



BUSINESS LAW

2^{EDITION}

Tejpal Sheth



Business Law

Second Edition

Tejpal Sheth

PEARSON

Delhi • Chennai

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ISBN: 978-93-325-4484-0

eISBN: 978-93-325-5889-2

Head Office: A-8 (A), 7th Floor, Knowledge Boulevard, Sector 62, Noida 201 309, Uttar Pradesh, India.

Registered Office: Module G4, Ground Floor, Elnet Software City, TS-140, Block 2 & 9 Rajiv Gandhi Salai, Taramani, Chennai 600 113, Tamil Nadu, India.

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Preface to the Second Edition

I am glad to present this second edition of *Business Law*. It will aid commerce and management students to learn business law or legal aspect of business. This book also serves the students pursuing CWA (Inter) from ICAI.

Like the previous edition, an attempt is made to cover the subject widely in a lucid way without compromising on the technical details.

The book is divided into 27 chapters. Each chapter is designed in four segments: 1) theory supported with necessary example and case study; 2) landmark judgements; 3) Questions—Test your knowledge; and 4) Multiple-choice Questions.

Chapters on Contract Act have been framed more concisely. Nowadays, company and LLP have become popular format of business, and therefore, provisions on Limited Liability Partnership Act, 2008 have been explained in detail. Following three new topics have been included in this edition:

1. Provident Fund and Miscellaneous Provisions Act, 1952;
2. Limited Liability Partnership Act, 2008; and
3. Employees' State Insurance Act, 1948.

The Companies Act, 2013 has repealed old Companies Act, 1956 during the year 2013 by Ministry of Corporate Affairs (MCA) and it has become fully functional by 2014. Chapters 18 to 22 contain applicable provisions of Companies Act, 2013. Likewise, all applicable amendments in topics of Foreign Exchange Management Act, 1999 and Information Technology Act, 2000 have been incorporated at suitable places.

Although every effort has been made on the accuracy of the content, there could always be some glitches. Moreover, there may be differences in interpretations also. I shall be happy to receive suggestions and comments from readers.

I would like to thank the publisher, Pearson Education, especially Vipin Kumar and Varun Goenka for their commitment to the project. I would also like to thank the faculties of various business schools and universities, students and readers for their continuous appreciation and creative suggestions.

Tejpal Sheth

Preface to the First Edition

Business law has day-to-day application in any kind of business. Since managers and executives are sometimes required to plead in front of the court, they need to have a good understanding of the legal aspect of business. However, the requirements of a commerce student are different from law students. This book adopts a fresh approach to study and read business law. It will also be useful for candidates appearing for B.Com., BBA, BBM and MBA examinations. It is written in a student-friendly language without compromising on the technical details.

This book is divided into 24 chapters. It covers various topics of business law, namely, Contract Act, Partnership Act, Sales of Goods Act, Consumer Protection Act, Negotiable Instrument Act, Bonus Act, Gratuity Act, Information Technology Act, Foreign Exchange Management Act and Companies Act. Each chapter consists of 4 elements. (i) Theory supported with necessary examples and case studies; (ii) landmark judgements; (iii) test your knowledge, and (iv) multiple-choice questions. The book is supported with interpretations, explanations and illustrations to help students understand provisions in a better way. A small case study is also given after the completion of the subject-matter to test the understanding of students. Case studies include questions asked in CA and CS examinations in the recent past. Questions under Test Your Knowledge segment are prepared with reference answers by highlighting relevant paragraph number. A large number of multiple choice questions along with answers will encourage both the student and the teacher to test their knowledge and take tests, respectively. Although every effort has been made to make the information provided on the laws as authentic as possible, claiming absolute accuracy will be too tall a claim. Moreover, there may be differences in interpretation.

I would like to thank CA M. N. Mone, CA Sandeep Kamdar, CS Hitesh Buch, CS Umesh Ved, CS Upen Shah, Professor Milan Shah, Professor Ashish Dholakia and Professor Charu Dholakia. I would also like to express my gratitude to Dhiraj Pandey and Ruchi Sachdev of Pearson Education for their interest and support in this project. They have been meticulous, prompt and a pleasure to work with. Last but not the least, I would like to thank my wife, parents and daughter for their sacrifice and cooperation for providing the necessary environment. I would be happy to receive any suggestions or comments for the improvement of the book and students may also reach me on my face book id, Tejpal Sheth.

