firm is dissolved, any person who was a partner immediately before the dissolution, or the agent of any such partner or person specially authorised in this behalf, may give notice to the registrar of such change or dissolution, specifying the date thereof; and the registrar shall make a record notice in the entry relating to the firm in the register of firms and shall file the notice along with the statement relating to the firm filed under section 59.

Recording of withdrawal of a minor. (2) when a minor who has been admitted to the benefits of partnership in a firm attains majority and elects to become or not to become a partner, and the firm is then a registered firm, he, or his agent specially authorised in this behalf, may give notice to the registrar that he has or has not become a partner and the registrar shall deal with the notice in the manner provided in subsection (1).

Rectification of mistakes (section 64)

- The registrar shall have power at all times to rectify any mistake in order to bring the entry in the register of firms relating to any firm into conformity with the documents relating to that firm filed under this chapter.
- On application made by all the parties who have signed any document relating to a firm filed under this chapter the registrar may rectify any mistake in such document or in the record or note thereof made in the register of firms.

Amendment of register by order of court (section 65)

A court deciding any matter relating to a registered firm may direct that the registrar shall make any amendment in the entry in the register of firms relating to such firm which is consequential upon its decision; and the registrar shall amend the entry accordingly.

Other provisions of general nature

Sections 66, 67, 68, 70 and 71 are other provisions of general nature. They are as follows:

Inspection of register and filed documents (section 66)

(1) the register of firms shall be open to inspection by any person on payment of such fee as may be prescribed.

(2) all statements notices and intimations, filed under this chapter shall be open to inspection, subject to such condition and on payment of such fee as may be prescribed.

Grant of copies (section 67)

The registrar shall on application furnish to any person on payment of such fee as may be prescribed, a copy, certified under his hand, of any entry or portion thereof in the register of firms.

Rules of evidence (section 68)

- Any statement, intimation or notice recorded or noted in the register of firms shall against any person by whom or on whose behalf such statement, intimation or notice was signed be conclusive proof of any fact therein stated.
- A certified copy of an entry relating to a firm in the register of firms may be produced in proof of the fact of registration of such firm, and of the contents of any statement, intimation or notice recorded or noted therein."

Penalty for furnishing false particulars (section 70)

Any person who signs any statement, amending statement notice or intimation under this chapter containing any particular which he knows to be false or does not believe to be true, or containing particulars which he knows to be incomplete or does not believe to be complete, shall be punishable with imprisonment which may extend to three months, or with fine, or with both.

15.3 Effect of non-registration

Section 69 provides—

"(1) no suit to enforce a right arising from contract or conferred by this act shall be instituted in any court by or on behalf of any person suing as a partner in a firm against the firm or any person alleged to be or to have been a partner in the firm unless the firm is registered and the person suing is or has been shown in the register of firms as partners in the firm.

- No suit to enforce a right arising from a contract shall be instituted in any court by or on behalf of a firm against any third party unless the firm is registered and the persons suing are or have been shown in the register of firms as partners in the firm.
- The provisions of sub-section (1) and (2) shall apply to a claim of set-off or other proceedings to enforce a right arising from a contract, but shall not affect:—
- The enforcement of any right to sue for the dissolution of a firm or for accounts of a dissolved firm or any right or power to realize the property of dissolved firm, or
- The power of an official assignee, receiver or court under the presidency towns insolvency act, 1909, or the provincial insolvency act, 1920 to realize the property of an insolvent partner.

This section shall not apply—

To firms or to partners in firms which have no place of business in the territories to which this act extends, or whose places of business in the said territories are situated in areas to which by notification under section 56, this chapter does not apply, or

To any suit or claim of set-off not exceeding one hundred rupees in value which, in the presidency towns, is not of a kind specified in section 19 of the presidency small causes courts act, 1882, or, outside the presidency towns is not of a kind specified in the second schedule to the provisional small causes courts act, 1887, or to any proceeding in execution or other proceeding incidental to or arising from any such suit or claim."

