

FOUNDATION COURSE

MOCK TEST PAPER – 2

PAPER 2: BUSINESS LAWS AND BUSINESS CORRESPONDENCE AND REPORTING

SECTION: 2A: BUSINESS LAWS

ANSWERS

1. (a) Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in section 10. According to the provisions there should be an intention to create legal relationship between the parties. Agreements of a social nature or domestic nature do not contemplate legal relationship and as such are not contracts, which can be enforced. This principle has been laid down in the case of *Balfour v. Balfour*. Accordingly, applying the above provisions and the case decision, in this case son cannot recover the amount of Rs. 1 lakh from father for the reasons explained above.
- (b) The House of Lords in *Salomon Vs. Salomon & Co. Ltd.* laid down that a company is a person distinct and separate from its members, and therefore, has an independent separate legal existence from its members who have constituted the company. But under certain circumstances the separate entity of the company may be ignored by the courts. When that happens, the courts ignore the corporate entity of the company and look behind the corporate façade and hold the persons in control of the management of its affairs liable for the acts of the company. Where a company is incorporated and formed by certain persons only for the purpose of evading taxes, the courts have discretion to disregard the corporate entity and tax the income in the hands of the appropriate assessee.
- (1) The problem asked in the question is based upon the aforesaid facts. The three companies were formed by the assessee purely and simply as a means of avoiding tax and the companies were nothing more than the façade of the assessee himself. Therefore, the whole idea of Mr. Krishna was simply to split his income into three parts with a view to evade tax. No other business was done by the company.
- (2) The legal personality of the three private companies may be disregarded because the companies were formed only to avoid tax liability. It carried no other business, but was created simply as a legal entity to ostensibly receive the dividend and interest and to hand them over to the assessee as pretended loans.
- (c) **"Goods"** means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale. [Section 2(7) of the Sales of Goods Act, 1930]
- 'Actionable claims' are claims, which can be enforced only by an action or suit, e.g., debt. A debt is not a movable property or goods. Even the Fixed Deposit Receipts (FDR) are considered as goods under Section 176 of the Indian Contract Act read with Section 2(7) of the Sales of Goods Act.
2. (a) As per section 40 of the Indian Contract Act, 1872, the promise under a contract may be performed, as the circumstances may permit, by the promisor himself, or by his agent or his legal representative.
- (i) **Promisor himself:** If there is something in the contract to show that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor. This means contracts which involve the exercise of personal skill or diligence, or which are founded on personal confidence between the parties must be

performed by the promisor himself.

- (ii) **Agent:** Where personal consideration is not the foundation of a contract, the promisor or his representative may employ a competent person to perform it.
  - (iii) **Legal Representatives:** A contract which involves the use of personal skill or is founded on personal consideration comes to an end on the death of the promisor. As regards any other contract the legal representatives of the deceased promisor are bound to perform it unless a contrary intention appears from the contract. But their liability under a contract is limited to the value of the property they inherit from the deceased.
  - (iv) **Third persons:** As per Section 41 of the Indian Contract Act, 1872, when a promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor. That is, performance by a stranger, accepted by the promisee, produces the result of discharging the promisor, although the latter has neither authorised nor ratified the act of the third party.
  - (v) **Joint promisors:** When two or more persons have made a joint promise, then unless a contrary intention appears by the contract, all such persons must jointly fulfill the promise. If any of them dies, his legal representatives must, jointly with the surviving promisors, fulfill the promise. If all of them die, the legal representatives of all of them must fulfill the promise jointly
- (b) **Meaning:** A LLP is a new form of legal business entity with limited liability. It is an alternative corporate business vehicle that not only gives the benefits of limited liability at low compliance cost but allows its partners the flexibility of organising their internal structure as a traditional partnership. The LLP is a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, the liability of the partners will be limited.

