UNIT – III

LESSON-27

THE NEGOTIABLE INSTRUMENTS ACT, 1881

CONTENTS

3.27. 1 Meaning and characteristics of Negotiable Instruments

3.27. 2 Essential Characteristic Features of a Negotiable Instrument

3.27. 3 Presumptions as to negotiable instruments
Check your progress: 27

AIMS AND OBJECTIVES

This unit deals with the most important aspect of negotiable instruments which are essential for all types of business transactions. After reading this unit, the students will be able to understand all details regarding negotiable instruments.

This unit aims at providing insight on the following topics

i. Meaning of negotiable instruments
ii. Parties to negotiable instruments
iii. Characteristics of negotiable instruments
iv. Types of negotiable instruments and their characteristic features
v. Endorsement etc.

INTRODUCTION

Negotiable Instrument means a promissory note, bill of exchange or cheque, payable either to order or to the bearer. In business transactions, a clear knowledge of all these are required.

The Negotiable Instruments Act, 1881 came into force on 1st March, 1881. It extends to the whole of India except the State of Jammu and Kashmir.

The Act deals with the law relating to three specific classes of Negotiable Instruments viz. Promissory Note, Bill of Exchange and Cheque. The Act does not apply to:

a. Indian Paper Currency Act, 1871

b. the local usage relating to any instrument in an oriental language (for example, hundies)

But where no custom is established, the Act will apply to Hundies.

3.27.1 MEANING AND CHARACTERISTICS OF NEGOTIABLE INSTRUMENT (SECTION 13)

Meaning of Negotiable Instrument [Section 13(1)]:

Negotiable Instrument means a promissory note, bill of exchange or cheque, payable either to order or to the bearer. But, this definition doesn't explain the features of a Negotiable Instrument. According to Willis, "A negotiable instrument is one the property in which is acquired by anyone who takes it bonafide, and for value, notwithstanding any defect of title in the person from whom he took it." Thus, a negotiable instrument must possess two features:

i. The right of ownership contained in the instrument can be transferred from one person to another by mere delivery if it is payable to bearer or by endorsement and delivery if payable to order, and

ii. The transferee taking the instrument in good faith and for consideration gets a good title to the same even though the title of the transferor is defective.

(a) **Meaning of Negotiable Instrument Payable to Order [Explanation I to Section 13(1)]**

A promissory note, bill of exchange or cheque is payable to order if, either of the following two conditions is fulfilled:

(a) It must be expressed to be so payable, or

(b) It must be expressed to be payable to a particular person and it must contain words which prohibit transfer or indicate an intention that it shall not be transferable.

(b) **Meaning of Negotiable Instrument Payable to Bearer [Explanation II to Section 13(1)]**

A promissory note, bill of exchange or cheque is payable to bearer if either of the following two conditions is fulfilled.

(a) It must be expressed to be so payable, or

(b) The only or last endorsement must be an endorsement in blank.

Clarification Regarding Negotiable Instruments Payable to the Order of a Specified Person [Explanation III to Section 13(1)]

Where a promissory note, bill of exchange or cheque, either originally or by endorsement, is expressed to be payable to the order of a specified person and not to him or his order, it is nevertheless payable to him or his order at his option. In Raghunath v. Bihari Lal, the document signed by Raghunath stated "I promise to pay you (Bihari Lal) on demand the sum of Rs 7000", it was contended that as the document stated nothing about the amount being payable to the order of a person or to the bearer, it was not a negotiable instrument and hence not a promissory note. Held that even if the amount was payable to a specified person it was a valid promissory note.

Notes:

(i) In addition to a promissory note, bill of exchange or cheque, there may be other negotiable instruments recognised by the usage or custom or other Acts. For example, Share Warrant, Dividend Warrant, Bearer Debenture etc. Free transferability makes these instruments negotiable.

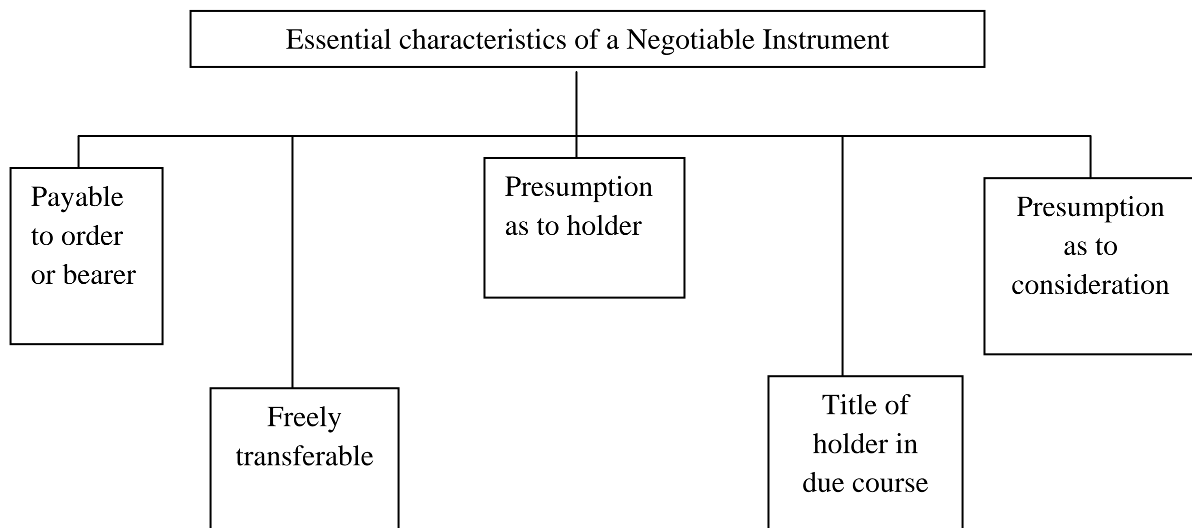
(ii) Railway Receipt (R/R), Bill of Lading, Dock Warrant, Deposit Receipts are not negotiable instruments because they cannot give a better title to the transferee than that of the transferor.

Can there be more than one payee? [Section 13(2)]:

A negotiable instrument may be made payable to two or more payees jointly, or it may be made payable in the alternative to one of the two, or some of the several payees.

3.27.2 ESSENTIAL CHARACTERISTIC FEATURES OF A NEGOTIABLE INSTRUMENT

The essential characteristics of a negotiable instrument have been shown below:



a. Payable to order or to Bearer: It must be payable either to order or to bearer.

b. Freely Transferable: An instrument payable to order is negotiable by endorsement and delivery and an instrument payable to bearer is negotiable by mere delivery.

c. Presumption as to Holder: Every holder of a negotiable instrument is presumed to be a holder in due course.

d. Title of Holder in due Course Free from all Defects: A holder in due [i.e., the person who became the possessor of negotiable instrument before maturity, for valuable consideration and in good faith) gets the instrument free from all defects in the title of the transferor.

e. Presumption as to Consideration: Every negotiable instrument is presumed to have been made, drawn, accepted, endorsed, negotiated or transferred for consideration.

3.27.3 PRESUMPTIONS AS TO NEGOTIABLE INSTRUMENTS [SECTION 118]

Until the contrary is proved, the following presumptions shall be made:

a. Of consideration: That every negotiable instrument was made or drawn accepted, endorsed, negotiated or transferred for consideration.

b. As to date: That every negotiable instrument bearing a date was made or drawn on such date.

c. As to time of acceptance: That every accepted bill of exchange was accepted within a reasonable time after its date and before its maturity.

d. As to time of transfer: That every transfer of a negotiable instrument was made before its maturity.

e. As to time of endorsement: That the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.

f. As to stamp: That a lost promissory note, bill of exchange or cheque was duly stamped.

g. As to holder in due course: That the holder of a negotiable instrument is a holder in due course except where the instrument has been obtained from its lawful owner, or from any person in lawful custody thereof, by means of an offence or fraud, or has been obtained from the maker or acceptor thereof by means of an offence of fraud, or for unlawful consideration, and the burden of proving that the holder is a holder in due course lies upon him.

h. As to protest: In a suit upon an instrument which has been dishonoured, the Court shall, on proof of the protest, presume the fact of dishonour, unless and until such fact is disproved.

Check your progress 27:

What are the essentials characteristics of negotiable instruments?

LESSON 28
TYPES OF NEGOTIABLE INSTRUMENTS

CONTENTS

3.28. 1 Types of negotiable instruments
Check your progress: 28

3.28.1 TYPES OF NEGOTIABLE INSTRUMENTS

The various types of negotiable instruments are given below:

Type of instrument	Meaning	Example
1. Bearer instrument [Explanation II to Section 13(1)]	A promissory note, bill of exchange or cheque is payable to bearer if either of the following two conditions is fulfilled: a. It must be expressed to be so payable, or b. The only or last endorsement must be an endorsement in blank. Notes: i. A promissory note cannot be made payable to the bearer. i. A bill of exchange cannot be made payable to bearer on demand. [Section 31 of the Reserve Bank of India Act, 1934] A bearer instrument can be transferred by mere delivery.	"Pay to R or bearer"

2. Order Instrument [Explanation I to Section 13(1)]	A promissory note, bill of exchange or cheque is payable to order if either of the following two conditions is fulfilled: a. It must be expressed to be payable to order, or b. It must be expressed to be payable to a particular person and it must not contain words which prohibit transfer or indicate an intention that it shall not be transferable. Note: An order instrument can be transferred by an endorsement on it and then its delivery.	"Pay to R or order" "Pay to the order of R" "Pay to R"
3. Inland Instrument [section 11]	A promissory note, Bill of exchange or cheque is an inland instrument if both the following conditions are fulfilled: a. It must be drawn in India, b. It must be payable in India, or it must be drawn upon any person resident in India. Notes: i. Protest of inland bill is optional ii. An inland instrument remains inland even if it has been endorsed in a foreign country.	i. "A bill drawn in Delhi on a merchant in Agra and accepted payable in London." ii. "A bill drawn in Delhi on a merchant in London and accepted payable in Agra."
4. Foreign Instrument [Section 12]	An instrument which is not an inland instrument is deemed to be a foreign instrument.	i. "A bill drawn in Delhi on a merchant in London and accepted payable in London."

	Note: Foreign bills must be protested for dishonour if such protest is required by the law of the place where they are drawn [Section 104]	ii. "A bill drawn in London on a merchant in Agra and accepted payable in Agra."
5.Ambiguous Instruments [Section 17]	An ambiguous bill means an instrument which can be construct either as a promissory note or a bill of exchange. Its holder may at his option treat it either as promissory note or a bill. Once he exercises his option, the instrument shall be thence forward treated accordingly.	i. "A bill drawn by an agent acting within his authority upon his principal." ii. "A bill drawn upon a fictitious person."
6. Inchoate Instruments [Section 20]	When one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instrument then in force in India, and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount.	"A bill drawn payable to ...or order"

	Provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereunder. Notes: i. The principal of this rule is one of estoppel. ii. The signer is liable if the following conditions are fulfilled: a. The blanks must be filled in and the instrument must be completed. b. The instrument must have been delivered to the transferee. c. The instrument must be stamped one and the stamp affixed must be sufficient to cover the amount filled in the instrument. ii. A holder in due course can recover in excess of the amount intended to be paid by the signer provided the amount is covered by the stamp affixed on the instrument. The provisions of this Section cannot be applied to a cheque which is not required to be stamped.	

7. Instruments payable on demand [Sections 19 and 21]	Instruments payable on demand means the instruments in which no time for payment is mentioned. A cheque is always payable on demand. A promissory note or bill of exchange is payable on demand- a. when no time for payment is specified, or b. when it is expressed to be payable on demand, or at sight or on presentment Notes: i. 'At sight' and presentment means on demand. ii. An instrument payable on demand may be presented for payment at anytime.	i. "1 promise to pay B Rs 500." ii. "I promise to pay B Rs 500 on demand." iii. "Pay B Rs 500 at sight." iv. "Pay B Rs 500 on presentment."
8. Time Instrument	Time instruments mean the instruments in which time for payment is mentioned. A promissory note or bill of exchange is a time instrument when it is expressed to be payable- a. after a specified period b. On a specific day c. After sight d. on the happening of event which is certain to happen	i. "I promise to pay B Rs 500 after 3 months." "I promise to pay ii. Rs 500 on 1st Jan., 1998." iii. "I promise to pay B Rs 500 after sight." iv. "I promise to pay B Rs 500 after C's death."