Tejpal Sheth

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Tejjal Sheth is an associate member of Institute of Company Secretaries of India. He holds an MBA degree in International Business and Diploma in Pharmacy. Apart from practising company secretary, he is dynamic and well-known educator in the professional stream. He is a visiting faculty in many reputed MBA colleges and professional institutes such as, ICSI, ICAI, ICWAI, and Amity Global Business School for more than 15 years. He has taught innumerable students of CA, CS, CWA, BBA, and MBA programme on various topics like business law, mercantile law, corporate law, business ethics, and communication. He has served as a member of various committees of Ahmedabad Chapter of ICSI. He is a member of expert panel of calubindia.com.

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The Indian Contract Act, 1872: Nature and Kind of Contracts



Learning Objectives

After reading this chapter, you will be able to understand:

- What is an agreement and a contract?
- What are the essential elements of a contract?
- Types of contracts

1.1 SCOPE OF THE ACT

The Indian Contract Act was passed and implemented to control various kinds of commercial and business contracts. The preamble of the Contract Act states where it is expedient to define and amend certain parts of the law relating to contracts. Therefore, this act is not a complete code of contracts. It deals with general principles of the Law of Contract and Special Contract. The Contract Act is divided into 10 chapters.

The Contract Act came into force on 1 September 1872. The act is applicable to the whole of India except for the state of Jammu and Kashmir. The law of contract creates *jus in personam* and not *jus in rem*. *Jus in personam* means personal rights—the rights against a person or a party with whom you have entered into a contract. Therefore, it can be said that *jus in personam* provides the right to a contracting party to claim against another.

The Contract Act only provides rules and regulations for the purpose of contract. It does not list any rights and liabilities between parties to the contract. Rights and liabilities and their manner of performance are decided by the parties themselves under the contract but it is within the purview of the act.

Examples

1. A sells his car to B for ₹ 1 lakh. A has a right to recover the price of the car from B. The right of A is a right in personam, i.e., against a particular person B. This is *jus in personam*.
2. B buys a car and becomes the owner of the car. He has a right to have a quiet possession of the car and enjoy it against the whole world. Nobody in the world can disturb him in his right. The right of B is *jus in rem*, i.e., the right against the whole world.


Case Study

A and B of Srinagar entered into a contract on 1 September 2006 as per the provisions of the Indian Contract Act. Can they enforce the contract?

1.2 WHAT IS A CONTRACT?**1.2.1 Contract**

In the words of Pollock, ‘every agreement and promises enforceable by law is contract’. Section 2(h) of the Indian Contract Act, 1872 states that ‘an agreement enforceable by law is contract’. This definition gives us two ingredients—an agreement and ‘enforceable by law’. We can summarize it as under.

Contract = An agreement + enforceable by law

1.2.2 Agreement

An agreement means a promise and a reciprocal set of promises forming consideration for each other—Section 2(e). This definition gives us three ingredients—promise and a consideration. We can summarize it as under.

Agreement = Promise + reciprocal promise + consideration

1.2.3 Promise

As per Section 2(b) of the Contract Act, a proposal when accepted becomes a promise.

Promise = Proposal by one person + its acceptance by another person

1.2.4 Proposal

Section 2(a) states that ‘when one person signifies another person his willingness to do or abstain from doing anything with a view to obtaining the assent of that other to such an act or abstinence, he is said to make a proposal’. A Proposal is also known as an offer.

1.2.5 Parties to an Agreement/a Contract

Promisor: A person making the proposal (offer) is known as a promisor. He is also known as an offeror. We can also recognize him as a proposer.

Promisee: A person accepting the proposal (offer) is known as a promisee. He is also known as an offeree. We can also recognize him as an acceptor.

1.2.6 Enforceability of an Agreement

It means an agreement which creates some legal obligation; if this agreement is not followed by any party to contract, he can be sued.