Section 69 forbids the institution of certain suits in respect of partnerships which have not been registered under the act. The rules stated in the section are mandatory, *i.e.*, the court has no discretion in the matter. Although registration is optional, the disability inflicted by section 69 is so compulsive and comprehensive that there is no escape from it. The court can return the suit if the firm is not registered irrespective of whether the point of registration has-been pleaded by the parties and whatever be the stage of the suit. Defect is not curable by the consent of the parties. In *c/t verses jayalakshmi rice & oil mills,* air 1971 sc 1015:(1971) 1 scc 280, it was held that where a suit has been filed without registration, but registration has been subsequently obtained, the suit does not become regularized; the only alternative such a case is to file a fresh suit after registration if it is still within time. Thus subsequent registration cannot cure the initial defect without withdrawing the suit. ***The best course in such a case is to withdraw the suit, get the firm duly registered and then file afresh suit if it is within time.*** In *buhari trading co. Verses star metal co.,* air 1983 mad 150, it was held that dismissal of a suit on account of non-registration does not prevent the institution of a new suit after registration on the same cause of action. However registration can be effected only if the statement required to be furnished to the registrar of firms is signed by all the partners or their specially authorized agents and duly verified (section 58) and when disputes have arisen between partners all of them may not agree to get the firm registered. As held in *keshavlal & co. Verses chunnilal & co.,* air 1941 rang. 1% a partner cannot enforce his co-partner or co-partners to join in

the registration of the firm. The only remedy of the partner or partners desiring to bring a suit in such a case will be to ask for dissolution of the firm and accounts or for accounts if the firm is already dissolved. This right is expressly saved by sub-section (3)(a) of section 39.

In *sharat vasant kotak verses ramniklal mohanlal chawda,* (1998), it was held that registration of the firm does not cease on reconstitution of the firm pursuant to induction of a new partner. Therefore, fresh registration is not needed when such reconstitution is done. However, information about changes in the partnership have to be given and failure to do so attract penalty under section 69-a.

Suits between partners and firm (section 69(1)]

Sub-section (1) of section 69 provides that no partner or alleged partner, can file a suit to enforce a *right arising from contract or conferred by the act* against the other partners or alleged partners of the firm, unless the firm is registered and the person suing is or has been shown in the register of firms as a partner in the firm. Thus two conditions are necessary to enable a partner to sue his co-partners or the firm. *First,* the firm should be registered before instituting the suit and *second,* the name of the partners suing must be shown in the register of firms as partners in the firm. The main object of section 69 is to prevent a partner from enforcing his claims against fellow partners if the firm is not registered and to compel in such a case dissolution of the firm by laying down that the court will entertain suits only when dissolution and accounts and winding up of the affairs of the firm is sought 01 where accounts or winding up of the affairs of an already dissolved firm is sought.

Suits between firm and third parties [s. 69(2)]

Section 69(2) provides that a firm shall not be able to file a suit to enforce *a right arising from contract* unless it is registered and the names of the partners suing are or have been shown in the register of firms. The suit must be instituted by or on behalf of the f*irm* the name of which has been shown in the register of firms. The *person suing,* e.g., the names of the persons who are partners at the date of the institution of the suit must have been shown in the register of firms. These requirements or conditions of the section are mandatory.

In haldiram bhujiwala verses anand kumar deepak kumar, (2000) it was held that the expression" arising from a contract" used in section 69(2) refers to a contract entered into by the unregistered firm with the third-party defendant in the course of natural business dealings. It does not refer to a contract referred to in the plaint as a historical fact other words, the contract by the registered firm referred to in section 69(2) must not only be one entered into by the firm with the third-party defendant but must also be one entered into by the plaintiff firm in the course of the business dealings of the plaintiff firm with such third-party defendant. Section 2(d) of the act defines "third parties" as persons who are not partners of the firm. In this case an unregistered firm is suit for permanent injunction to restrain the defendants from using the plaintiffs trade mark/name which was based on statutory rights under the trademarks act and common principles of tort applicable to passing-off actions held,

was not barred by section 69(2). Earlier in raptakas brett co. Ltd. Verses ganesh property, (1998) the supreme court expressed similar view that section 69(2) cannot bar the enforcement by way of a suit by an unregistered firm in respect of a statutory right or a common law right. On the facts of that case, it was held that the right to evict a tenant upon expiry of the lease was not a right "arising from a contract" but was a common law right or a statutory right under the transfer of property act. The fact that the plaint in that case referred to a lease and to its expiry, made no difference. Hence, the said suit was held not barred. Reference to the lease in the plaint, the court observed, was obviously treated as a historical fact.