	Notes: i. The expression 'after sight' means- a. in a promissory note, after presentment for sight b. in a bill of exchange, after acceptance or noting for non-acceptance or protest for non-acceptance. ii. A cheque cannot be a time instrument because the cheque is always payable on demand.	
9. Accommodation Bills	An accommodation bill means a bill which is drawn, accepted without consideration. Provisions relating to such bills: a. The accommodated party cannot, after he has paid the amount of the bill, recover the amount from any person who became a party to the bill for his accommodation [Explanation 1 to Section 43] b. The person who becomes the holder of such a bill in good faith and for consideration, after maturity, may recover the amount from any prior party [Section 59].	X who needs funds, draws a bill on Y who bill and gets the bill discounted with his banker and on due date remits the requisite amount to Y to enable him to meet the bill; such a bill is an accommodation bill.

10. Fictitious Bill	A fictitious bill is a bill in which the name of the drawer or the payee or both is fictitious. When both the drawer and payee of a bill are fictitious persons, the acceptor is liable to a holder in due course if the holder in due course can show that the signature of the supposed drawer and that of the first endorser (payee) are in the same handwriting [Section 42].	i. A bill drawn upon X in favour of P and the drawer is a fictitious person. ii. X had drawn a bill upon Y in favour of Z who is a fictitious person.
11. Documentary Bill	A documentary bill means a bill to which the documents of title to the goods (i.e. Railways Receipt, Bill of Lading) and other documents are attached.	
12. Clean Bill	A clean bill means a bill to which no document relating to the goods (for the transaction of which the bill is being drawn) is attached.	
13. Escrow [Section 46, Para 3]	A negotiable instrument which is delivered conditionally or for a special purpose as a collateral security or for safe custody only and not for the purpose of transferring absolutely the property therein, is called' Escrow'. The liability to pay in case of an escrow does not arise if conditions agreed upon are not fulfilled or the purpose for which the instrument was delivered is not satisfied. This however, does not affect rights of a holder in due course.	

14. Bills in sets [Sections 132 & 133]	Bills of exchange drawn in parts is called bills in sets. Provisions relating to 'Bills in sets' are: a. Each part must be numbered. b. Each part must contain a provision that it shall continue to be payable only so long as the other parts remain unpaid. c. Each part must contain reference to the other parts. d. Each part must be signed and delivered by the drawer. e. All the parts of the whole set need not be accepted. f. When a person accepts or endorses different parts of the bill in favour of different persons, he and the subsequent endorsers of each part are liable on such parts if it were a separate bill. As between holders in due course of different parts of the same set, he who first acquired title to his part is entitled to the other parts and the money represented by the bill. [Section 133]	

Check your progress 28:

Enumerate the types of negotiable instruments.

LESSON-29

PROMISSORY NOTE [SECTION 4]

CONTENTS

3.29. 1 Essential Characteristics of a Promissory Note
3.29. 2 Parties to a Promissory Note
Check your progress: 29

According to Section 4 of the Negotiable Instruments Act, 1881, "A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to the order of a certain person or to the bearer of the instrument."

Notes:

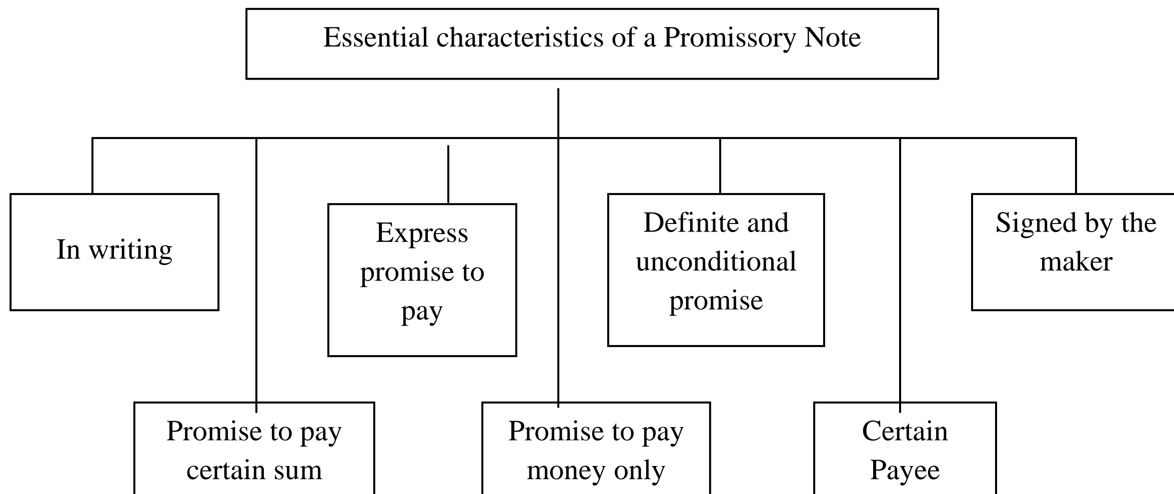
i. A promissory note may be payable on demand or after a definite period of time

ii. The words "or to the bearer of the instrument" have become inoperative in view of the provision contained in Section 31(2) of the Reserve Bank of India Act, which provides that no person in India other than Reserve Bank of India or the Central Government can make or issue promissory note payable to the bearer of the instrument.

iii. A bank note or currency note is not a promissory note because it is money itself.

3.29.1 ESSENTIAL CHARACTERISTICS OF A PROMISSORY NOTE

The essential characteristics of a promissory note are as follows:



i. In writing: It must be in writing. In other words, an oral promise does not make a promissory note since it is not an instrument.

   Example: A promises to pay B a sum of Rs. 500 on telephone. This promise will not make a promissory note because it is not in writing.

ii. Express promise to pay: There must be an express promise to pay and not mere acknowledgement of indebtedness.

Example: State with reasons whether each of the following instruments is a Promissory note or not:

(a) "Mr B, I owe you Rs 500."

(b) "We have received the sum of Rs 500 in cash from Mr B."

(c) "We have received the sum of Rs 500 in cash from Mr B. This amount will be repaid on demand".

(d) "We promise to pay Mr B a sum of Rs 500".

Solution: Cases (a) and (b): These instruments are not promissory notes because there is no express promise to pay. These instruments are merely acknowledgements of indebtedness.

Cases (c) and (d): These instruments are promissory notes because there is an express promise to pay.

In Akbar Khan vs. Attar Singh (ILR 1936, 17 Lahore, 557 DC) a document was made with the following words, "This receipt is hereby executed by B ... for Rs 43,000 received from A, the amount to be payable after two years. Interest @ Rs 5 % to be charged". Held the instrument was not a Promissory Note as it was a mere receipt stating the terms of repayment.

iii. Definite and unconditional promise: The promise must be definite and unconditional. It may be noted that a promise to pay is not conditional if it depends upon an event which is certain to happen but the time of its occurrence may be uncertain.
   Example: State with reasons whether each of the following instruments is a Promissory Note or not.

a. "I promise to pay B Rs 500 seven days after my marriage withMadhuri or Sridevi".

b. "I promise to pay B Rs 500 on D's death provided D leaves me enough to pay that sum".

c. "I promise to pay Rs 500 on D's death".

Solution:

Cases (a) and (b): These instruments are not promissory notes because the promise to pay is not unconditional. In Beardsley vs. Baldwin (1741) 93 IR 1094, a written undertaking to pay a certain amount within a specified time after defendant's marriage was not recognised as a promissory note because possibly the defendant may never marry and the sum may never become payable.

Case (c): This instrument is a promissory note because the promise to pay is unconditional as it is certain that D will die.

iv. Signed by the maker: It must be signed by the maker. The purpose of signature is to authenticate the instrument. The signatures can be made on any part of the instrument.

v. Promise to pay certain sum: The promise must be to pay a certain sum. Negotiable Instruments are meant for free circulation and if their value is not clearly mentioned on the instruments, their circulation would be materially impeded. The sum payable is also certain in the following cases:

a. Where it is payable along with interest and either the amount of interest itself or the rate of interest is given.

b. Where it is payable at a specified rate of exchange.

c. Where it is payable by instalments with a provision that a default being made in payment, the unpaid balance shall become due [Section 5].

Example:
State with reasons whether each of the following instruments is a Promissory Note or not.

a. "I promise to pay 8 Rs 500 and all other sums which shall be due to him."

b. "I promise to pay B Rs 500, first deducting thereout any money which he may owe me".

c. "I promise to pay B Rs 500 along with interest thereon."

Solution:
The aforesaid instruments are not promissory notes because the sum payable is not certain.

vi. Promise to pay money only: The payment must be in money and money only.

Example: State with reasons whether each of the following instruments is a Promissory note or not:

a. "I promise to deliver to B 1000 kg of paddy."
b. "I promise to pay B Rs 500 and deliver 1000 kg of paddy."
c. "I promise to pay B Rs 500 and to deliver to him by black horse on 1st January next".

Solution: The aforesaid instruments are not promissory notes because the payment is not in money and money only.

vii. Certain payee: The payee must be certain. Where the payee is designated by description only (say captain of a particular cricket team, president of a particular club, manager of a particular bank), the promissory note is valid if the payee can be ascertained by evidence.

A promissory note cannot be made payable to the maker himself. Such a note is invalid. However, it becomes a valid promissory note if it is endorsed by the maker because it then becomes payable to bearer (if endorsed in blank) or it becomes payable to the endorsee or his order (if endorsed specially).

Requirements under the Indian Stamp Act, 1899: A promissory note must be stamped with adhesive stamp or engrossed on a stamp paper of proper value. This requires the cancellation of such stamp which may be done by writing his name across the stamp or initials with the date of his writing or in any other effectual manner.

Notes:

i. The omission of consideration received, place and date will not invalidate the instrument.

ii. An undated instrument will be treated as having been made on the date of delivery.

iii. An ante-dated or post-dated instrument is not invalid.

3.29.2 PARTIES TO A PROMISSORY NOTE

There are two parties to a promissory note as under:

i. The maker: The person who makes the promissory note is called the maker.

ii. The payee: The person to whom or to whose order the payment is to be made is called the payee.

Check your progress 29:

What are promissory notes?

LESSON-30

BILL OF EXCHANGE [SECTION 5]

CONTENTS

3.30. 1 Essential Characteristics of a Bill of Exchange
3.30. 2 Parties to a Bill of Exchange
3.30. 3 Acceptance
3.30. 4 Essentials of a Valid Acceptance
3.30. 5 Types of Acceptance
3.30. 6 Effect of Qualified Acceptance
Check your progress: 30

According to Section 5 of the Negotiable Instruments Act, 1881, "A bill of exchange is an instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to, or to the order of a certain person or the bearer of the instrument." Thus, a bill is an order by a creditor upon his debtor requiring him to pay the money to the person specified.

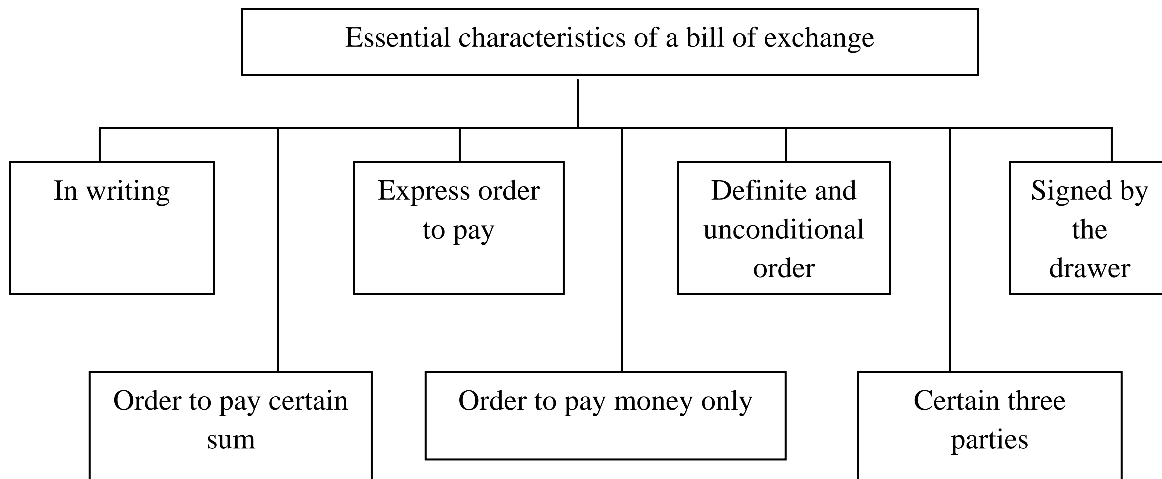
Notes:

i. A bill of exchange may be made payable to bearer on demand or after a definite period of time.

ii. A bill of exchange cannot be made payable to bearer on demand because Section 31 of the Reserve Bank of India Act prohibits the issue of such bills of exchange.