Case Study

A promises to deliver his watch to B and, in return, B promises to pay a sum of ₹ 2000. Is it an agreement or a contract?

1.3 ESSENTIAL ELEMENTS OF VALID CONTRACTS—SECTION 10

In order to determine whether an agreement is a contract or not, one has to see whether all the essentials, as required under the Indian Contract Act, are present in the agreement. The essentials required to be satisfied for a valid contract are as under.

1.3.1 Offer and Acceptance

There must be an offer and its acceptance. An offer is a starting point for any contract. No valid contract can come into existence without an offer. The offer is considered as the first step in the contract. The offer should be accepted to form a valid contract.

1.3.2 Intention to Create Legal Relation

There must be an intention to create a legal relation. In all social, domestic, moral, religious or political agreements, the usual presumption is that the parties do not intend to create the legal obligations. However, in business agreements, the usual presumption is that the parties intend to create the legal obligations.

Example

A invites B to a dinner and B accepts it. If A fails to serve the dinner, B cannot go to court. The invitation for dinner is a social agreement.

1.3.3 Lawful Consideration

The lawful consideration means something in return. As a contract contains the reciprocal set of promises, a consideration is necessary. The consideration must be lawful and should have a commercial value.

Example

A promises to pay ₹ 50,000 on a certain date to B without any promise in exchange. This is not a valid contract.

1.3.4 Free Consent

A contract is made when one person makes an offer while another person accepts the offer. This acceptance of the offer should be made without any force or threat. It means that a consent given should be free and genuine.

Example

A has two cars—one black and the other white. He offers to sell one of his cars to B. A intends to sell the black one while B accepts the offer believing that it is for the white car. Here, A and B are not thinking in the same sense of a particular thing. In this situation, there is a mistake, so it cannot be said to be a free consent.

1.3.5 Lawful Object

Every agreement has some objects or purposes. The object of an agreement should not be illegal, immoral or opposed to the public policy. In simple words, we can say that the object of an agreement must be lawful.

Example

A promised to pay ₹ 1 lakh to B to kill C. The killing of a person is punishable under the IPC. Therefore, the promise is unlawful and void.

1.3.6 Capacity of Parties

Every person is not competent to enter into a contract. Person who has attained the age of majority with a sound mind and not disqualified under any act is competent to enter into a contract.

1.3.7 Agreement Must Not Be Expressly Declared Void or Illegal

If a certain agreement is expressly declared to be void by the law of country then such an agreement, if entered into, shall not be enforceable by the court.

1.3.8 Certainty of Meaning

An agreement contains terms as decided by the parties. The terms of agreement must be certain and unambiguous. If the terms of an agreement are uncertain, it is not a valid contract.

Example

A agreed to pay ₹ 5 lakh to B for an ultra-modern decoration of his drawing room. The agreement is void because the meaning of the term 'ultra-modern' is not certain.

1.3.9 Possibility to Perform

Every agreement contains reciprocal promises. The promises under the contract must be possible to perform. If the parties have agreed on the contract which contains any promise not possible to perform in real life, the contract will not be considered as a valid contract.

Example

A agrees to discover treasure by magic for B. The agreement is void because the act in itself is impossible to be performed from the very beginning.

1.3.10 Legal Formalities

In some cases, the document in which the contract is incorporated has to be stamped. In some other cases, a contract, besides being a written one, has to be registered. Thus, where there is a statutory requirement that the contract should either be made in writing or registered, the required formalities must be complied with.

Therefore, we can say that an agreement will become a contract when it satisfies all the essentials of a valid contract. If any one of the elements of a valid contract is missing, it is treated as an invalid contract. All the agreements may or may not be a contract but all the contracts are basically agreements. All agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void. Nothing herein contained shall affect any law in force in India and not hereby expressly repealed, by which any contract is required to be made in writing or in the presence of witnesses, or any law relating to the registration of the documents.

Case Study

A promised to pay his son B a sum of ₹ 1 lakh if B passed CA exams in the first attempt. B passed the examination on his first attempt but A failed to pay the amount as promised. B filed a suit for the recovery of the amount. State whether B can recover the amount under the Indian Contract Act, 1872.