#### **Steps to incorporate LLP:**

- (i) Name reservation
    - The first step to incorporate Limited Liability Partnership (LLP) is reservation of name of LLP.
    - Applicant has to file e- Form 1, for ascertaining availability and reservation of the name of a LLP business.
  - (ii) Incorporate LLP
    - After reserving a name, user has to file e- Form 2 for incorporating a new Limited Liability Partnership (LLP).
    - e-Form 2 contains the details of LLP proposed to be incorporated, partners'/ designated partners' details and consent of the partners/ designated partners to act as partners/ designated partners.
  - (iii) LLP Agreement
    - Execution of LLP Agreement is mandatory as per Section 23 of the Act.
    - LLP Agreement is required to be filed with the registrar in e- Form 3 within 30 days of incorporation of LLP.
3. (a) A minor cannot be bound by a contract because a minor's contract is void and not merely voidable. Therefore, a minor cannot become a partner in a firm because partnership is founded on a contract. Though a minor cannot be a partner in a firm, he can nonetheless be admitted to the benefits of partnership under Section 30 of the Act. In other words, he can be validly given a share in the partnership profits. When this has been done and it can be done with the consent of all the partners then the rights and liabilities of such a partner will be governed under Section 30 as follows:

### Rights:

- (i) A minor partner has a right to his agreed share of the profits and of the firm.
- (ii) He can have access to, inspect and copy the accounts of the firm.
- (iii) He can sue the partners for accounts or for payment of his share but only when severing his connection with the firm, and not otherwise.
- (iv) On attaining majority he may within 6 months elect to become a partner or not to become a partner. If he elects to become a partner, then he is entitled to the share to which he was entitled as a minor. If he does not, then his share is not liable for any acts of the firm after the date of the public notice served to that effect.

- (b) **BREACH OF CONTRACT- DAMAGES:** Section 73 of the Indian Contract Act, 1872 lays down that when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract to be likely to result from the breach of it.

The leading case on this point is "*Hadley v. Baxendale*" in which it was decided by the Court that the special circumstances under which the contract was actually made were communicated by the plaintiff to the defendant, and thus known to both the parties to the contract, the damages resulting from the breach of such contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from the breach of contract under these special circumstances so known and communicated.

The problem asked in this question is based on the provisions of Section 73 of the Indian Contract Act, 1872. In the instant case 'X' had intimated to 'Z' that he was purchasing water bottles from him for the purpose of performing his contract with 'Y'. Thus, 'Z' had the knowledge of the special circumstances. Therefore, 'X' is entitled to claim from 'Z' Rs. 500/- at the rate of 0.50 paise i.e. 1000 water bottles x 0.50 paise (difference between the procuring price of water bottles and contracted selling price to 'Y') being the amount of profit 'X' would have made by the performance of his contract with 'Y'.

If 'X' had not informed 'Z' of 'Y's contract, then the amount of damages would have been the difference between the contract price and the market price on the day of default. In other words, the amount of damages would be Rs. 750/- (i.e. 1000 water bottles x 0.75 paise).

#### 4. (a) Right of lien of an unpaid seller

The legal provisions regarding the right of lien of an unpaid seller has been stated from Sections 47 to 49 of the Sale of Goods Act, 1930 which may be enumerated as follows:

- (i) According to Section 47 the unpaid seller of the goods who is in possession of them is entitled to retain possession of them until payment or tender of the price in the following cases namely:
  - (a) where the goods have been sold without any stipulation as to credit.
  - (b) where the goods have been sold on credit, but the term of credit has expired; or
  - (c) where the buyer becomes insolvent.

The seller may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer.

- (ii) Section 48 states that where an unpaid seller has made part delivery of the goods, he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstances as to show an agreement to waive the lien.

- (iii) According to Section 49 the unpaid seller loses his lien on goods:
  - (a) when he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods.
  - (b) when the buyer or his agent lawfully obtains possession of the goods;
  - (c) by waiver thereof

The unpaid seller of the goods, having a lien thereon, does not lose his lien by reason only that he has obtained a decree to the price of the goods.