3.30.1 ESSENTIAL CHARACTERISTICS OF A BILL OF EXCHANGE

Essential characteristics of a bill of exchange are as follows:



1. In writing: It must be in writing
2. Express order to pay: There must be an express order to pay and not a mere request to pay.
3. Definite and unconditional order: The order must be definite and unconditional.
4. Order to pay certain sum: The order must be to pay a certain sum.
5. Order to pay money only: The order must be to pay money only.
6. Certain three parties: The three parties (i.e., drawer, drawee and payee) must be certain and must be mentioned in the instrument. It may be noted that the drawer and payee can be the same person but the drawer and drawee cannot be the same person.
7. Signed by the drawer: It must be signed by the drawer.

3.30.2 PARTIES TO A BILL OF EXCHANGE

There are three parties to a bill of exchange as under:

i. Drawer: The person who draws a bill of exchange is called the drawer.

ii. Drawee: The person on whom the bill of exchange is drawn is called the drawee. He is also called as an acceptor of the bill.

iii. Payee: The person named in the instrument to whom or to whose order the money is directed to be paid by the instrument, is called the payee.

3.30.3 ACCEPTANCE

Meaning of Acceptance

It is only the bill of exchange which requires acceptance. A bill is said to be accepted when the drawee (i.e., the person on whom the bill is drawn), after putting his signature on it, either delivers it or gives notice of such acceptance to the holder of the bill or to some person on his behalf. After the drawee has accepted the bill, he is known as the acceptor.

However, acceptance is not necessary to make a valid bill. If a bill is not accepted, it does not become invalid. It only becomes dishonoured by non-acceptance.

Acceptance in Case of Bills in Sets

Where a bill is drawn in sets, the acceptance is required to be put on one part only.
Where the drawee signs his acceptance on two or more parts, he may become liable on each of them respectively.

3.30.4 ESSENTIALS OF A VALID ACCEPTANCE

The essentials of a valid acceptance are as follows:

Written: It must be in writing and not oral.

Signed: It must be signed by the drawee personally or through his duly authorised agent.

On the bill: It must be on the bill whether on the face or on the back of the bill.

Delivered: The drawee must either deliver the bill or give notice of his acceptance to the holder of bill or to some person on his behalf.

3.30.5 TYPES OF ACCEPTANCE

Acceptance may be either general or qualified.

General Acceptance: An acceptance is said to be general when the drawee assents without qualification to the order of the drawer.

Qualified Acceptance: An acceptance is said to be qualified when the drawee assents subject to qualification. It may be noted that an acceptance will not be treated as a qualified acceptance unless the qualification is expressed on the bill in the clearest language. The qualification may relate to an event, amount, place, time, etc. According to Section 86, an acceptance is qualified under the following circumstances:

a. where it is conditional declaring the payment to be dependent on the happening of an event therein stated;

b. Where it undertakes the payment of part only of the sum ordered to be paid;

c. where no place of payment being specified on the order, it undertakes the payment at a specified place, and not otherwise or elsewhere; or where, a place of payment being specified in the order, it undertakes the payment at some other place and not otherwise or elsewhere;

d. where it undertakes the payment at a time other than that at which under the order it would be legally due;

e. where it is not signed by all drawees who are not partners.

3.30.6 EFFECT OF QUALIFIED ACCEPTANCE

Where the acceptance is qualified, the holder of a bill, may at his option, treat the bill as dishonoured and after giving due notice of dishonour, sue the drawer and prior endorsers. If he accepts a qualified acceptance without obtaining the consent of all prior parties thereto, all prior parties whose consent is not obtained are discharged as against the holder and those deriving title from him.

Examples of qualified acceptance

i. Accepted payable when in funds.
ii. Accepted payable on giving up bill of lading.
iii. Accepted payable when a cargo consigned to me is sold.
iv. A bill drawn for Rs 1,000 accepted for Rs 900 only.
v. Accepted payable at Delhi only where no place of payment is specified in the order.
vi. Accepted payable at Delhi only where the place of payment specified in the order was Bombay.
vii. Accepted payable 4 months after date where the bill drawn as payable months after date.
viii. Accepted by A, B and C where drawees were A, B, C and D who were not partners.

Distinction between Bill of Exchange and Promissory Note
A Bill of Exchange differs from a Promissory Note in the following respects:

Basis of distinction	Bill of exchange	Promissory note
1. No. of parties	There are three parties drawer, drawee and payee.	There are two parties - maker and payee.
2. Promise/order	It contains an unconditional order given by a creditor to a debtor.	It contains an unconditional promise given by a debtor to a creditor.
3. Nature of liability	The liability of the drawer is secondary and conditional.	The liability of the maker is primary and absolute.
4. Acceptance	It requires acceptance to become a valuable instrument.	It does not require any acceptance since it is a valuable instrument right from the beginning.
5. Same identity of payer and payee.	The drawer and payee may be the same person.	The maker and payee cannot be the same person.

6. Payable to bearer.	It can be payable to bearer. It cannot be drawn as payable to bearer on demand.	It cannot be payable to bearer.
7. Protest for dishonour	It requires the protesting for dishonour.	It does not require any protesting.
8. Notice of dishonour	Notice of dishonour must be given to all persons (including drawer) liable to pay.	Such notice is not required to be given to the maker.

Check your progress 30:

Write about a bill of exchange.

LESSON-31
CHEQUE [SECTION 6]

CONTENTS

3.31. 1 Essential Characteristics of a Cheque
3.31. 2 Parties to a Cheque
3.31. 3 Crossing of a Cheque
3.31. 4 Bouncing or dishonour of Cheque
Check your progress: 31

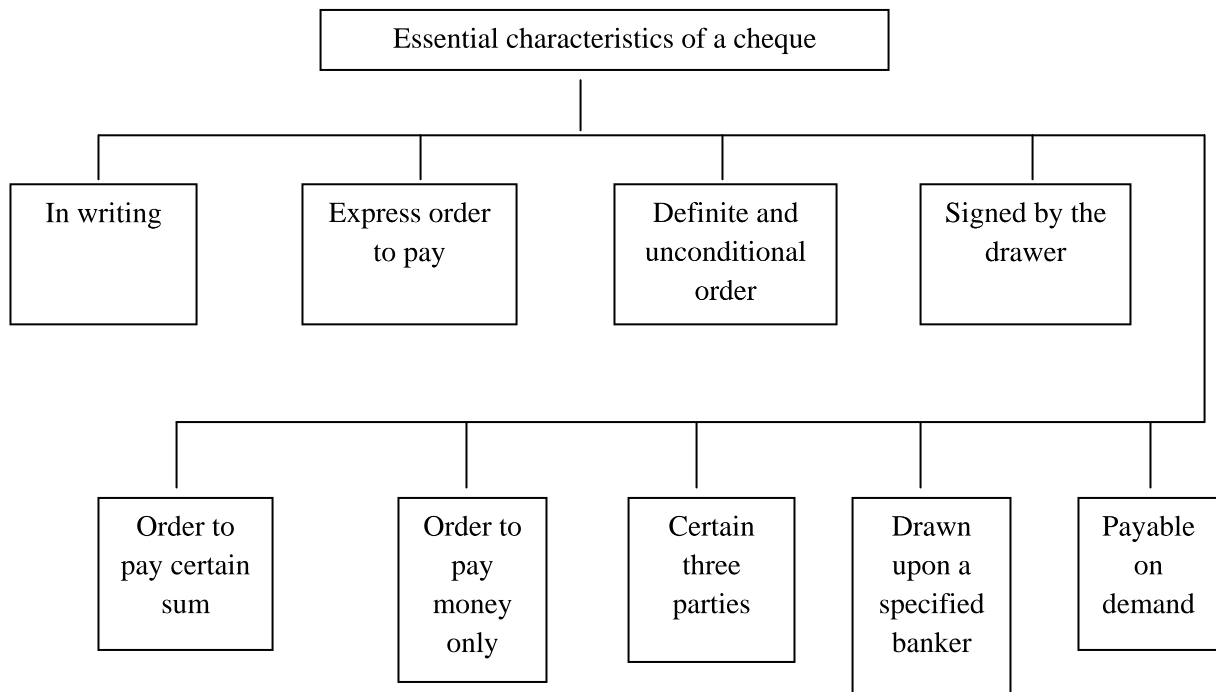
A cheque is a bill of exchange which is

(a) drawn upon a specified banker, and

(b) payable on demand.

3.31.1 ESSENTIAL CHARACTERISTICS OF A CHEQUE

Essential characteristics of a cheque have been shown below:



i. In writing: It must be in writing.
ii. Express order to pay: There must be an express order to pay and not request to pay.
iii. Definite and unconditional order: The order must be definite and unconditional.
iv. Signed by the drawer: It must be signed by the drawer.
v. Order to pay certain sum: The order must be to pay a certain sum.
vi. Order to pay money only: The order must be to pay money only.
vii. Certain three parties: The three parties (i.e., drawer, drawee and payee) be certain and must be mentioned in the instrument.

In addition to the aforesaid essentials of a bill of exchange, the cheque must also satisfy the following two requirements:

1. Drawn upon a specified banker: It must always be drawn upon a banker.
2. Payable on demand: It must always be payable on demand.

Thus, all cheques are bills of exchange in the sense that these have all the essential elements of a bill of exchange. But all bills of exchange are not cheques because a bill of exchange becomes a cheque only when it satisfies the aforesaid two additional requirements.

Notes:

i. No acceptance of a cheque is required.
ii. Cheque is not required to be stamped.

3.31.2 PARTIES TO A CHEQUE

There are three parties to a cheque as under:

a. Drawer: The person who draws the cheque is called the drawer.
b. Banker: The bank on which the cheque is drawn is called the drawee,
c. Payee: The person in whose favour the cheque is drawn is called the payee. The payee may be a third party or the drawer himself.

Distinction between a Cheque and a Bill of Exchange

Basis of distinction	Cheque	Bill of Exchange
1. Drawer	It is always drawn on a bank	It can be drawn upon an individual as well as a bank
2. Payable on demand	It is always payable on demand	It need not always be payable on demand
3. Payable to bearer on demand	It can be drawn payable to bearer on demand	It cannot be payable to bearer on demand
4. Acceptance	It does not require an acceptance.	It requires an acceptance of the drawee.
5. Stamp	It does not require a stamp.	It requires a stamp.
6. Three days of grace	It is not entitled to three days of grace.	A bill, unless payable on demand is entitled to three days of grace.
7. Crossing	It can be crossed.	It cannot be crossed.
8. Form	Its fixed form is honoured by a banker.	There is no fixed form.
9. Notice of dishonour	Notice of dishonour is not required.	Notice of dishonour is usually required.
10. Countermanding	It can be revoked by countermanding of payment.	It cannot be countermanded.

3.31.3 CROSSING OF A CHEQUE [SECTIONS 123 to 131A]

Crossing: The Crossing of a Cheque is an instance of an alteration which is authorised by the Act. A cheque is said to be crossed when it bears across its face two parallel transverse lines which are usually drawn on the left hand top corner of the cheque.

Purpose of Crossing: The purpose of Crossing is to direct the drawee (banker) to pay the amount of cheque only to a banker so that the party who receives the payment of the cheque can be easily traced.

Types of Crossing: There are two types of Crossing, viz. general crossing and special crossing.

Notes:

Only the cheques can be crossed. The promissory notes or bills of exchange cannot be crossed.

A general crossing can be converted into special crossing but a special crossing cannot be converted into general crossing. If the holder converts the special crossing into general crossing by striking out the banker's name, it will amount to material alteration.

A special crossing can be made only once except where the second special crossing is made by a banker to another banker to act as an agent of the former.

Where a cheque contains special crossing to more than one banker, then the paying banker shall refuse to make the payment of the same.

Who can Cross a Cheque after Issue [Section 125]

A cheque may be crossed after its issue in the following manner:

Case	Right to cross
1. Where a cheque is uncrossed	The holder may cross it generally or specially
2. Where a cheque is crossed generally	The holder may cross it specially by adding the name of same banker.
3. Where a cheque is crossed generally or specially	The holder may add the word 'Not Negotiable'.
4. Where a cheque is crossed specially	The banker to whom it is crossed may again cross it specially to another banker (his agent) for collection.

Can a Cheque be Crossed Specially more than once? [Section 127]
A cheque cannot be crossed more than once. It is only a special crossing which may require a second crossing. This is allowed only when a Banker in whose favour a crossing is made, can once again cross it in favour of his agent for collection. Therefore, a banker is, except for the above stated case, prohibited to make payment on a cheque bearing more than one crossing.

3.31.4 BOUNCING OR DISHONOUR OF CHEQUES

A cheque is said to be bounced or dishonoured by non-payment when the drawee of the cheque makes default in payment upon being duly required to pay the same.