Case Study

Salman promises Katrina to give a real pearl necklace at the time of his marriage. Salman fails to give it at the time of marriage. Can Katrina complain about the non-fulfillment of the promise against Salman at any court?

Case Study

State with reason, in brief, whether any contract is made in the following cases.

1. You have invited your business partner for a lunch.
2. When you eat meals at a restaurant.
3. When you board a public bus.
4. When you call a taxi on telephone.
5. When you put a coin in the slot of a weighing machine.

1.4 DISTINGUISH BETWEEN AN AGREEMENT AND A CONTRACT

Matter	Agreement	Contract
Meaning	Every promise or a set of promises forming consideration for each other is an agreement.	Agreement enforceable by law is a contract.
One in another	All agreements are not contracts.	All contracts are agreements.
Enforceable at law	May or may not be enforceable.	Always enforceable by law.
Rights to parties	It does not always grant right.	It always grants rights.

1.5 TYPES OF CONTRACT OR CLASSIFICATION OF CONTRACT

On the Basis of the Mode of Formation	On the Basis of Performance	On the Basis of Validity or Enforceability
Express contract	Executed contract	Valid contract
Implied contract	Executory contract	Void contract
Quasi-contract	Partly executed and partly executory	Voidable contract
E-contract	Unilateral contract	Illegal agreement
	Bilateral contract	Unenforceable contract
		Certain contract in writing

1.5.1 Express Contract

An express contract is a contract made by the use of words spoken or written.

Example

A says to B 'Will you purchase my bike for ₹ 20,000?' B says 'Yes' to A.

1.5.2 Implied Contract

An implied contract is a contract which is made otherwise than by the words spoken or written. It came into existence on account of an act or conduct of the parties.

Examples

1. A stops a taxi by waving his hand and boards it. There is an implied contract that A will pay the prescribed fare on reaching his destination.
2. Withdrawal of cash from the ATM of a bank.

1.5.3 Quasi-contract

The quasi-contract is explained in detail in Chapter 8.

1.5.4 E-contract

An e-contract is a contract made through the electronic mode.

1.5.5 Executed Contract

In an executed contract both the parties have performed their promises under a contract. It is a contract where, under the terms of contract, nothing remains to be done by the parties.

Example

A sells his car to B for ₹ 1 lakh. A delivered the car and B paid the price. This is an executed contract.

1.5.6 Executory Contract

In an executory contract both the parties are yet to perform their promises. In other words, it is a contract where parties have to still perform their obligation in the future.

Example

A sells his car to B for ₹ 1 lakh. If A is still to deliver the car and B is yet to pay the price, it is an executory contract.

1.5.7 Partly Executed and Partly Executory Contract

In a partly executed and partly executory contract, one party has already performed his promise and the other party has yet to execute his promise.

Example

A sells his car to B. Though A has delivered the car, B has yet to pay the price. For A it is an executed contract, whereas it is an executory contract on the part of B since the price has yet to be paid.

1.5.8 Unilateral Contract

A unilateral contract is also known as a one-sided contract. It is a contract where only one party has to perform his promise. In such a contract, the promise on one side is exchanged for an act on the other side. After the formation of a unilateral contract, only one party remains liable to perform his obligation because the other party has already performed his obligation.

Example

Alap promises to pay ₹ 1000 to anyone who finds his lost cellphone. Bansi finds and returns it to Alap. From the time Bansi found the cell phone, the contract came into existence. Now Alap has to perform his promise, i.e., the payment of ₹ 1000.

1.5.9 Bilateral Contract

In a bilateral contract both the parties have to perform their respective promises. It is also known as a two-sided contract. Here, the obligation is outstanding on the part of both the parties.

Example

A promises to sell his car to B for ₹ 1 lakh and agrees to deliver the car on the receipt of the payment by the end of the week. The contract is bilateral as both the parties have exchanged a promise to be performed within a stipulated time.

1.5.10 Valid Contract

If the contract entered into by the parties and satisfies all the elements of a valid contract as per the act, it is said to be a valid contract.