**Right of lien and Right to stoppage the goods in transit; distinction:**

- (i) The essence of a right of lien is to retain possession whereas the right of stoppage in transit is right to regain possession.
  - (ii) Seller should be in possession of goods under lien while in stoppage in transit (1) Seller should have parted with the possession (2) possession should be with the carrier and (3) Buyer has not acquired the possession.
  - (iii) Right of lien can be exercised even when the buyer is not insolvent but it is not the case with right of stoppage in transit.
  - (iv) Right of stoppage in transit begins when the right of lien ends. Thus the end of the right of lien is starting point of the right of stoppage the goods in transit.
- (b) The problem in the question is based on the 'Implied Authority' of a partner provided in Section 19 of the Indian Partnership Act, 1932. The section provides that subject to the provisions of Section 22 of the 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. The authority of a partner to bind the firm conferred by this section is called his 'Implied Authority' [Sub-Section (1) of section 19]. Furthermore, every partner is in contemplation of law the general and accredited agent of the partnership and may consequently bind all the other partners by his acts in all matters which are within the scope and object of the partnership. Hence, if the partnership is of a general commercial nature, he may buy goods on account of the partnership.

Considering the above provisions and explanation, the questions as asked in the problem may be answered as under:

- (i) The firm's contention is not tenable, for the reason that the partner, in the usual course of the business on behalf of the firm has an implied authority to bind the firm. The firm is, therefore, liable for the price of the goods.
- (ii) In the second case also, the answer would be the same as above, i.e. the implied authority of the partner binds the firm.

In both the cases, however, the firm ABC can take action against A, the partner but it has to pay the price of stationery to the supplier D.

5. (a) Section 26 of the Sale of Goods Act, 1930 provides that unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at buyer's risk whether delivery has been made or not. Further Section 18 read with Section 23 of the Act provides that in a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer, unless and until the goods are ascertained and where there is contract for the sale of unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be express or implied. Applying the aforesaid law to the facts of the case in hand, it is clear

that Mr. Samuel has the right to select the good out of the bulk and he has sent his men for same purpose.

Hence the problem can be answered based on the following two assumptions and the answer will vary accordingly.

(a) **Where the bales have been selected with the consent of the buyer's representatives:**

In this case, the property in the 60 bales has been transferred to the buyer and goods have been appropriated to the contract. Thus, loss arising due to fire in case of 60 bales would be borne by Mr. Samuel. As regards 40 bales, the loss would be borne by Mr. Varun, since the goods have not been identified and appropriated.

(b) **Where the bales have not been selected with the consent of buyer's representatives.**

In this case, the property in the goods has not been transferred at all and hence the loss of 100 bales would be borne by Mr. Varun completely.

- (b) **Doctrine of ultra vires:** The meaning of the term *ultra vires* is simply "beyond (their) powers". The legal phrase "*ultra vires*" is applicable only to acts done in excess of the legal powers of the doers. This presupposes that the powers are in their nature limited. To an ordinary citizen, the law permits whatever does the law not expressly forbid.

It is a fundamental rule of Company Law that the objects of a company as stated in its memorandum can be departed from only to the extent permitted by the Act - thus far and no further [*Ashbury Railway Company Ltd. vs. Riche*]. In consequence, any act done or a contract made by the company which travels beyond the powers not only of the directors but also of the company is wholly void and inoperative in law and is therefore not binding on the company. On this account, a company can be restrained from employing its fund for purposes other than those sanctioned by the memorandum. Likewise, it can be restrained from carrying on a trade different from the one it is authorised to carry on.

The impact of the doctrine of *ultra vires* is that a company can neither be sued on an *ultra vires* transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, when one deals with a company one is deemed to know about the powers of the company. If in spite of this you enter into a transaction which is *ultra vires* the company, you cannot enforce it against the company. For example, if you have supplied goods or performed service on such a contract or lent money, you cannot obtain payment or recover the money lent. But if the money advanced to the company has not been expended, the lender may stop the company from parting with it by means of an injunction; this is because the company does not become the owner of the money, which is *ultra vires* the company. As the lender remains the owner, he can take back the property *in specie*. If the *ultra vires* loan has been utilised in meeting lawful debt of the company then the lender steps into the shoes of the debtor paid off and consequently he would be entitled to recover his loan to that extent from the company.

An act which is *ultra vires* the company being void, cannot be ratified by the shareholders of the company. Sometimes, act which is *ultra vires* can be regularised by ratifying it subsequently. For instance, if the act is *ultra vires* the power of the directors, the shareholders can ratify it; if it is *ultra vires* the articles of the company, the company can alter the articles; if the act is within the power of the company but is done irregularly, shareholder can validate it.