Liability of Drawee on Dishonour of a Cheque [Section 31]:

The drawee of a cheque must compensate the drawer for any loss or damage caused by non-payment if the following three conditions are fulfilled:

i. If the drawee has sufficient funds of the drawer in his hands;

ii. If the funds are properly applicable to such payment;

iii. If the drawee is duly required to pay the cheque.

Note : The drawee (i.e., paying banker) is liable to drawer and not to any person.

Liability of Drawer on Dishonour of a Cheque [Section 138]

On dishonour of a cheque, the drawer is punishable with imprisonment for a term not exceeding 1 year or with fine not exceeding twice the amount of a cheque or with both if the following conditions are fulfilled:

a. If the cheque was drawn to discharge a legally enforceable debt or other liability;

b. If the cheque is returned by the bank unpaid due to insufficiency of funds in the account of drawer;

c. If the cheque has been presented to the bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier;

d. If the payee or the holder in due course of the cheque has made a demand for the payment of the said amount of money by giving a notice, in writing, to the drawer of the cheque within fifteen days of the receipt of information by him from the bank regarding the return of the cheque as unpaid; and

e. If the drawer of such cheque has failed to make the payment of the said amount of money to the payee or to the holder in due course of the cheque, within fifteen days of the receipt of the said notice.

Cases in which a Banker must Refuse to Honour a Customer's Cheque:

A banker must refuse to honour a customer's cheque in the following cases:

i. Stop payment: When the banker receives instructions from the customer not to honour (i.e. stop payment) a particular cheque issued by him.

ii. Garnishee order: When the banker receives a Garnishee Order, i.e., a prohibiting order by any court attaching the money in the customer's account.

iii. Death: When the banker receives a notice of the death of his customer.

iv. Insolvency: When the banker receives a notice of the insolvency of his customer.

v. Insanity: When the banker receives a notice of the insanity.

vi. Assignment: When the banker receives a notice of assignment of his credit balance from a customer.

vii. Defect in title: When the banker suspects or has reason to believe that the title of the person presenting the cheque is defective.

viii. Loss of Cheque: When the banker receives a notice of loss of cheque from his customer.

ix. Material alteration: When there is a material alteration in the cheque and such alteration has not been authenticated by his customer by putting his signature.

x. Different signature: When the signature of the drawer does not tally with the specimen signature kept by the bank.

xi. Notice of closure: When the banker receives a notice in respect of closure of account.

xii. Irregular endorsement: When there is an irregular endorsement.

Cases in which a Banker may refuse to Honour a Customer's Cheque:

i. A banker may refuse to honour a customer's cheque in the following cases: Insufficient funds: When funds in the customer's account are insufficient to honour the cheque presented.

ii. Funds not applicable: When funds in the customer's account are not applicable for the cheque presented.

iii. Presentment at different branch: When the cheque is presented at the branch other than the branch where the customer who has issued the cheque, has the account.

iv. Presentment after banking hours: When the cheque is presented after the banking hours.

v. Stale cheque: When the cheque is presented after 6 months from the date of its issue.

vi. Post dated cheque: When the cheque is presented before the actual date on which it is written to be payable.

vii. Undated cheque: When the cheque is undated [Griffith v. Dalton (1940)].

Meaning of Holder [Section 8]

A person is called holder of a negotiable instrument if he satisfies the following two conditions:

a. he must be entitled to the possession of the instrument in his own name; and

b. he must be entitled to receive/recover the amount due on the instrument from the parties liable under the instrument.

Thus, Holder means the bearer of the bearer instrument and the endorsee or payee of the order instrument. He must be a *dejure* holder and not a *defacto* holder. He should be the owner thereof at law, whatever be his position in equity. It may be noted that under English Law, actual possession of the instrument is essential to be a Holder but such physical possession is not necessary under the Negotiable Instruments Act.

Example X advanced Rs. 10,000 to Y who executed a promissory note in the name of Z a benamidar. On Maturity Y failed to pay the amount due and X brought an action against Y. It was held that X could not recover the amount because he was not entitled to the promissory note in his own name. [Sarjoo Prasad v. Ramapayari Debi]

Note: Only a holder can bring a legal action to recover the amount due on the instrument.

Holder in case of loss or destruction :

Where a note, bill or cheque is lost or destroyed, its holder is the person who was entitled to the instrument in his name at the time of such loss or destruction. For example, the finder of a lost instrument payable to bearer or a person in wrongful possession of such instrument is not a holder. Similarly, an agent holding an instrument for his principal will also not be a holder of it although he may receive its payment.

Holder in due Course [Section 9]:

A person is called a holder in due course if he satisfies the following conditions:

i. He must be a holder.

ii. He must have become, for consideration, either the possessor of the instrument if payable to bearer, or payee or endorsee thereof if payable to order. Such consideration must not be unlawful and need not be adequate.

iii. He must have obtained the instrument before its maturity. He must become the holder before the amount becomes payable there on. A person taking the bill or note on the day on which it becomes payable is not a holder as he takes it after it has become payable since the instrument may be discharged at any time on that day.

iv. He must have obtained the instrument in good faith, i.e. without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

v. He must receive the instrument complete and regular on the face of it, e.g. in Arab Bank Ltd. vs. Ross (1952) 2Q.B.216; the payee in the promissory note was described as F and F.N. & Co., whereas endorser endorsed the note as F and F.N. omitting the words 'company'. Held, the endorsee did not constitute to be a holder in due course since the endorser and the payee appeared to be different person making the instrument not complete and regular on the face of it.

Check your progress 31:

What are the essential characteristics of cheque?

LESSON-32

MATURITY OF A NEGOTIABLE INSTRUMENT

[SECTIONS 22 to 25]

CONTENTS

3.32. 1 Capacity and authority of a person to be a party to a negotiable instrument
3.32. 2 Negotiation and Assignment
Check your progress: 32

Meaning of Maturity [Section 22]

The Maturity of a promissory note or bill of exchange is the date on which it falls due.

Days of Grace [Section 22]

Every instrument payable otherwise than on demand is entitled to three days of grace.

Calculation of Date of Maturity [Sections 23 to 25]

The date of maturity in various cases is calculated as under:

Case	Date of maturity
1. In case of bill or note payable on a specified day.	Third day after the specified day.
2. In case of bill or note payable on stated number of months after date [Section 23]	Third day after the date on which the period of the bill or note shall expire. Note: The period shall expire on that day of the month which corresponds with the day on which the bill is dated. If the month in which the period terminates has no corresponding day, the period shall be deemed to expire on the last day of such a month.
3. In case of bill payable on a stated number of months after sight and accepted for honour [Section 23]	Third day after the date on which the period of the bill or note shall expire. Note: The period shall expire on that day of the month which corresponds with the day on which the bill is accepted for honour. If the month in which the period terminates has no corresponding day, the period shall be deemed to expire on the last day of such month.

4. In case the day on which a note or bill is at maturity, is a public holiday [Section 25]	The next preceding business day. Note: The expression public holidays includes Sundays and any other day declared by the Central Government by notification in the Official Gazette to be a public holiday.
5. In case the day on which a note or bill is at maturity is an emergency/unforeseen public holiday.	The next following business day.

Note: The day on which the bill/note is drawn or presented for acceptance, sight or the day on which the event happens, must be excluded. [Section 24]

3.32.1 CAPACITY AND AUTHORITY OF A PERSON TO BE A PARTY TO A NEGOTIABLE INSTRUMENT [SECTIONS 26 to 28]

Meaning of Capacity:

Capacity here means competence to contract so as to bind oneself.

Who can Bind and be Bound [Section 26]:

Every person capable of contracting, according to the law to which he is subject, may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Position of Minor [Section 26]:

A minor may draw, enndorse, deliver and negotiate such instrument so as to bind all parties, except himself.

In other words, the instrument will be valid and binding on all parties except the minor.

Note: It is the estate of a minor (not the minor as person) which is liable for debts arising out of ‘necessaries’ supplied to minor.

Can Liability Under Instrument be Incurred through an Agent [Section 27]: Every person capable of binding himself or of being bound, may so bind himself or be bound by a duly authorised agent acting on his behalf.

Does an Agent's General Authority include an Authority to Accept or Endorse a Bill [Section 27]:

A general authority to transact business and to receive and discharge debts does not confer upon an agent the power of accepting or endorsing bills of exchange so as to bind his principal.

Does an Agent's Authority to Draw a Bill include an Authority to Endorse [Section 27]:

An authority to draw bill of exchange does not of itself impart an authority to endorse.

Liability of an Agent [Section 28]:

An agent who signs his name on a promissory note, bill of exchange or cheque without indicating thereon that he signs as an agent, or that he does not intend thereby to incur personal responsibility, is liable personally on the instrument.

Exception to the aforesaid rule:

An agent is not persona1ly liable to those who induced him to sign upon the belief that the principal only would be held liable.

Note:

The mere signature of an agent in his own name with the word 'agent' added does not exempt him from personal liability [Liverpool Bank vs. Walter]

3.32.2 NEGOTIATION AND ASSIGNMENT [SECTIONS 14,47, 48, 60]

Meaning of Negotiation [Section 14]:

An instrument is said to be negotiated when a promissory note, bill of exchange or cheque is transferred to any person so as to constitute that person the holder of the instrument.

Thus, the essence of the negotiation is that it must be made with the intention of transferring a title of the instrument to the transferee.

Meaning of Assignment:

An instrument is said to be assigned when a promissory note, bill of exchange or cheque is transferred by means of a written and registered document under the provisions of the Transfer of Property Act, 1882. The person who transfers his right to recover the payment of a debt is called an assignor and the person to whom such rights are transferred is called an assignee. The assignee takes the instrument subject to all equities which arise between the party liable and the assignor. Thus, the assignee gets the rights of the assignor only. He does not rights of a holder in due course.

Check your progress 32:

What is negotiation and what is assignment?

LESSON-33

ENDORSEMENT [SECTIONS 15, 16, 50, 51, 52, 56]

CONTENTS

3.33. 1 Meaning of Endorsement

3.33. 2 Kinds of Endorsements

Check your progress: 33

3.33.1 MEANING OF ENDORSEMENT [SECTION 15]

The process of transferring an instrument is called an endorsement. An endorsement means signing the negotiable instrument on the back or face thereof or on a slip of paper (called allonge) annexed thereto for the purpose of negotiation. The person who endorses the instrument is called the "endorser" and the person in whose favour the instrument is endorsed is called the 'endorsee'.

Who may Endorse/Negotiate [Section 51]:

Every sole maker, drawer, payee or endorsee, or all of several joint makers, drawers, payees or endorsees of a negotiable instrument may endorse and negotiate the same if the negotiability of such instrument has not been restricted or excluded as mentioned in Section 50 [Section 51]. In other words, a stranger (i.e., a person other than those stated above) cannot endorse a negotiable instrument. If a stranger endorses it, the endorsement is void and he cannot be made liable as endorser. [Thakersey vs. Kishandas]

A maker or drawer of payee or endorsee may endorse or negotiate an instrument only if he is a holder thereof [Explanation to Section 51].

Essential Requirements of a Valid Endorsement The essential requirements of a valid endorsement are as follows:

i. It must be on the back or face of instrument or on a slip of paper (called allonge) annexed thereto.
ii. It must be signed by the endorser.
iii. It must be completed by the delivery of the instrument.
iv. It must be made by the holder of the instrument.

3.33.2 KINDS OF ENDORSEMENTS

General Endorsement or Blank Endorsement:

An endorsement is said to be in blank if the endorser signs his name only. An instrument endorsed in blank becomes payable to the bearer thereof even although it was originally payable to order.

Special Endorsement or Full Endorsement:

An endorsement is said to be full if the endorser

i. signs his name, and
ii. adds a direction to pay the amount to or to the order of a specified person.

Restrictive Endorsement:

An endorsement is said to be restrictive if it restricts/ excludes the right of further negotiation.

Thus, in case of restrictive endorsement, the endorsee does not become the owner of the instrument as in case of other endorsement.

Partial Endorsement:

An endorsement is said to be a partial endorsement when it purports to transfer only a part of the amount of the instrument. A partial endorsement is invalid.

Exception: Where an instrument has been paid in part, the fact of the part payment may be endorsed on the instrument and it may then be negotiated for the residue.

Conditional Endorsement or Qualified Endorsement:

An endorsement is said to be a conditional endorsement if it limits or negatives the liability of the endorser.

Check your progress 33:

What are the kinds of endorsements?

LESSON-34

MATERIAL ALTERATION [SECTIONS 20, 49, 87, 89, 125]

CONTENTS

3.34. 1 Meaning of Material Alteration

3.34. 2 Effect of Material Alteration
Check your progress: 34
Lesson End Activities

3.34.1 MEANING OF MATERIAL ALTERATION

An alteration can be called a material alteration if it alters or attempts to alter the character of the instrument and affects or is likely to affect the contract which the instrument contains or is evidence of. Thus, it totally alters the business effect of the instrument. It makes the instrument speak a language other than that intended.