1.5.11 Void Contract

A contract which ceases to be enforceable by law is known as a void contract. A void contract is not enforceable by the court. Generally, a valid contract ceases to be enforceable on the change in circumstances or on the change of provisions of an act.

1.5.12 Voidable Contract

When the contract is entered into without the free consent of party, it is considerate as a voidable contract. The definition of the act states that a voidable contract is enforceable by law at the option of one or more parties but not at option of the other parties. Voidable contract will be considered as valid if it is not cancelled by the aggrieved party within a reasonable time.

1.5.13 Illegal Agreement

An illegal agreement is one which is forbidden by law. All illegal agreements are void *ab initio*. It cannot be enforced by any court. Not only that any associated or collateral transaction to an illegal agreement is also void. No action is allowed on an illegal agreement. No action can be taken for the recovery of the money paid under illegal agreement or for the breach of the illegal agreement. The parties to an illegal agreement cannot get help from the court. No suit can be filled or any action taken in respect of the illegal agreement.

1.5.14 Unenforceable Contract

A contract which satisfies all the requirements of the contract but has technical defects is called an unenforceable contract. A contract is said to have a technical defect when it does not fulfil the legal formalities required by some other act. When such legal formalities are complied with later on, the act becomes enforceable.

1.5.15 Certain Contracts in Writing

The Contract Act never specifies that the contract to be valid should be in writing. It means an oral contract or a contract without any kind of writing is also valid. However, it is difficult to prove before the courtroom when the dispute arises.

The contracts are required to be in writing only if any other act specifically requires it to be so. Like the hire-purchase act requires that the hire-purchase agreement should be in writing.



Case Study

A, a tradesman, left certain goods at B's house by mistake. B treated and used the goods as his own. Can the tradesman recover the money of the goods used by B?



Case Study

Mohan agrees to pay Sohandada ₹ 50,000 to kill a business competitor. Mohan has borrowed this money from his friend but now refuses to pay him back. Can his friend claim it by approaching the court? Would your answer be different in any manner if his friend does not have the knowledge about the purpose of borrowing?



Case Study

A agrees to sell his DVD player to B promising to deliver it on the date of payment. B promises to pay the amount within one month. What kind of contract is it?

1.6 DISTINGUISH BETWEEN VOID AND VOIDABLE CONTRACT

Matter	Void Contract	Voidable Contract
Definition	It means contract which ceases to be enforceable.	It means an agreement enforceable by law, by one or more parties.
Nature	Valid when made but subsequently becomes unenforceable.	It remains as voidable until cancelled by the party.
Rights or remedy	No legal remedy is available for the void contract.	Aggrieved party has a remedy to cancel the contract.
Performance of contract	Party cannot demand the performance of contract.	If aggrieved party does not cancel it within a reasonable time, performance can be demanded.
Reason	Contract becomes void due to change in law or circumstances.	If consent is not obtained freely then it is regarded as a voidable contract.
Damages	Party cannot claim damages.	Party can demand damages in certain cases.

1.7 DISTINGUISH BETWEEN VOID AND ILLEGAL AGREEMENT

Matter	Void Agreement	Illegal Agreement
What	Void agreement is not prohibited by law.	It is prohibited by law.
Effect on collateral transaction	Any agreement which is collateral to the void agreement is enforceable.	Any agreement or transaction which is collateral to illegal agreement is not enforceable.
Punishment	It is not punishable.	It is punishable.
Void <i>ab initio</i>	May not void <i>ab initio</i> .	Always void <i>ab initio</i> .

1.8 SIMILARITIES BETWEEN VOID AND ILLEGAL AGREEMENTS

Both the void and the illegal agreements are unenforceable agreements, hence void. Restitution (restoration of benefits) is not possible in either of the two agreements.

LIST OF LANDMARK JUDGEMENTS

1. *Balfour vs Balfour (1919)*

A husband agreed to pay 30 pound to his wife every month while he was abroad. As he failed to pay the promised amount, his wife sued him for the recovery of the amount. Here she could not recover it as it was a social agreement and the parties did not intend to create legal relations.