If a firm is reconstituted prior to the date of filing suit by the firm against a third party but notice regarding the reconstitution is given to the registrar of firms and note taken accordingly in registrar of firms subsequent to the filing of the suit, the suit is not maintainable even though the plaint is amended on a later date, that cannot save the suit.

In *halidram bhujiwala verses anant kumar deepak kumar,* it was held that the handicap caused by section 69 can be overcome by getting the firm registered before the suit is filed. It cannot be rectified by subsequent registration. A fresh suit will have to be filed after registration provided that is still within the period of limitation.

In *hind trading and mgs. Co. Verses didi modes (p) ltd.,* it was held that if the reconstitution of the firm is notified to the registrar, the firm continues to enjoy the status of a registered firm.

Section 69(2) is also not applicable in case of rights arising independently of contract, i.e., they remain enforceable. In *virendra dresses verses varinder garments,* an action was instituted by an unregistered to restrain the defendant firm committing an infringement of the firm's trade mark. It was held that the suit was maintainable.

In *padam singh jain verses chandra brothers,* it was held the rights conferred on a landlord by a tenancy legislation are statutory rights and where the landlord is a partnership firm it can bring a suit for the eviction of a tenant on a statutory ground whether the firm is registered or not.

In *sharad vasant kotak verses ramnilal mohanlal chawla, (*1948) , section 69 (2-a), as amended in the state of maharashtra, requires two conditions before a partner can sue for dissolution of a firm and for accounts:

16. **Exceptions** (s. 69(3) and s. 69(4)]

In the following cases section 69 is no bar for instituting a suit by an unregistered firm ;

(1) right to sue for dissolution of firm and for accounts of dissolved firm

According to section 69(3) the provisions of sub-sections (1) and (2) shall not affect the enforcement of any right to sue (1) for the dissolution of a firm or (2) for accounts of a dissolved firm or (3) any right or power to realize the property of a dissolved firm. Thus the intention of the legislature was to cripple the firm while it was a going concern. In *s. Ahmed khan verses turup mohd. Hayat,* the plaintiff and the defendant formed a partnership for plying a taxi and bought a car for rupees. 8,500, contributing rupees. 3,000 and rupees. 5,500 respectively. Subsequently the defendant without the consent and knowledge of the plaintiff returned the car back to the buyer and received refund of the purchase price. The plaintiff filed a suit to recover his contribution of rupees. 3,000. The firm was not registered. The suit was allowed as instituted. The court held that the defendant's own act in disposing of the taxi-car showed his intention to put an end to the business of the firm and the plaintiff was enforcing his co-ownership interest and not suing as a partner

(2) the power of an official assignee, receiver or court to realize the property of an insolvent partner

According to section 69(3) (b), non-registration of a firm shall not affect the powers of an official assignee, receiver or court under the presidency towns insolvency act, 1909 or the provincial insolvency act, 1920, to realize the property of an insolvent partner.

(3) firms or the partners in firms which have no place of business where this act extends

Section 69(4) says that the section 69 is not applicable to firms or to partners in firms which have no place of business in the territories to which this act extends, or whose place of business in the said territories are situated in areas to which, by notification under section 56, this chapter [chapter vii (section 56 to 71)] does not apply.

(4) any suit or claim or set-off not exceeding one hundred rupees

Section 69 is not applicable to any suit or claims or set-off not exceeding one hundred rupees in value. This limit should be raised now as the purchasing power of rupees has decreased substantially.

(5) Suit by third parties

A third party can sue a firm whether it is registered a not. Thus the disability is imposed only upon an unregistered partnership firm, and not upon others, there is no disability on a sole proprietor or joint hindu families.