Material alteration	Non-material alteration
1. Alteration of date of instrument(e.g.,if a bill dated Ist May,1998) is changed to a bill dated 1st June, 1998.	1. Conversion of instrument payable to order into one payable to bearer.
2. Alteration of time of payment(e.g.,if a bill payable three months after date is changed to a bill payable four months after date).	2. Conversion of instrument payable to bearer into order.
3. Alteration of place of payment (e.g., if a bill payable at Delhi is changed to bill payable at Bombay).	3. Elimination of the words' or order' from an endorsement.
4. Alteration of amount payable (e.g., if a bill for Rs 1000 is changed to a bill for Rs 2000)	4. Addition of the words 'on demand' to a note in which no time or payment is expressed.
5. Conversion of blank endorsement into special endorsement	
6. Addition of a new party to an instrument.	
7. Alteration of one of the clauses of the instrument containing a penal action.	

Material Alterations Authorised by the Act [Sections 20, 49, 125]:

The following material alterations have been authorised by the Act and do not require authentication:

i. Filling blanks of inchoate instruments [Section 20]
ii. Conversion of a blank endorsement into an endorsement in full [Section 49]
iii. Crossing of cheques [Section 125]

3.34.2 EFFECT OF MATERIAL ALTERATION [SECTIONS 87 AND 88]

An instrument which is materially altered becomes void against all persons who were parties to it at time of alteration and did not consent to it unless such alteration was made in order to carry out the common intention of the original parties.

The effect of material alteration on liability of various parties is summarised:

Persons	Effect
1. Persons who were parties at the time of alteration and did not consent to alteration.	Such persons are altogether discharged from liability under that instrument. Such persons shall not be liable even to a bonafide purchaser of the instrument having no notice of alteration.
2. Persons who were parties at the time of alteration and consented to alteration and persons who became parties to the instrument subsequent to the alteration.	Such persons continue to be liable under that instrument.

Protection to a Person Paying a Materially Altered Instrument [89]:

The payer of a materially altered instrument is discharged from all liability on the instrument if the following two conditions are fulfilled:

(a) The alteration must not be apparent; and

(b) The payment must be made in due course.

Example:

X draws a cheque for Rs. 1000 and Y, a holder without the consent of X, alters the figure 1000 into 10,000 and makes the instrument look like a cheque drawn for Rs 10,000. The banker who pays such cheque in due course is discharged from all liability under the cheque since the alteration was not apparent.

Check your progress 34:

What is material alteration?

Lesson end activities:

A bill is drawn as "pay to X or order the sum of ten thousand rupees". In the margin the amount stated is Rs.1,000. Discuss the legal position.

THE INDIAN PARTNERSHIP ACT, 1932

AIMS AND OBJECTIVES

This unit aims at enabling the students

i. To understand the concept of partnership
ii. The regulations applicable to partnership firms
iii. The types of partners
iv. Registration of firms
v. Relations of firms
vi. Rights and duties of partners and
vii. Dissolving partnership firms

INTRODUCTION

Partnership is one of the specific contracts which as a part of the Indian Contract Act, 1872. In 1930, however, the provisions relating to partnership contract were repealed and a separate Act called the Indian Partnership Act, 1932 was passed which is in force till today. It extends to the whole of India except the State of Jammu and Kashmir.

LESSON-35
NATURE OF PARTNERSHIP

CONTENTS

3.35. 1 Definition of Partnership
3.35. 2 Characteristics of Partnership
3.35. 3 Formation of Partnership
3.35. 4 Partners, Firm, Firm Name
Check your progress: 35

The law of partnership is contained in the Indian Partnership Act, 1932, which came into force on 1st October, 1932. Prior to the enactment of this Act, it was embodied in Chapter XI of the Indian Contract Act, 1872. It was, however, found that the provisions relating to partnership, as contained in the Contract Act, were not exhaustive. Hence the present Partnership Act. The Act is substantially based on the English Law on the subject as contained in the Partnership Act, 1890. The main principles are the same but at places certain alterations have been made to adapt the law to the peculiar conditions prevailing in India. The most important change brought about by the Act is the provision for the registration of firms.

A contract of partnership is a special contract. Where the Partnership Act is silent on any point, the general principles of the law of contract apply (Sec. 3).

In chapters 5-1 to 5-3, unless otherwise stated, Sections referred to are those of the Indian Partnership Act, 1932.

3.35.1 DEFINITION OF PARTNERSHIP

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 (Sec. 4, Para 1). Persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm' (Sec. 4, Para 2).

3.35.2 CHARACTERISTICS OF PARTNERSHIP

If we analyse the definition of partnership, the following essential characteristics stand out:

1. Association of two or more persons:

There should be at least two competent persons to form a partnership. As regards the maximum number of partners in a firm, Sec. 11 of the Companies Act, 1956 provides that the number of partners in a firm carrying on banking business should not exceed ten and in any other business twenty. If the number of partners exceeds this limit, the partnership becomes an illegal association. It ceases to be a partnership if the number gets reduced to one by any reason.

The term ‘person’ as used in Sec. 4 does not include a firm [Duli Chand etc. vs. Commr. of Income-tax, A.I.R. (1956) S.C. 354]. This is because a firm is not a separate legal entity. As such two partnership firms cannot enter into partnership, though all the partners of the two

firms may form a partnership out of their separate firms provided their numbervdoes not exceed the statutory limit. A company is a 'person' within the meaning of Sec. 4 [M.M. Pulimood vs. Registrar of Firms, (1987) 61 Comp. Cas. 209 (Ker.)]. It may, being an entity distinct from its members, enter into a contract of partnership if it is authorised by its Memorandum of Association [Steel Bros. & Co. Ltd. vs. Commr. of Income tax, A.I.R (1958) S.C. 315].

2. Agreement:

The partnership relation is one of contractual nature. It arises from contract and not from status (Sec. 5, para 1), as agreement between the partners is the basis of this contract. The agreement may be express (i.e., oral or written) or implied. Implied agreement may be inferred from the course of dealing or the conduct of the parties. The agreement may be for a fixed period, or for the execution of a particular adventure, or it may give option to the partners to withdraw from the partnership at any time. Partnership is thus created by contract; it does not arise by operation of law (as in the case of co-owners) or from status (as in the case of a Joint Hindu Family) or from inheritance. Partnership agreement, like any other contract, must have all the essential elements of a valid contract.

3. Business:

A partnership can be formed only for the purpose of carrying on some business. ‘Business’ includes every trade, occupation and profession [Sec. 2 (b)]. The word ‘business’ generally conveys the idea of a running business involving numerous transactions. Besides that a person may become a partner with another in a particular adventure. The business to be carried on by the firm must be legal.

4. Sharing of profits:

The object of partnership must be to make profit. Profit means net profit, i.e., excess of returns over outlays, the excess of what is obtained over the cost of obtaining it. Profit must be distributed among the partners in an agreed ratio. If any person claiming to be a partner is deprived of his right to share in the profits of the business, he is not a partner as his carrying on the business is n profit. But the reverse is not necessarily true. A person may share in the profits of partnership, but still he may not be a partner. The sharing of profit also involves sharing of loss which in fact is negative profit. But as between the partners, it may be agreed that one or more of the partners shall not be liable for losses.

5. Mutual agency:

The business of partnership may be carried on by all the partners or any of them acting for all. A partner is both an agent (in the sense that he can bind by his acts the other partners) and the principal (in the sense that he can be bound by the acts of the partners). The question whether a person is or is not a partner depends in nearly all cases upon whether he has the authority to act for those who are admittedly partners and whether those admitted partners have the authority to act for him.

Law of partnership - an extension of the law of agency

The partnership business may be carried on by all the partners or any of them acting for all. Thus, the relationship of principal and agent is established among partners and this relationship is governed by the law of agency. Sec. 18 also provides that, subject to the provisions of the Partnership Act, a partner is the agent of the firm for the purposes of the business of the firm. The leading case on the point is:

Cox v. Hickman, (1860) H.L.C. 268. A trader carried on his business under the supervision of his creditors. The object of carrying on the business was to pay them off out of the profits of the

business. Held, no partnership existed between the trader and the creditors. It was rightly observed in this case.

“The law as to partnership is undoubtedly a branch of the law of the principal and agent. The liability of one partner for the acts of his co-partners is in truth the liability of a principal for the acts of his partners when two or more persons are engaged as partners in an ordinary trade, each of them has an implied authority from the others to bind all others by contracts entered into according to usual course of business in that trade........... “ .

A partner assumes a two-fold character:

He is an agent of the firm so far his dealings with the outside world for the purposes of the business of the firm are concerned. He can bind the firm by his acts provided

a. the acts are within the scope of his authority

b. they are done in the firm’s name and

c. they are done for the purposes of the business of the firm.

He is a principal so far as the other partners are concerned. The relation between the partners inter se (i.e., between r among themselves) is that of principals.

Example:

A, B and C are partners in a business. D, an outsider, deals with the firm through A. As between A and D, A is the principal. But as between A, B and C, A is also the agent of

Band C. As such A, B and C can all sue D. D can also sue A, B and C. Furthermore, A is accountable to B and C because he is in this transaction an agent of B and C.

To sum up : the law of partnership governing relations of the partners inter se and with the outside world is an extension of the law of principal and agent.

3.35.3 FORMATION OF PARTNERSHIP

A partnership is based on an agreement. The partnership agreement may be made orally or in writing or may be implied from the course of dealing among partners. However, all the essential elements of a 'valid contract' must be present. There must be free and genuine consent of the parties who must be competent to contract. The object of the partnership should be lawful and other legal formalities should be complied with. But the following two points should be noted in this connection:

i. Minor partner:

 A minor may be admitted to the benefits of partnership with the consent of all the other partners.

ii. Consideration:

 As no consideration is required to create an agency (Sec. 185 of the Indian Contract Act. 1872), no consideration is required to create partnership which is an extension of the law of agency.

Partnership deed:

The agreement creating partnership may be express (i.e., oral or written) or implied, and the latter may be inferred from the conduct or the course of dealing of the parties or from the circumstances of' the case. However, it is in the interest of the partners that the agreement must be in writing. The document which contains this agreement is called partnership deed. It usually contains provisions relating to the nature and the principal place of business, the name of the firm, the names and addresses of the partners, the duration of the firm, profit sharing ratio, interest on capital and drawings, valuation of goodwill on the death or retirement of a partner, management, accounts, arbitration, etc. The deed must be duly stamped as required by the Indian Stamp Act, 1889.

Who may be partners?

A contract of partnership may be entered into by every person who is competent to enter into a contract (Sec. 11 of the Indian Contract Act, 1872].

Alien enemy:

A alien enemy cannot enter into a contract of partnership with an Indian subject. An alien friend can do so.

Minor:

A minor cannot become a partner in a firm but with the consent of all the other partners, he may be admitted to the benefits partnership.

Person of unsound mind:

A person of unsound mind is not competent to enter into a contract of partnership.

Corporation:

A corporation, i.e., a registered company, can enter into a contract of partnership as a single individual but not as a group of individuals comprising it [Sri Murugan Oil Industries (Pvt.) Ltd. vs. A.U. Suryanarayana Chettiar, (1963) 33 Comp, Cas. 833 (Mad.)].

3.35.4 PARTNERS, FIRM, FIRM NAME

Persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm', and the name under which the business is carried on is called the 'firm name'[Sec. 4, Para 2]. The firm name is only a short way of expressing the names of all the partners. The partners of a firm may carry on business under any name and style which they please to adopt. But this is subject to the following two limitations:

A firm name shall not contain any words expressing or implying the sanction, approval or patronage of the Government. The State Government may, however, signify its consent to the use of such words by a firm as part of its name by order in writing [Sec. 58 (3)].

The law safeguards the trade names and goodwill of other persons who are already in existence, The mere fact that a firm has already been doing business under a certain name does not prevent a new firm from adopting it. But if the name is used with a fraudulent intention, the law will intervene. The firm may be restrained from the adoption of such name by injunction.

Partnership and firm

Partnership is merely an abstract legal relation between the partners. It is, in other words, an abstract thing. A firm is a collective name for all the partners. It is a concrete thing. Partnership may be styled as the invisible tie binding the partners together. The firm is the visible body (collective group) of those partners who are thus bound together.

Legal status of firm:

In mercantile or commercial usage, a firm is deemed to have existence distinct from the partners constituting it. In some of the continental countries also a firm is recognised as a person distinct from the partners constituting it. But in England and India, a firm is not a distinct legal entity apart from the partners constituting it [Malabar Fisheries Co. vs.