6. (a) **No consideration, no contract:** Every agreement, to be enforceable by law must be supported by valid consideration. An agreement made without any consideration is void. No consideration, no contract is a general rule. However, Section 25 of the Indian Contract Act, 1872 provides some exceptions to this rule, where an agreement without consideration will be valid and binding. These exceptions are as follows:

- (i) **Agreement made on account of natural love and affection**: Section 25 (1) provides that if an agreement is (i) in writing (ii) registered under the law and (iii) made on account of natural love and affection (iv) between the parties standing in a near relation to each other, it will be enforceable at law even if there is no consideration.
- (ii) **Compensation for past voluntary services**: Section 25(2) provides that a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, is enforceable.
- (ii) **Promise to pay time-barred debts (Section 25 (3))**: Where there is an agreement, made in writing and signed by the debtor or by his agent, to pay wholly or in part a time barred debt, the agreement is valid and binding even though there is no consideration.
- (iv) **Contract of agency (Section 185)**: No consideration is necessary to create an agency.
- (v) **Completed gift (Explanation 1 to Section 25)**: A completed gift needs no consideration. Thus, if a person transfers some property by a duly written and registered deed as a gift he cannot claim back the property subsequently on the ground of lack of consideration.

**Or**

“**Coercion**” is the committing or threatening to commit any act forbidden by the Indian Penal Code 1860, or the unlawful detaining or threatening to detain any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement. (Section 15 of the Indian Contract Act, 1872).

It is also important to note that it is immaterial whether the Indian Penal Code, 1860 is or is not in force at the place where the coercion is employed.

**Effects on validity**: According to section 19 of the Act, when consent to an agreement is caused by coercion, the contract is voidable at the option of the party, whose consent was so caused. The aggrieved party, whose consent was so caused can enforce the agreement or treat it as void and rescind it. It is seen that in all these cases though the agreement amounts to a contract, it is voidable. The injured party might insist on being placed in the same position in which he might have been had the vitiating circumstances not been present.

Where a contract is voidable and the party entitled to avoid it decides to do so by rescinding it, he must restore any benefit which he might have received from the other party. He cannot avoid the contract and at the same time enjoy the benefit under the rescinded/avoided contract. (Section 64)

**(b) Partnership Deed**

Partnership is the result of an agreement. No particular formalities are required for an agreement of partnership. It may be in writing or formed verbally. But it is desirable to have the partnership agreement in writing to avoid future disputes. The document in writing containing the various terms and conditions as to the relationship of the partners to each other is called the ‘partnership deed’. It should be drafted with care and be stamped according to the provisions of the Stamp Act, 1899. Where the partnership comprises immovable property, the instrument of partnership must be in writing, stamped and registered under the Registration Act.

**Partnership deed may contain the following information:-**

1. Name of the partnership firm.
2. Names of all the partners.
3. Nature and place of the business of the firm.
4. Date of commencement of partnership.
5. Duration of the partnership firm.
6. Capital contribution of each partner.

7. Profit Sharing ratio of the partners.
8. Admission and Retirement of a partner.
9. Rates of interest on Capital, Drawings and loans.
10. Provisions for settlement of accounts in the case of dissolution of the firm.
11. Provisions for Salaries or commissions, payable to the partners, if any.
12. Provisions for expulsion of a partner in case of gross breach of duty or fraud.

A partnership firm may add or delete any provision according to the needs of the firm.

- (c) (i) **Correct:** Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company. In the case of a public company, any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration. In exactly the same way, 2 or more persons can form a private company.
- (ii) **Incorrect:** The common seal is a seal used by a corporation as the symbol of its incorporation. The Companies (Amendment) Act, 2015 has made the common seal optional by omitting the words “and a common seal” from Section 9 so as to provide an alternative mode of authorization for companies who opt not to have a common seal. This amendment provides that the documents which need to be authenticated by a common seal will be required to be so done, only if the company opts to have a common seal. In case a company does not have a common seal, the authorization shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.