Commr. of Income-tax, Kerala, AI.R. (1980) S.C. 176). Unlike a company which is a corporate body, it is not regarded as a person in the eyes of the law. 'Firm' is only a compendious description, i.e., abridged name for the individuals who compose it [Munshi Ram vs. Chhehrata Municipality, AI.R. (1979) S.C.1250] ; it is not a legal entity. Its name is merely an abbreviated or abridged name for all its partners. The rights and obligations of a firm are really the rights and obligations of the partners who compose the firm.

Do the same partners in two different firms constitute one firm ?

An agreement between the partners of a firm 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. It will depend on the intention of the partners whether they intend to-

i. constitute two separate partnerships and therefore two distinct firms or
ii. extend merely a partnership, originally constituted to carry on one business, to the carrying on of another business.

The intention of the partners will have to be decided with reference to the terms of the agreement and all the surrounding circumstances including evidence as to the interlacing (entangling together) or interlocking (uniting together) of management, finance and other incidents of the respective businesses (Deputy Commr. of Sales Tax vs. K. Kelukutty, A.I.R (1985) S.C. 1143].

Check your progress 35:

Define partnership

LESSON-36
TEST OF PARTNERSHIP

CONTENTS

3.36. 1 Test of partnership

3.36. 2 Duration of partnership

Check your progress: 36

3.36.1 TEST OF PARTNERSHIP

In order to determine the existence of partnership between a group of persons, the definition in Sec. 4 is used as a test, i.e., one must look to the agreement between them. If the agreement is to share the profits of a business, and the business is carried on by all or any of them acting for all there is partnership, otherwise not. The difficulty arises when there is no specific agreement constituting partnership among the partners, or the agreement is such as does not specifically speak of partnership. In such a case, we have to refer to Sec. 6 which embodies the rule laid down in the case of Cox vs. Hickman, (1860) H.L.C. 268.

Real relation is the basis:

The general principle which serves as a guide to determine whether a group of persons does or does not constitute partnership as laid down in Sec. 6 is as follows:

"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."

Determination of real relation:

The real relation between the parties is to be determined from all the facts, i.e., the written or verbal agreement, surrounding circumstances at the time when the contract was entered into, conduct of the parties, and other relevant facts, e.g., books of account, correspondence, evidence of employees, etc. These are not considered individually to ascertain the existence of partnership, but are taken collectively and their cumulative effect is taken into consideration. In effect it is the substance of the thing, and not the form, that has to be looked to. The parties may expressly state in a document that they are not partners but they may turn out to be partners in the eyes of the law, when all the other facts are taken into account. Again, a statement by the parties in a document that they are partners may not necessarily constitute them partners in law.

Mixed question of law and fact:

Whether a genuine partnership exists or not is a mixed question of law and fact. The fact that a partner was entitled to a fixed percentage of profits of the firm only and not to share its losses and he was excluded from operating bank accounts of the firm, were inconsequential in determination of the question [Helper Girdharbhai vs. Saiyed M.M. Kadri, (1987) 3 S.S.C.538].

Cases where no partnership relation: Sec. 6 enumerates, in its two Explanations, cases where the partnership relation does not exist. These cases are:

Joint owners sharing gross returns:

Joint owners of property sharing profits or gross returns arising from the property do not become partners (Explanation 1 to Sec. 6).

Example:

A and B jointly purchased a tea shop. Each of them contributed a half of the expense incurred for the purchase of pottery and utensils. They then leased out the shop and shared the rent equally. Held, they were co-owners and not partners [GovindNair vs. Maga, AI.R. (1933) Rang. 120].

If, however, co-owners start a business with a view to sharing profits of the business, they become partners.

Sharing of profits:

The sharing of profits is prima facie a strong evidence of partnership but the fact that there is sharing of profits between some persons will not automatically make them partners. Therefore, 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 the business does not of itself make him a partner with the persons carrying on the business. In particular, there is no partnership-

Where a person has lent money to persons engaged or about to engage in business and receives a rate of interest varying with the profit.

Example:

A advanced money to two merchants who agreed to carry on the business subject to the control of A in several respects. A was to receive a commission of 20 per cent on all profits. Held, there was no partnership [Mollow March & Co.vs. The Court of Wards (1872) L.R. 2 C.P. 419).

Where a Servant or agent is engaged in a business, and receives his remuneration as a share of profit:

Example:

A, a contractor for loading and unloading rail wagons, appointed a servant to manage it. The servant was to receive 75 per cent of the profits and was to bear all losses, if any. Held, the servant was the agent of A and not his partner [Munshi Abdul Latif vs. Gopeshwar, A.I.R. (1933) Cal. 204).

Where the widow or child of a deceased partner receives a portion of the profit:

Where a person has sold his business along with its goodwill and receives a portion of the profits in consideration of the sale (Explanation 2 to Sec. 6).

Although the sharing of profits of a business is a strong test of partnership, yet whether the relation of partnership does or does not exist must depend upon the real intention and conduct of the parties.

The real test is mutual agency:

To conclude, one may say that the true test of 'partnership is not the sharing of profits by a person or the contribution of capital or the holding of a particular property jointly, but whether the business is carried on by him or by another on his account so that there is a mutual agency between them. If relation of principal and agent exists between the parties constituting a group, formed with a view to earn profits a business, we can say that there is partnership.

Who are not partners (Sec.5, Para 2):

The following persons (in addition to those already discussed) are not partners:

i. The members of a Hindu undivided family carrying on family business as such
ii. A Burmese Buddhist husband and wife carrying on business as such.

3.36.2 DURATION OF PARTNERSHIP

The partners may, at the time when they enter into partnership agreement, fix the duration of the partnership or may say nothing about it. In the former case, the partnership is called a partnership for a fixed term, and in the latter case, a partnership-at-will. Sometimes, a partnership is formed for the purpose of carrying on a particular adventure or undertaking. In such a case, it is called a particular partnership.

Partnership for a fixed term:

In this case, the partnership is entered into for a fixed period of time. When the fixed period is over, it comes to an end. The partners may, however, continue to carry on the business after the expiry of the fixed period. In such a case the mutual rights and duties of partners remain the same as they were before the expiry of fixed period and the partnership becomes partnership-at-will [Sec. 17 (b)].

Partnership-at-will:

Where no provision is made by contract between the partners for the duration of the partnership, or for the determination of the partnership, the partnership is “partnership-at-will” (Sec. 7). It may be dissolved by any partner by giving a notice in writing to all other partners of his intention to dissolve the firm. When such a notice is given, the firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned, as from the date of communication of the notice (Sec. 43) [Bodheshwar vs. Jatindra Nath,A.I.R. (I976) Gau. 12]. A partner-at-will can undoubtedly name a date as from which the firm would stand dissolved, but that date can, in no case, be prior to the date of issue of his notice [V.V.P. Thangarau vs. K. V. Perumal, A.I.R. (l980) Mad. 7] . The notice should be an unambiguous intimation of a final intention to dissolve partnership, and should be served on all the other partners. Notice once given cannot be withdrawn unless all the other partners agree to it [Jones v. Lloyd. (1874) I.R. 18 Eq. 265].

Particular partnership:

When a person becomes a partner with another person or persons in a particular adventure or undertaking, such a partnership is known as “particular partnership” (Sec. 8). It comes to an end as soon as that adventure is completed. If it is continued after the completion of that adventure for which it was entered into, it becomes partnership-at-will. In such a case, rights and liabilities of the partners in respect of the other adventures are the same as those in respect of the original adventure or undertaking [Sec. 17 (c)].

Check your progress 36:

How can partnership be tested?

LESSON-37

REGISTRATION OF FIRMS

CONTENTS

3.37. 1 Procedure for registration

3.37. 2 Time of registration

3.37. 3 Effects of non-registration

3.37. 4 Alterations

Check your progress: 37

The Partnership Act does not provide for the compulsory registration of firms. It has left it to the option of the firms to get themselves registered. But indirectly, by creating certain disabilities from which an unregistered firm suffers, it has made the registration of firms compulsory. Sec. 69 deals with such disabilities. These disabilities are such that, sooner or later, every firm has to get itself registered. However, registration does not create partnership; it is only a reliable evidence of the existence of partnership. It also affords protection to outsiders dealing with the firm.

3.37.1 PROCEDURE FOR REGISTRATION (SECS. 58 AND 59)

The registration of a firm may be effected at any time by filing an application in the form of a statement, giving the necessary information, with the Registrar of Firms of the area. Sec. 57 empowers a State Government to appoint Registrars of Firms for the purposes of the Partnership Act and define the areas within which they shall exercise their powers and perform their duties.

The application for registration of a firm shall be accompanied by the prescribed fee. It shall state:

(a) the name of the firm ;

(b) the place or principal place of business of the firm

(c) the names of other places where the firm carries on business

(d) the date when each partner joined the firm

(e) the names in full and permanent addresses of the partners

(f) the duration of the firm.

The statement shall be signed by all the partners or by their agents specially authorised in this behalf [Sec. 58 (1)]. It shall also be verified by them in the prescribed manner [Sec. 58 (2)].

When the Registrar is satisfied that the above provisions have been duly complied with, he shall record an entry of the statement in the Register of Firms (maintained by Registrar of Firms in respect of each registered firm for recording the necessary information relating to that firm) and file the statement (Sec. 59). He shall then issue under his hand a certificate of registration. Registration is effective from the date when the Registrar files the statement and makes entries in the Register of Firms and not from the date of presentation of the statement to him [Commr. of Income-Tax vs. Jayalakshmi R. & O. Mars, A.I.R. (197 1) S.C.1015]. Registration to a firm under Sec. 59 cannot be declined for the reason of a company being a partner of the firm [M.M. Pulimood vs. Registrar of Firms, (1987) 61 Comp. Cas. 209 (Ker.)].

3.37.2 TIME OF REGISTRATION

As to the time of the registration of a firm, there is no definite provision in the Act. Sec. 69 (2), however, lays down that no suit to enforce a right arising from a contract can 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. In other words, no suit by an unregistered firm is competent and the only course open to the Court is to dismiss it [Malhotra & Co. vs. Ramesh Mistri, AI.R. (1971) Punj. 212]. The point of time contemplated in Sec. 69 (2) is the time of the institution of the suit. That is to say, the firm must be a registered firm by the date of the institution of the suit [Shanker Housing Corporation vs. Mohan Devi, A.I.R. (1978) Delhi 255). This means before any suit is filed in a Law Court, registration must be effected. Subsequent registration does not cure initial defect at the time of the institution of the suit. The right course in such a case is to withdraw the suit from the Court, get the firm registered and then file a fresh suit.

3.37.3 EFFECTS OF NON-REGISTRATION (SEC. 69)

1. Suits between partners and firm:

A person suing as a partner of an unregistered firm cannot sue the firm or any partners of the firm to enforce a right arising from a contract or conferred by the Partnership Act. He can do so if -

i. the firm is registered, and

ii. the person suing is or has been shown in the Register of Firms as a partner in the firm [Sec. 69 (1)].

2. Suits between firm and third parties:

An unregistered firm cannot sue a third party to enforce a right arising from a contract until

i. the firm is registered and
ii. the names of the persons suing appear as partners in the Register of Firms [Sec. 69 (2)].

A plaint filed by an unregistered firm in contravention of Sec. 69 (1) and (2) is treated as a void plaint (Abani Kanta Pal, In the matter of, A.I.R (1986) Cal. 143]. This view finds support from a decision of the Supreme Court In Loonkaran Sethia vs. Ivan E. John, AI.R. (1977) S.C. 336.

In Shreeram Finance Corpn. vs. Yasin Khan, AI.R. (1989) S.C. 1769, a suit by the appellants (partners) was hit by the provisions of Sec. 69 (2), as on the date when the suit was filed, two of the partners shown as partners as per relevant entries in the Register of Firms were not, in fact, partners, one new partner had come in and two minors had been admitted to the benefits of the partnership firm regarding which no notice was given to the Registrar of Firms. Thus, the persons suing, namely, the current partners as on the date of the suit were not shown as partners in the Register of Firms. As such the suit was not maintainable in view of the provision of Section. 69 (2).

3. Claim of set-off:

An unregistered firm or any partner thereof cannot claim a set-off in a proceeding instituted against the firm by a third party to enforce a right arising from a contract, until the registration of the firm is effected (Sec. 69 (3)]. This right of set-off, however, is not affected if the claim of set-off does not exceed Rs. 100 in value [Sec. 69 (4) (b)].

Non –registration, however, does not affect-

1. The right of a firm or partners, of a firm having no place of business in India.
2. The right to any suit or claim of set-off not exceeding Rs. 100 in value.
3. The right of a partner to sue for the dissolution of the firm, or for the accounts of the dissolved firm, or for share of the property of the dissolved firm. (D.C. Upreti vs. B.D. Karnatak, AI.R. (1986) All. 32].

   It should be noted that this disability of a partner to sue disappears with the dissolution of the firm.
4. The powers of an Official Assignee, Receiver or Court to realise the property of an insolvent partner of an unregistered firm.
5. The right of a third party to proceed against an unregistered firm or any of its partners.
6. The right of an unregistered firm to enforce a right arising otherwise than out of a contract (Sec. 69 (3) and (4)].

It should however be noted that a decree passed in a suit filed by an unregistered firm is not a nullity and where the plea of non-registration is not raised in the suit itself, it cannot be raised in a separate suit [Kalyan Sahai vs. Firm Lachminarain, AI.R. (1951) Raj. 11].

3.37.4 ALTERATIONS

If any alteration relating to the following matters takes place in the case of a registered firm, a statement or intimation is to be sent to the Registrar of Firms for incorporating the necessary change in Register of Firms.

1. Change in the name of the firm or in location of the principal place of business of the registered firm (Sec. 60).
2. Closing and opening of branches (Sec. 6I).
3. Change in names and addresses of partners (Sec. 62).
4. Change in the constitution of the firm and its dissolution or election of a minor partner on attaining majority to continue as partner or sever his connection (Sec. 63).

Penalty for false particulars (Sec. 70):

If any person supplies incomplete information to the Registrar or signs any statement containing false or incomplete information to be supplied Registrar, he is punishable with imprisonment which may extend to three months, or with fine, or with both.

Inspection of Register of Firms and documents and grant of copies (Secs. 66 and 67):

The Register of Firms shall be open to inspection by any person on payment of such fee as may be prescribed [Sec. 66 (1)]. Further all statements, notices and intimations filed with the Registrar shall be open to inspection subject to prescribed conditions and payment of prescribed fees [Sec. 66 (2)]. The Registrar shall also, on application, furnish to any person on payment of the prescribed fee a certified copy of any entry in the Register of Firms (Sec. 67).

Rules of evidence (Sec. 68):

Any statement, notice or intimation recorded with the Registrar by any person shall be a conclusive proof against him of any fact therein stated. The third parties can, however, challenge the fact of a statement and prove that it is false and is based on misrepresentation or fraud.

Check your progress 37:

What are the effects of non-registration of partnership firms?

LESSON-38

RELATIONS OF PARTNERS

CONTENTS

3.38. 1 Relations of partners to one another

3.38. 2 Rights of a partner

3.38. 3 Duties of a partner

Check your progress: 38

3.38.1 RELATIONS OF PARTNERS TO ONE ANOTHER

The relations of the partners of a firm to one another are usually governed by the agreement among them. Such agreement may be express or may be implied from the course of dealing among them. It may be varied by consent of all them, and such consent may be expressed or may be implied by a course of dealing [Sec. 11 (I)]. Where there is no specific agreement or where the agreement is silent on a certain point, the relations of partners to one another as regards their rights and duties are governed by Secs. 9 to 17 of the Partnership Act.

3.38.2 RIGHTS OF A PARTNER

1. Right to take part in business:

The partnership agreemenit usually provides the mode of the conduct of the business. Subject to any such agreement between the partners, every partner has a tight to take part in the conduct of the business [Sec. 12 (a)]. This is based on the general principle that partnership business is the common business of all the partners. But where a partner neglects or refuses to perform his duties and the burden of performing such duties for the conduct of the business falls on other partners, the other partners have a right to compensation [Krishnamachariar vs. Sankara, (1921) AP.C. 91].

2. Right to be consulted:

Every partner has an inherent right to be consulted in all matters affecting the business of the partnership and express his views before any decision is taken by the partners.

Where there is any difference of opinion among the partners as to ordinary matters connected with the business, it may be settled, subject to contract between the partners, by a majority of the partners. The majority of the partners in exercising their power must act in good faith, and before the matter is decided every partner must have expressed his

opinion. If the partners are equally divided those who forbid the change must have their way. But as to important matters concerning the nature of the business, no change may be effected without the consent of all the partners. [Sec.12 (c)]. Thus, for example, no change can be made in the nature of the business, nor can the place of the business be changed nor the sale of the business effected, unless all the partners agree to it .

3. Right of access to accounts:

Subject to contract between the partners, every partner has a right to have access to and inspect and copy any of the books of the firm [Sec. 12 (d)]. A minor partner may have access to and inspect any of the accounts of the firm [Sec. 30 (2)] but not 'books'.

4. Right to share in profits:

In the absence of any agreement, the partners are entitled to share equally in the profits earned and are liable to contribute equally to the losses sustained by the firm [Sec. 13 (b)].

5. Right to interest on capital:

The partnership agreement may contain a clause as to the right of the partners to claim interest on capital at a certain rate. Such interest, subject to contract between the partners, is payable only out of profits, if any, earned by the firm [Sec. 13 (c)].

6. Right to interest on advances:

Where a partner makes, for the purposes of the business of the firm, any advance beyond the amount of capital, he is entitled to interest on such advance at the rate of six per cent per annum [Sec. 13 (d)]. Such interest is not only payable out of the profits of the business but also out of the assets of the firm.

7. Right to be indemnified:

A partner has authority, in an emergency to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances. Such acts of the partner bind the firm (Sec.21). If as a consequence of any such act, the partner incurs any liability or makes any payment, he has a right to be indemnified [Sec. 13 (e)].

8. Right to the use of partnership property:

Subject to contract between the partners, the property of the firm must be held and used by the partners exclusively for the purposes of the business of the firm. No partner has a right to treat it as his individual property (Sec. 15). If a partner uses the property of the firm directly or indirectly for his private purpose, he must account to the firm for the profits which he may have earned by the use of that property.

9. Right of partner as agent of the firm:

Every partner for the purposes of the business of the firm is the agent of the firm (Sec. 18). And subject to the provisions of the Indian Partnership Act, the act of a partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm (Sec. 19).

10. No new partner to be introduced:

Every partner has a right to prevent the introduction of a new partner unless he consents to that or unless there is an express term in the contract permitting such introduction [Sec. 31 (1)]. This is because partnership is found on mutual trust and confidence.

11. No liability before joining:

A person who is introduced as a partner into a firm is not liable for any act of the firm done before became a partner [Sec. 31 (2)].

12. Right to retire:

A partner has a right to retire

a. with the consent of all the other partners, or

b. in accordance with an express agreement between the partners, or

c. Where the partnership is at will, by giving notice to all the other partners of his intention to retire [Sec. 32 (1)].

13. Right not to be expelled:

A partner has a right not to be expelled from the firm by any majority of the partners, save in the exercise in good faith of powers conferred by the contract between the partners [Sec. 33 (1)].

14. Right of outgoing partner to share in the subsequent profits:

Where a partner has died, or has ceased to be a partner by retirement, expulsion, insolvency or any other cause, the surviving or continuing partners may carry on the business with the property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate. In such a case, legal representative of the deceased partner or the outgoing partner, in the absence of a contract to the contrary, is entitled, at his option, to-

a. such share of the profits as is proportionate to his share in the property of the firm, or

b. interest at the rate of 6 per cent per annum on the amount of his share in the property of the firm (Sec. 37).

3.38.3 DUTIES OF A PARTNER

Partnership is a contract of uberrimae fidei. The partners must act with utmost good faith as the very basis of partnership is mutual trust and confidence. According to Sec. 9, which deals with the general duties of partners, partners are bound-

a. to carry on the business of the firm to the greatest common advantage,

b. to be just and faithful to each other, and

c. to render true accounts and full information of all things affecting the firm or any partner or his legal representative.

The other duties are spread over the Partnership Act. These duties are summed up as under:

1. To carry on business to the greatest common advantage:

Every partner is bound to carry on the business of the firm to the greatest common advantage. He is bound in all transactions affecting the partnership, to do his best in the common interest of the firm. He must share with other partners any benefit which he may have been able to obtain from other people and in which the firm is in honour and conscience entitled to participate.

Example:

B and C were partners in a business as sugar refiners. C was authorised to buy sugar for the firm. He, without B's knowledge supplied to the firm his own sugar at the market price. He had bought the sugar at a lower price and thus made a considerable profit. Held, he must account to the firm for the profit made [Bentley vs. Craven (1853) 18 Beav. 75].

2. To observe faith:

Partnership is a fiduciary relation. Every partner must be just and faithful, and observe utmost good faith towards every other partner of the firm. Good faith requires that he shall not obtain a private advantage at the expense of the firm. He is bound, in all transactions affecting the partnership, to do his best in the common interest of the firm.

3. To indemnify for fraud:

Every partner is bound to indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm. This is an absolute duty of a partner and no partner can act himself out of it (Sec. 10). The innocent partners of the firm are, however, liable to third parties for the fraud of any of the partners. But they can proceed to claim damages against the partner who has committed the fraud.

4. To attend diligently:

Subject to contract between the partners, it is the duty of every partner to attend diligently to his duties in the conduct of the business of the firm [Sec. 12 (b)], and to use his knowledge and skill to the common advantage of all the partners.

5. Not to claim remuneration:

A partner is not entitled to recover any remuneration in any form for taking part in the conduct of the business of the firm. It is, however, usual to allow some remuneration to the working partners provided there is a specific agreement to that effect. [Sec. 13 (a)].

Where a pardanashin lady was a partner, it was held that it was just and reasonable that some allowance must be made to the other partners for the trouble they took in running the business of the firm [G. Krishna vs. S. Mukhi, 16 C.W.N. 299]. Similarly, where undue labour and extra trouble is imposed on one partner by another partner's wilful neglect of the business to which he ought to attend, he is entitled to compensation [Krishnamachariar vs. Sankara, (1921) A.P.C. 91].

6. To share losses:

It is the duty of every partner to contribute to the losses of the firm. In the absence of any agreement to the contrary, partners are bound to contribute equally to the losses sustained by the firm [Sec. 13 (b)]. An agreement to share profits implies an agreement to share losses also.

7. To indemnify for wilful neglect:

Every partner is, subject to contract between the partners, bound to indemnify the firm for any loss caused to it by his wilful neglect in the conduct of the business of the firm [Sec.13 (f)]. The firm is, however, liable to the third persons for the wilful neglect or fraud of any of the partners.

8. To hold and use property of the firm exclusively for the firm:

It is the duty of every partner of the firm to hold and use the property firm exclusively for the purposes of the business of the firm. The partners may agree differently but, in such a case, there should be a specific agreement to that effect (Sec. 15).

9. To account for personal profits:

If a partner derives any benefit, without the consent of the other partners, from partnership transactions (or from any use by him of the partnership property, name or business connection), he must account for it and pay it to the firm. This is because the relationship between partners is a fiduciary relationship and no partner is entitled to make any personal profit [Sec. 16 (a)].

Example:

A, B, and C carry on business of partnership as merchants. D, to whom they send goods for sale on commission, secretly allows C a share in the commission which he received in consideration of C using his influence to send consignments to him. A and B come to know of the secret share of C. They can compel C to render account to the firm for the money so received by him.

10. To account for profits in competing business:

A partner must not carry on any business of the same nature as competing with that of the firm. If he does that, he is bound to account for and pay to the firm all profits made by him in that business. This is, however, subject to contract between the partners [Sec. 16 (b)].

Example:

A and B are partners in a business which consists of supplying meat to the government. Subsequently, it is found out that A is engaged with C in the supplying of meat to the same government.

A is bound to account to the firm for the profits so made by him (Loch vs. Lynam, (1854) 4 Ir. C.R. 188).

11. To act within authority:

Every partner is bound to act within the scope of his actual or implied authority (Sec. 19 (1)]. Where he exceeds the authority conferred on him and the firm suffers a loss, he shall have to compensate the firm for any such loss.

12. To be liable jointly and severally:

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

13. Not to assign his rights:

A partner cannot assign his rights and interest in the firm to an outsider so as to make him the partner of the firm. He can, however, assign his share of the profit and his share in the assets of the firm (Sec. 29).

Check your progress 38:

What are the rights of partners?

LESSON-39
DISSOLUTION OF FIRM

CONTENTS

3.39. 1 Dissolution of firm
3.39. 2 Dissolution of partnership
3.39. 3 Dissolution without the order of the court
3.39. 4 Dissolution by court
3.39. 5 Rights and liabilities of partners on dissolution
Check your progress: 39
Lesson End Activities
Let Us Sum Up

The ‘dissolution of partnership’ between all the partners of a firm is called the ‘dissolution of the firm’ (Sec. 39). This means there is a difference between 'dissolution of partnership’ and ‘dissolution of partnership’.

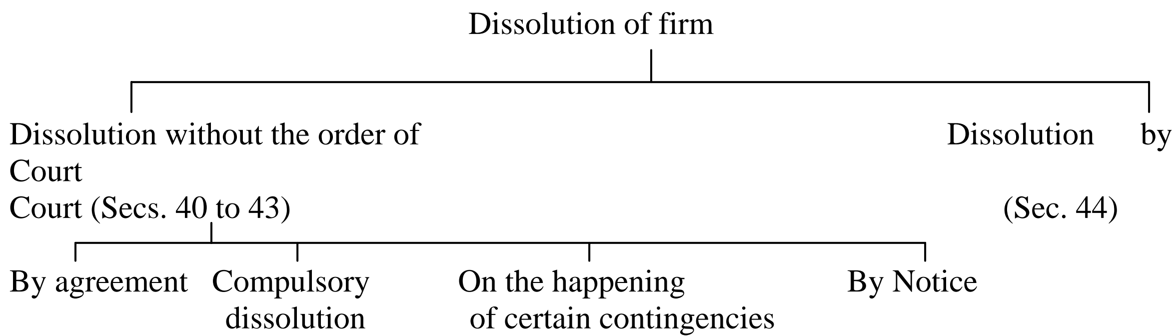
3.39.1 DISSOLUTION OF FIRM

It means complete breakdown or extinction of the relationship of partnership between all the partners of a firm. If this breakdown or severance of partnership relation is between a few and not all the partners (and the business is carried on), this amounts to dissolution of partnership and not of the firm.

3.39.2 DISSOLUTION OF PARTNERSHIP

It involves only a change in the relation of the partners. For example, if there is a partnership between A, B and C, and C retires, the partnership between A, B and C comes to end and partnership between A and B comes into being. The new firm with A and B as its partners is called 'reconstituted firm'. Thus retirement of a partner from a firm does not dissolve the firm. It merely severs the partnership relation between the retiring partner and the continuing partners. It leaves the partnership amongst the continuing partners unaffected and the firm continues with the changed constitution.

Dissolution of a firm may be voluntary or without the order of the Court, or it may take place by the order of the Court.



3.39.3 DISSOLUTION WITHOUT THE ORDER OF COURT

It may take place in one of the following ways:

1. Dissolution by agreement (Sec. 40):

   A firm may be dissolved –

(a) with the consent of all the partners, or

(b) in accordance with a contract between them.

The contract for the dissolution of the firm may be express or implied.

2. Compulsory dissolution (Sec. 41):

A firm is compulsorily dissolved-

(a) By the adjudication of all partners or all the partners but one as insolvent. The reason for this is simple. A partner on being adjudicated insolvent ceases to be a partner on the date on which the order of adjudication is made (Sec. 34 (1)]. If, therefore, all or all the partners but one are adjudicated insolvent, the firm can no longer exist, for there must be at least two partners to constitute a firm.

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.

Example:

A, a resident in India, and B a resident in Pakistan, are partners. War breaks out between India and Pakistan. The partnership becomes unlawful and is dissolved automatically on the outbreak of war.

If the business of a partnership is unlawful from its very inception, such partnership is void and no question of its dissolution arises. If some out of the several businesses or adventures of a partnership become unlawful, the illegality of one or more of the

businesses or adventures will not of itself cause the dissolution of the firm in respect of its lawful businesses or adventures.

3. Dissolution on the happening of certain contingencies (Sec. 42):

Subject to contract between the partners, a firm is dissolved by-

i. the expiry of the term for which the firm was constituted,
ii. the completion of the particular adventure or adventures, if the firm is constituted for the execution thereof,
iii. the death of a partner, and
iv. the adjudication of a partner as an insolvent.

4. Dissolution by notice of partnership-at-will (Sec. 43):

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. (Sec. 43 (1)]. The firm, in such a case, is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned, as from the date of the communication of the notice [Sec. 43 (2); Bodheshwar vs. Jatindar Nath. AI.R, (1976) Gau. 12]. The notice should be an unambiguous intimation of a final intention to dissolve the partnership, and should be served on all the other partners. Notice once given cannot be withdrawn unless all the other partners agree to it [Jones vs. Lloyd (l874) I.R 18 Eq. 265].

3.39.4 DISSOLUTION BY COURT

Under Sec. 44, the Court may, at the suit of a partner, dissolve a firm on the following grounds:

1. Insanity:
Where a partner has become of unsound mind, the Court may dissolve the firm on the petition of any of the other partners or by the next friend of the insane partner [Sec. 44 (a)].

2. Permanent incapacity:
Where a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as a partner, the Court may dissolve the firm [Sec. 44 (b)]

3. Misconduct:
Where a partner, other than the partner suing, is guilty of misconduct and it is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business, the Court may dissolve the firm [Sec. 44 (c)].

The following cases have been held to be sufficient grounds for the dissolution of a firm:

i. Gambling by a partner on a stock exchange, though such gambling may in no way be connected with the business of the firm;
ii. Fraudulent breach of trust by a partner;
iii. Persistent refusal or neglect by a partner to attend to the business
iv. Taking away of partnership books by a partner.

4. Persistent breach of agreement:

Where a partner, other than the partner suing, wilfully or persistently commits breach of the partnership agreements relating to the management of the affairs of the firm or conduct of its business, or otherwise so conducts himself that it is reasonably practicable for the other partners to carry on the business the firm with him, the Court may, at the instance of any of the other partners, dissolve the firm [Sec. 44 (d)]. Thus if one of the partner keeps erroneous accounts and omits to enter receipts or if there is continued quarrelling between the partners or there is such a state of animosity that all mutual confidence is destroyed, the Court may order for the dissolution of the firm.

5. Transfer of interest:

Where a partner has in any way transferred the whole of his interest in the firm to a third party or where his share has been attached under a decree, or sold in the recovery of arrears of land revenue, the Court may dissolve the firm at the instance of any other partner [Sec. 44 (e)].

6. Business working at a loss:

Where the business of the firm cannot be carried on except at a loss, the Court may dissolve the firm at the suit of a partner [Sec. 44 (e)]. This clause gives discretion to the Court to dissolve a firm for a fixed term even though the term has not expired, if the business thereof cannot be carried on except at a loss. A partnership is formed essentially to earn and share profits of the partnership. If the business can be carried on only at a loss, the attainment of the common end, with a view to which the partnership was formed, becomes impossible. In such a case, the Court may dissolve the firm.

7. Any other ground:

The Court may dissolve a firm on any ground which renders it just and equitable that the firm should be dissolved [Sec. 44 (f)]. Lord Lindley has observed in this regard that "refusal to meet on matters of business, continued quarrelling, and such a state of animosity as precludes all reasonable hope of reconciliation and friendly co-operation, have been held sufficient to justify- a dissolution. It is not necessary in order to induce the Court to interfere, to show personal rudeness on the part of one partner to the other, or even any gross misconduct as a partner. All that is necessary is to satisfy the Court that it

is impossible for the partners to place that confidence in each other which each has a right to expect and that such impossibility has not been caused by the person seeking to take advantage of it."

Sec. 44 is not made subject to the contract between the partners and gives a right to a partner to seek the assistance of the Court to have a partnership dissolved on grounds specified in the Section [V. Venkataswami vs. G. Venkataswamy, AI.R. (1954) Mad. 9].

3.39.5 RIGHTS AND LIABILITIES OF PARTNERS ON DISSOLUTION

Rights of a partner on dissolution

On the dissolution of a partnership firm, a partner has the following rights, namely-

1. Right to have business wound up (Sec. 46):

On the dissolution of a firm every partner or his representative is entitled to have the property of the firm applied in payment of outside debts and liabilities of the firm, and have the surplus distributed among the partners or their representatives in accordance with their rights. This right of a partner is called “partner’s lien”.

2. Right to have the debts of the firm settled out of the property of the firm(Sec. 49):

Where a firm is dissolved, the debts of the firm are settled out of the property of the firm, and if there is any surplus it is utilised towards payment of the private debts of the partners. Similarly as regards the private debts of the partners, the private estate is first applied in payment of the private debts and if there is any surplus, and if there be a need, it is utilised towards the settlement of the debts of the firm.

3. Right to personal profits earned after dissolution (Sec. 50):

Where any partner has bought the goodwill of the firm on its dissolution, he has right to use the firm name and earn profit by its use.

4. Right to return of premium on premature dissolution (Sec. 51):

Where a partner has paid a premium on entering into partnership for a fixed term and the firm is dissolved before the expiration of the term, he is entitled to repayment of the whole or part of the premium, regard being had to-

i. the terms upon which he became a partner, and
ii. the length of the time during which he was a partner.

No refund can, however, be claimed where the dissolution

i. though prematurely is due to the death of a partner, or
ii. is mainly due to the misconduct of the partner who had paid the premium, or
iii. is in pursuance of an agreement which contains no provision for refund of the premium or any part thereof.

5. Right where partnership contract is rescinded for fraud or misrepresentation (Sec. 52):

Where a contract creating partnership is rescinded on the ground of fraud or misrepresentation of one of the partners, the partner entitled to rescind has the following rights, namely,

i. Right of lien on the surplus assets:

   He has a lien on the surplus assets after the debts of the firm have been paid, for any sum paid by him for the purchase of his share in the firm and for any capital contributed by him.

ii. Right of subrogation:

   He is subrogated to the rights of the partnership creditors in respect of any payment made by him towards the debts of the firm. This means if he pays off any creditor of the firm from his own pocket, he steps into the shoes of that creditor. i.e., he becomes the creditor of the firm for that amount.

iii. Right to be indemnified:

   He has also a right to be indemnified by the partner or partners guilty of fraud or misrepresentation against all the debts of the firm.

6. Right to restrain partners from use of firm name or property (Sec. 53):

After a firm is dissolved, every partner or his representative may restrain any other partner or his representative from carrying on similar business in the firm name or from using any of the property the firm for his own benefit, until the affairs of the firm have been completely wound up. This restriction does not apply

i. When there is contract between the partners to the contrary, or
ii. when a partner has bought goodwill of the firm.

Liabilities of a partner on dissolution:

1. Liability for acts of partners done after dissolution (Sec. 45):

In order to absolve partners of the liability for any act done after dissolution of the firm, a public notice must be given of the dissolution. If this is not done, the partners continue to be liable as such to third parties for any act done by any of them after the dissolution. Further in such a case the act of a partner done after the dissolution is deemed to be an act done before the dissolution.

Example:

A and B, partners in a trade, agree to dissolve the partnership. They execute a deed for that purpose declaring the partnership dissolved as from January 1, but do not discontinue the business of the firm or do not give a public notice of the dissolution. On February 1, A indorses a bill in the partnership name to C. The firm is liable on the bill.

The following, however, are not liable for the acts done after the dissolution of the firm, and no notice of dissolution need be given:

i. the estate of a deceased partner,
ii. the insolvent partner, and
iii. the sleeping or dormant partner who retires.

2. Continuing authority of partners for purposes of winding up (Sec. 47):

After the dissolution of a firm, the authority of each partner to bind the firm, and the other mutual rights and obligations of the partners continue, so far as may be necessary-

i. to wind up the affairs of the firm, and
ii. to complete transactions begun but unfinished, at the time of the dissolution.

The firm is not liable for the act of an insolvent partner in the above two cases. But, if a partner represents himself or knowingly permits himself to be represented as a partner of the insolvent partner, the firm is liable on the ground of 'holding out'.

Check your progress 39:

How are partnership firms dissolved?

Lesson end activities:

Go to a bank and learn about various types of negotiable instruments and their features.

Collect information on successful partnership business.

Let us sum up:

- The Negotiable Instruments Act, 1881 came into force on 1st March, 1881.
- Negotiable Instrument means a promissory note, bill of exchange or cheque, payable either to order or to the bearer.
- According to Section 4 of the Negotiable Instruments Act, 1881, "A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to the order of a certain person or to the bearer of the instrument."
- According to Section 5 of the Negotiable Instruments Act, 1881, "A bill of exchange is an instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to, or to the order of a certain person or the bearer of the instrument." Thus, a bill is an order by a creditor upon his debtor requiring him to pay the money to the person specified.
- A cheque is a bill of exchange which is drawn upon a specified banker, and payable on demand.
- The process of transferring an instrument is called an endorsement
- 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 (Sec. 4, Para 1). Persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm' (Sec. 4, Para 2).
- A partnership is based on an agreement. The partnership agreement may be made orally or in writing or may be implied from the course of dealing among partners. However, all the essential elements of a 'valid contract' must be present.
- Persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm', and the name under which the business is carried on is called the 'firm name' [Sec. 4, Para 2].
- The registration of a firm may be effected at any time by filing an application in the form of a statement, giving the necessary information, with the Registrar of Firms of the area.